EURASIA DRILLING COMPANY LIMITED

Consolidated Financial Statements

(prepared in accordance with US GAAP)

As of December 31, 2013 and 2012
and for each of the years in the two year period
ended December 31, 2013

Contents

ZAO KPMG
10 Presnenskaya Naberezhnaya
Moscow, Russia 123317

Telephone +7 (495) 937 4477
Fax +7 (495) 937 4400/99
Internet www.kpmg.ru

Auditors' Report

To the Board of Directors

Eurasia Drilling Company Limited

We have audited the accompanying consolidated financial statements of Eurasia Drilling Company Limited and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2013 and 2012, and the consolidated statements of comprehensive income, stockholders' equity and cash flows for 2013 and 2012, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Audited entity: Eurasia Drilling Company Limited

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

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

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

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Eurasia Drilling Company Limited and its subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for 2013 and 2012 in accordance with U.S. generally accepted accounting principles.

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

Usov A.I.

Director, power of attorney dated October 1, 2013 No. 79/13

ZAO KPMG

March 20, 2014

Moscow, Russian Federation

Eurasia Drilling Company Limited
Consolidated Balance Sheets
As of December 31, 2013 and 2012
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	2013	2012
Assets			
Current assets			
Cash and cash equivalents	3	777,792	305,333
Accounts receivable, net	4	530,568	529,069
Inventories		212,859	213,058
Taxes receivable	9	45,867	27,201
Deferred income tax assets	9	11,815	11,175
Other current assets	7	12,514	13,792
Total current assets		**1,591,415**	**1,099,628**
Property, plant and equipment	5	2,008,756	1,768,119
Deferred income tax assets	9	1,784	2,156
Goodwill	6	104,695	107,998
Other non-current assets	7	15,083	57,154
Total assets		**3,721,733**	**3,035,055**
Liabilities and stockholders' equity			
Current liabilities			
Accounts payable and accrued liabilities		539,299	465,256
Advances received		1,269	2,288
Current portion of long-term debt	8	104,394	257,860
Taxes payable	9	113,622	90,276
Deferred income tax liabilities	9	11,849	6,499
Total current liabilities		**770,433**	**822,179**
Long-term debt	8	1,010,086	442,013
Accrued pension liability	10	12,494	15,598
Deferred income tax liabilities	9	107,564	92,639
Other non-current liabilities		4,669	-
Total liabilities		**1,905,246**	**1,372,429**
Stockholders' equity	13		
Common stock		1,469	1,469
Treasury stock, at cost		(1,977)	(1,652)
Additional paid-in capital		653,379	684,398
Retained earnings		1,369,335	1,072,369
Accumulated other comprehensive loss		(205,719)	(93,958)
Total stockholders' equity		**1,816,487**	**1,662,626**
Total liabilities and stockholders' equity		**3,721,733**	**3,035,055**

W. Richard Anderson
CFO of Eurasia Drilling Company Limited

EURASIA DRILLING COMPANY LIMITED CAYMAN ISLANDS

March 24, 2014

Eurasia Drilling Company Limited
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2013 and 2012
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	2013	2012
Revenues			
Drilling and related services		3,473,555	3,222,830
Other sales and services		14,375	14,503
Total revenues		**3,487,930**	**3,237,333**
Cost of services, excluding depreciation and taxes	12	(2,221,207)	(2,151,336)
General and administrative expenses, excluding depreciation and taxes		(168,878)	(161,270)
Taxes other than income taxes		(157,680)	(134,733)
Depreciation		(265,929)	(249,987)
Litigation settlement	14	(50,996)	-
Gain on disposal of property, plant and equipment		1,608	4,786
Income from operating activities		**624,848**	**544,793**
Interest expense		(58,254)	(53,661)
Interest income		17,189	12,094
Currency transaction (loss) gain		(705)	631
Other expenses		(615)	(8)
Income before income taxes		**582,463**	**503,849**
Income tax expense	9	(150,381)	(121,840)
Net income		**432,082**	**382,009**
Basic earnings per share of common stock (US dollars)	13	2.94	2.60
Diluted earnings per share of common stock (US dollars)	13	2.94	2.59
Other comprehensive income:			
Foreign currency translation (loss) gain		(113,912)	76,010
Pension benefits:			
Prior service benefit (cost)		695	(931)
Actuarial gain (loss)		1,456	(847)
Other comprehensive (loss) income		**(111,761)**	**74,232**
Comprehensive income		**320,321**	**456,241**

Eurasia Drilling Company Limited
Consolidated Statements of Stockholders' Equity
For the years ended December 31, 2013 and 2012
(All amounts in thousands of US dollars, unless otherwise noted)

	Common stock	Treasury stock, at cost	Additional paid-in capital	Retained earnings	Accumu-lated other comprehen-sive income/ (loss), net of tax	Total Stock-holders' equity
Balances as of January 1, 2012	**1,469**	**(2,244)**	**680,198**	**793,111**	**(168,190)**	**1,304,344**
Net income	-	-	-	382,009	-	**382,009**
Other comprehensive income	-	-	-	-	74,232	**74,232**
Comprehensive income						**456,241**
Disposal of treasury stock	-	592	-	-	-	**592**
Incentive compensation plan	-	-	4,200	-	-	**4,200**
Dividends declared	-	-	-	(102,751)	-	**(102,751)**
Balances as of December 31, 2012	**1,469**	**(1,652)**	**684,398**	**1,072,369**	**(93,958)**	**1,662,626**
Net income	-	-	-	432,082	-	**432,082**
Other comprehensive income	-	-	-	-	(111,761)	**(111,761)**
Comprehensive income						**320,321**
Purchase of treasury stock	-	(32,264)	-	-	-	**(32,264)**
Disposal of treasury stock	-	920	-	-	-	**920**
Exercise of incentive compensation plan	-	31,019	(31,019)	-	-	**-**
Dividends declared	-	-	-	(135,116)	-	**(135,116)**
Balances as of December 31, 2013	**1,469**	**(1,977)**	**653,379**	**1,369,335**	**(205,719)**	**1,816,487**

Eurasia Drilling Company Limited
Consolidated Statements of Cash Flows
For the years ended December 31, 2013 and 2012
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	2013	2012
Cash flows from operating activities			
Net income		**432,082**	**382,009**
Adjustments for non-cash items:			
Depreciation		265,929	249,987
Deferred income tax		26,804	34,307
Gain on disposal of property, plant and equipment		(1,608)	(4,786)
Increase (decrease) in allowance for doubtful accounts receivable		111	(2,833)
Foreign currency exchange rate difference (unrealized)		1,372	1,546
Incentive plan		-	4,200
All other items – net		5,514	3,186
Changes in operating assets and liabilities:			
Accounts receivable		(39,484)	(126,878)
Inventories		(12,991)	(10,527)
Taxes receivable and payable		(2,328)	29,300
Other current assets and liabilities		11,862	32,588
Accounts payable and accrued liabilities		64,566	2,000
Advances received		(776)	(1,644)
Net cash provided by operating activities		**751,053**	**592,455**
Cash flows from investing activities			
Purchases of property, plant and equipment		(553,096)	(616,499)
Change in restricted cash	7	45,400	(3,400)
Proceeds from sale of property, plant and equipment		7,871	11,121
Loans issued		-	(20,637)
Loan principal collections		3,589	17,136
Investment in associate		-	(5,643)
Net cash used in investing activities		**(496,236)**	**(617,922)**
Cash flows from financing activities			
Proceeds from issuance of long-term debt		810,800	25,729
Principal repayments of long-term debt		(427,118)	(153,893)
Dividends paid		(102,751)	(68,976)
Purchase of treasury stock		(32,264)	-
Net cash provided by (used in) financing activities		**248,667**	**(197,140)**
Effect of exchange rate changes on cash		(31,025)	18,159
Net increase (decrease) in cash and cash equivalents		**472,459**	**(204,448)**
Cash and cash equivalents at beginning of period		305,333	509,781
Cash and cash equivalents at end of period	**3**	**777,792**	**305,333**
Supplemental disclosures of cash flow information			
Interest paid (net of amount capitalized)		37,199	50,706
Income tax paid		126,393	92,294

Note 1. Organization and environment

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

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

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

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

As of December 31, 2013 and 2012 OOO Burovaya Kompaniya Eurasia had on-shore operating branches in Kogalym, Perm, Usinsk and Samara in the Russian Federation.

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

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

In June 2010, the Group acquired a 100% interest in OOO Meridian which performs workover services in the Komi region. In April 2013 this company was merged into OOO KRS Eurasia.

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

In April 2011 the Group acquired a 100% interest in OOO Sibirskaya Geophisicheskaya Company (OOO SGC) and 100% in ZAO Samatlorsky KRS (ZAO SKRS). The acquired companies perform drilling and workover services in West Siberia. In April 2013 ZAO SKRS was merged into OOO KRS Eurasia.

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

The majority of the Group's revenues are currently derived from services provided to OAO LUKOIL and its affiliated entities (the "LUKOIL Group") and as such, the Group is economically dependent upon its contractual agreements with the LUKOIL Group (refer to note 17).

Note 1. Organization and environment (continued)

Business and economic environment

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

Basis of preparation

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

Note 2. Summary of significant accounting policies

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

Principles of consolidation

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

Use of estimates

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

Acquisitions

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

Note 2. Summary of significant accounting policies (continued)

Functional and reporting currency

The functional currency of the Company and its subsidiaries, except for OOO Burovaya Kompaniya Eurasia, OOO KRS Eurasia and OOO SGC is the US dollar. The functional currency of OOO Burovaya Kompaniya Eurasia, OOO KRS Eurasia and OOO SGC is the Russian ruble because this the currency of the primary economic environments in which they operate and in which cash is generated and expended. The Group's reporting currency is the US dollar.

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

- All assets and liabilities were translated from the functional to the reporting currency at the exchange rate effective at the reporting date;

- Equity items were translated from the functional to the reporting currency at the historical exchange rate;

- Items in the statement of comprehensive income and cash flows were translated from the functional currency to the reporting currency at rates, which approximate rates at the date of transaction.

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

The closing exchange rate as of December 31, 2013 and 2012 was 32.7292 and 30.3727 Russian rubles to one US dollar, respectively.

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

Cash and cash equivalents

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

Cash with restrictions on immediate use

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

Note 2. Summary of significant accounting policies (continued)

Accounts receivable

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

Inventories

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

Property, plant and equipment

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

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

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

Goodwill

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

Impairment of long-lived assets

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

Leased assets

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

Note 2. Summary of significant accounting policies (continued)

Leased assets (continued)

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

Income taxes

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

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

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

Interest-bearing borrowings

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

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

Pension benefits

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

Environmental expenditures

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

Note 2. Summary of significant accounting policies (continued)

Revenue recognition

Drilling and related services

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

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

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

Other sales and services

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

All sales are shown net of value added tax.

Treasury stock

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

Earnings per share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the reporting period. A calculation is carried out to establish if there is potential dilution in earnings per share if convertible securities were to be converted into shares of common stock or contracts to issue shares of common stock were to be exercised. If there is such dilution, diluted earnings per share are presented.

Share-based payments

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

Note 2. Summary of significant accounting policies (continued)

Commitments and contingencies

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

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

Changes in accounting policy

In February 2013, the FASB issued ASU No. 2013-02, "*Comprehensive Income (Topic 220*)," that requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. An entity is required to present, either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income but only if the amount reclassified is required under US GAAP to be reclassified to net income in its entirety in the same reporting period. ASU No. 2013-02 is effective for reporting periods beginning after December 15, 2012. The Group adopted the requirements of ASU No. 2013-02 starting from the first quarter of 2013. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

In January 2013, the FASB issued ASU No. 2013-01 *"Balance Sheet (Topic 20). Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities."* This ASU clarifies that scope of ASU No. 2011-11 *"Disclosures about Offsetting Assets and Liabilities"* applies to derivatives accounted for in accordance with Topic 815 "*Derivatives and Hedging,*" including derivatives, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are either offset in accordance with Section 210-20-45 or Section 815-10-45 or subject to an enforceable master netting arrangement or similar agreement. The purpose of ASU No. 2013-01 and ASU No. 2011-11 is to require entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The Group adopted the requirements of ASU No. 2013-01 and ASU No. 2011-11 starting from the first quarter of 2013. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows and did not require additional disclosures.

Recent accounting pronouncements

In July 2013, the FASB issued ASU No. 2013-11, *"Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists,"* which clarifies Topic 740 of the Codification. This ASU states that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. ASU No. 2013-11 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013, and should be applied prospectively. The Group is evaluating the effect of the adoption of ASU No. 2013-11 and does not expect any material impact on its results of operations, financial position or cash flows.

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

Note 2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

In March 2013, the FASB issued ASU No. 2013-05, "*Foreign Currency Matters (Topic 830*)," that requires entities to apply the guidance in Subtopic 830-30 to release any related cumulative translation adjustment into net income when a reporting entity ceases to have financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The cumulative translation adjustment should be released into net income only if the sale or transfer results in the complete or substantially complete liquidation of the foreign entity in which the subsidiary or group of assets had resided. Additionally, the amendments in this ASU clarify that the sale of an investment in a foreign entity includes both events that result in the loss of a controlling financial interest in a foreign entity and events that result in an acquirer obtaining control of an acquiree in which it held an equity interest immediately before the acquisition date (sometimes also referred to as a step acquisition). Accordingly, the cumulative translation adjustment should be released into net income upon occurrence of those events. ASU No. 2013-05 is effective for annual reporting periods beginning after December 15, 2013, and interim periods within those annual periods, and should be applied prospectively. The Group is evaluating the effect of the adoption of ASU No. 2013-05 and does not expect any material impact on its results of operations, financial position or cash flows.

Comparative amounts

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

Note 3. Cash and cash equivalents

Cash and cash equivalents include the following:

	As of December 31, 2013	As of December 31, 2012
Short-term deposit - Russian rubles	285,770	128,295
Cash held in banks - 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**

Note 4. Accounts receivable, net

Accounts receivable include the following:

	As of December 31, 2013	As of December 31, 2012
Trade accounts receivable	522,834	523,186
Advances given	19,513	18,460
	542,347	541,646
Allowance for doubtful accounts	(11,779)	(12,577)
Total accounts receivable, net	**530,568**	**529,069**

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

Note 5. Property, plant and equipment

Property, plant and equipment include the following:

	As of December 31, 2013	**As of December 31, 2012**
Machinery and equipment	2,261,584	2,121,620
Buildings	31,890	39,674
Vehicles	50,337	42,185
	2,343,811	2,203,479
Less: accumulated depreciation	(920,283)	(762,569)
Construction in progress	494,735	51,568
Advances given for property, plant and equipment	90,493	275,641
Total property, plant and equipment	**2,008,756**	**1,768,119**

During the year ended December 31, 2013 and 2012 the Group capitalized interest in amount of USD 14.7 million and nil, respectively. This amount is included in Construction in progress as of December 31, 2013.

Note 6. Goodwill

The movement in goodwill was as following:

Goodwill as of December 31, 2011	**105,399**
Cumulative translation adjustment	2,599
Goodwill as of December 31, 2012	**107,998**
Cumulative translation adjustment	(3,303)
Goodwill as of December 31, 2013	**104,695**

Note 7. Other current and non-current assets

The Group had restricted cash of nil and USD 45.4 million included in other non-current assets as of December 31, 2013 and 2012, respectively . This amount collateralized the Company’s issuance of commercial letters of credit.

The Group had additional restricted cash of nil and USD 4.0 million included in other current assets as of December 31, 2013 and 2012, respectively. This amount collateralized the Company’s issuance of a guarantee for a customer.

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

Note 8. Long-term debt

Long-term debt includes the following:

Lender	Final maturity date	As of December 31, 2013	As of December 31, 2012
Debt of the Company			
ZAO UniCredit Bank	2017	210,800	-
Loans from stockholders	2014	50,000	50,000
Debt of the Company's subsidiaries			
4.875% Eurobonds, maturing 2020	2020	600,000	-
8.4% Russian ruble bonds, maturing 2018	2018	152,769	164,622
OOO Rushong-Hua	2016	80,542	52,321
OAO Sberbank of Russia	2014	20,369	43,899
Raiffeisenbank	2016	-	220,000
Alfa Bank	2013	-	122,478
OAO Sberbank of Russia	2015	-	26,339
OAO Sberbank of Russia	2013	-	20,214
Total long-term debt		**1,114,480**	**699,873**
Current portion of long-term debt		(104,394)	(257,860)
Total non-current long-term debt		**1,010,086**	**442,013**

ZAO UniCredit Bank

Long-term debt with ZAO UniCredit Bank with an outstanding balance of USD 210.8 million as of December 31, 2013 is denominated in USD and bears interest at LIBOR+3.65% per annum.

Stockholders

Long-term loans from stockholders as of December 31, 2013 represent loans denominated in US dollars which bear interest at 5.8% and mature on December 31, 2014.

Debt of the Company's subsidiaries

Eurobonds

In April 2013, the Group issued non-convertible bonds totaling USD 600 million. The bonds were placed at face value with a maturity of 7 years. The bonds have a half year coupon period with a coupon yield of 4.875% per annum.

Russian ruble bonds

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

OOO Rushong-Hua

Long-term debt with OOO Rushong-Hua with an outstanding balance of USD 80.5 million as of December 31, 2013 is denominated in Russian rubles at effective interest rate of 6.3% per annum.

OAO Sberbank of Russia

Long-term debt with OAO Sberbank of Russia with an outstanding balance of USD 20.4 million as of December 31, 2013 is denominated in Russian rubles and bears interest at 7.7% per annum.

Note 8. Long-term debt (continued)

Debt of the Company's subsidiaries (continued)

OAO Sberbank of Russia (continued)

Long-term debt with OAO Sberbank of Russia with an outstanding balance of USD 26.3 million as of December 31, 2012 was denominated in Russian rubles, bore interest at 10.15% per annum and was paid before the maturity during the reporting period.

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

Raiffeisenbank

Long-term debt with Raiffeisen Bank was denominated in USD, bore interest at 5.65% per annum and was paid before the maturity during the reporting period.

Alfa Bank

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

Unused credit lines

As of December 31, 2013 and December 31, 2012 the Group had two unused lines with ZAO UniCredit Bank. The first one is a revolving line of credit denominated in Russian rubles which at the currency exchange rate as of December 31, 2013 equaled to USD 89.2 million. This line of credit is short-term in nature with a duration of 90 days and availability period until August 2015. The second one is a revolving overdraft line denominated in Russian rubles which at the currency exchange rate as of June 30, 2013 equals to USD 16.0 million and is available until September 2015. Both lines are solely intended for issuing or extending unsecured commercial letters of credit for the purpose of acquiring new drilling rigs (used as security for these lines). As of December 31, 2013 both lines were undrawn.

As of December 31, 2013 and December 31, 2012 the Group also had a revolving multi-currency overdraft line with OAO Sberbank of Russia denominated in Russian rubles which at the currency exchange rate as of December 31, 2013 equaled to USD 91.6 million and is available until June 2017. It is solely intended for issuing or extending unsecured commercial letters of credit for the purpose of acquiring new drilling rigs. As of December 31, 2013, the line was undrawn.

As of December 31, 2013 and December 31, 2012 the Group had secured a five-year loan facility of USD 227 million with an interest rate of three month LIBOR plus 3.65% per annum arranged by ZAO UniCredit Bank. The grace period for the principal is three years. The term of the facility is through December 27, 2017. The loan agreement also provides an irrevocable renewable bank guarantee of USD 45.4 million. As of December 31, 2013 the undrawn amount was USD 16.2 million.

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

Note 8. Long-term debt (continued)

Unused credit lines (continued)

As of December 31, 2013 the Group had an unsecured short-term loan facility of USD 100 million with an interest rate of three month LIBOR plus 1.75% per annum arranged by Raiffeisenbank. As of December 31, 2013 this loan was undrawn.

These unused lines of credit are secured by property, plant and equipment with a carrying amount of USD 165.9 million and USD 264.9 million as of December 31, 2013 and December 31, 2012, respectively.

Maturities of long-term debts outstanding at December 31, 2013 are as follows:

2014	2015	2016	2017	2018	2019 and Thereafter	Total
104,394	31,049	15,468	210,800	152,769	600,000	1,114,480

Note 9. Taxes

Income taxes

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

Operations in the Russian Federation are subject to a Federal income tax rate of 2.0% and a regional income tax rate that varies from 13.5% to 18.0% at the discretion of the individual regional administration. The Group’s foreign operations are subject to taxes at the tax rates applicable to the jurisdictions in which they operate.

The majority of the Group’s earnings in 2013 and 2012 were taxed in the Russian Federation.

As of December 31, 2013 and 2012, and during 2013 and 2012 the Group did not have any unrecognized tax benefits and thus, no interest and penalties related to unrecognized tax benefits were accrued. The Group’s policy is to record interest and penalties related to unrecognized tax benefits as components of income tax expense. In addition, the Group does not expect that the amount of unrecognized tax benefits will change significantly within the next twelve months.

The Company and its subsidiaries file standalone income tax returns in each country in which they operate. Income tax returns are open for inspection by the tax authorities in Russia for tax years 2010-2013, in Turkmenistan for 2010-2013, in Kazakhstan for 2013 and Cyprus for 2011-2012.

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

Note 9. Taxes (continued)

Income taxes (continued)

	Year ended December 31, 2013	Year ended December 31, 2013
Current income tax expense	123,577	87,533
Deferred income tax expense	26,804	34,307
Total income tax expense	**150,381**	**121,840**

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

	As of December 31, 2013	As of December 31, 2012
Deferred income tax assets – current	11,815	11,175
Deferred income tax assets – non-current	1,784	2,156
Deferred income tax liabilities - current	(11,849)	(6,499)
Deferred income tax liabilities – non-current	(107,564)	(92,639)
Net deferred income tax liability	**(105,814)**	**(85,807)**

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

	As of December 31, 2013	As of December 31, 2012
Inventories	25,177	15,884
Tax loss carrying forward	5,505	-
Accrued pension liability	2,499	3,128
Accounts payable and accrued liabilities	2,278	2,064
Property, plant and equipment	1,784	2,156
Other non-current assets	513	-
Long-term accounts receivable	43	97
Deferred income tax assets	**37,799**	**23,329**
Property, plant and equipment	(110,619)	(95,865)
Accounts receivable	(21,962)	(9,859)
Investments	(10,234)	(3,412)
Inventories	(798)	-
Deferred income tax liabilities	**(143,613)**	**(109,136)**
Net deferred income tax liabilities	**(105,814)**	**(85,807)**

Based upon the level of historical taxable income and expectations for future taxable income over future periods, in which the deferred income tax assets are deductible, management believes it is more likely than not the Group will realize the benefits of these deductible temporary differences as of December 31, 2013 and 2012.

The Company has not recognized deferred income taxes on USD 1,240 million of undistributed earnings of its Russian subsidiaries, since such earnings are considered to be reinvested indefinitely. If the earnings were distributed in the form of dividends, the Company would be subject to foreign withholding taxes. The amount of unrecognized deferred income tax liability is USD 62 million.

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

Note 9. Taxes (continued)

Income taxes (continued)

Based on the former Company's intercompany dividend policy the Company recognized deferred income tax on 20% of the undistributed earnings of its Russian subsidiaries from its on-shore segment earned during the reporting period and on 30% of the undistributed earnings of its Russian subsidiaries from its off-shore segment earned during the reporting period. Additionally the Company recognized deferred income tax on 10% of the undistributed earnings of its subsidiary OOO Burovaya Kompaniya Eurasia that remain after applying the former intercompany dividend policy. Effective January 1, 2014 OOO Burovaya Kompaniya Eurasia will distribute 30% of its net income earned since January 1, 2014 and the Russian off-shore segment will distribute 65% of its net income earned since January 1, 2014. The percentage of the distribution of the earnings of the other Russian subsidiaries of the Company remains unchanged (20%). The remaining balances of retained earnings of these companies are considered to be reinvested indefinitely. Management of the Company has the intention and the ability not to distribute these retained earnings.

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

	Year ended December 31, 2013	**Year ended December 31, 2012**
Income before income tax	582,463	503,849
Notional income tax at Russian statutory rate 20%	116,493	100,770
Increase in income tax due to:		
Non-deductible items, net	20,611	6,176
Regional rate differences	(3,032)	(2,179)
Withholding tax	11,726	4,258
Foreign rate differences	4,583	12,815
Total income tax expense	**150,381**	**121,840**

Taxes receivable include the following:

	As of December 31, 2013	**As of December 31, 2012**
Prepaid income tax	24,506	18,274
Prepaid value added tax	20,126	8,024
Value added tax recoverable	631	707
Other taxes	604	196
Total taxes receivable	**45,867**	**27,201**

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

Note 9. Taxes (continued)

Income taxes (continued)

Taxes payable include the following:

	As of December 31, 2013	As of December 31, 2012
Value added tax	76,872	53,112
Social taxes and contributions	17,026	15,720
Personal income tax	10,535	10,516
Income tax payable	5,899	1,649
Property tax	2,124	5,012
Other taxes	1,166	4,267
Total taxes payable	**113,622**	**90,276**

Note 10. Pension benefits

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

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

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

Employees also have the right to receive upon retirement the benefits accumulated under the previous pension plan when OOO Burovaya Kompaniya Eurasia was a subsidiary of the LUKOIL Group. This plan was replaced in December 2003. These benefits have been fixed and included in the benefit obligation as of December 31, 2013 and 2012. The amount was determined primarily based on a formula including past pensionable service and relative salaries as of December 31, 2003.

The Company uses December 31 as the measurement date for its post employment and post retirement benefits program. An independent actuary has assessed the benefit obligations as of December 31, 2013 and 2012.

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

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

Note 10. Pension benefits (continued)

The following table provides information about the benefit obligations and plan assets as of December 31, 2013 and 2012. The benefit obligations below represent the projected benefit obligation of the pension plan.

	2013	2012
Benefit obligations		
Benefit obligations as of January 1	19,804	15,171
Plan amendments	(353)	1,449
Service cost	1,718	1,324
Interest cost	1,261	1,277
Effect of exchange rate changes	(1,364)	997
Actuarial (gain) loss	(1,944)	969
Curtailment	(721)	-
Benefits paid	(2,248)	(1,878)
Benefits in case of death of a pensioner	-	495
Benefit obligations as of December 31	**16,153**	**19,804**
Plan assets		
Fair value of plan assets as of January 1	4,206	3,954
Employer contributions	1,764	1,580
Return on plan assets	233	312
Effect of exchange rate changes	(296)	238
Benefits paid	(2,248)	(1,878)
Fair value of plan assets as of December 31	**3,659**	**4,206**
Funded status	(12,494)	(15,598)
Amounts recognized in the consolidated balance sheet as of December 31		
Accrued pension liability	(12,494)	(15,598)

Weighted average assumptions used to determine benefit obligations as of December 31, 2013 and 2012:

	2013	2012
Discount rate	7.70%	7.10%
Rate of compensation increase	6.70%	7.10%

Weighted average assumptions used to determine net periodic benefit costs for the year ended December 31, 2013 and 2012:

	2013	2012
Discount rate	7.10%	7.80%
Expected return on plan assets	8.14%	8.63%
Rate of compensation increase	7.10%	7.30%

Included in accumulated other comprehensive loss as of December 31, 2013 and 2012, are the following pre-tax amounts that have not yet been recognized in net periodic benefit cost:

	2013	2012
Unamortized prior service cost	(976)	(1,988)
Unrecognized actuarial gain (loss)	552	(1,366)
Total loss	**(424)**	**(3,354)**

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

Note 10. Pension benefits (continued)

Amounts recognized in other comprehensive loss before tax during the years ended December 31, 2013 and 2012:

	2013	**2012**
Additional prior service (benefit) cost from plan amendment	(525)	1,483
Re-classified prior service cost amortization	(343)	(319)
Additional (gain) loss arising during the period	(1,820)	1,058
Re-classified gain amortization	-	-
Net amount recognized in other comprehensive (gain) loss for the period	**(2,688)**	**2,222**

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

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

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

Type of assets	**As of December 31, 2013**	**As of December 31, 2012**
Bank deposits	54%	73%
Russian corporate bonds	25%	4%
Shares in investment funds	12%	11%
Eurobonds	7%	8%
Other assets	2%	4%
	100%	100%

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

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

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

Note 10. Pension benefits (continued)

Components of net periodic benefit cost were as follows:

	Year ended December 31, 2013	Year ended December 31, 2012
Service cost	1,718	1,324
Interest cost	1,261	1,277
Less expected return on plan assets	(307)	(335)
Amortisation of prior service cost	540	312
Curtailment/settlement gain	(721)	-
Benefits in case of death of a pensioner	-	495
Total net periodic benefit cost	**2,491**	**3,073**

Accumulated benefit obligations were USD 13.1 million and USD 15.2 million as of December 31, 2013 and 2012, respectively.

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

	2014	2015	2016	2017	2018	5-year period 2014-2018	5-year period 2019-2023
Funded plans	549	565	768	669	601	3,153	2,626
Unfunded plans	1,754	1,193	1,370	1,554	1,656	7,527	8,111
Total expected benefits to be paid	**2,303**	**1,758**	**2,138**	**2,223**	**2,257**	**10,680**	**10,737**

Note 11. Fair value of financial instruments

The fair values of cash and cash equivalents (Level 1), current and long-term accounts receivable (Level 3) are approximately equal to their value as disclosed in the consolidated financial statements. The fair value of long-term receivables was determined by discounting with estimated market interest rates for similar financing arrangements.

The fair value of long-term debt (Level 3) differs from the amount disclosed in the consolidated interim financial statements as of December 31, 2013. The fair value as of December 31, 2012 approximately equals to its value as disclosed in the consolidated financial statements as of December 31, 2012. The estimated fair value of long-term debt as of December 31, 2013 was USD 1,098 million, as a result of discounting using estimated market interest rates for similar financing arrangements. This amount includes all future cash outflows associated with the long-term debt repayments, including the current portion and interest. Market interest rates mean the rates of raising long-term debt by companies with a similar credit rating for similar tenors, repayment schedules and similar other main terms. During the year ended December 31, 2013, the Group did not have significant transactions or events that would result in nonfinancial assets and liabilities measured at fair value on a nonrecurring basis.

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

Note 12. Cost of services, excluding depreciation and taxes

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

	Year ended December 31, 2013	Year ended December 31, 2012
Services of subcontractors	939,496	936,797
Wages and salaries	529,648	488,407
Materials	397,801	414,288
Fuel and energy	184,671	152,785
Transportation of employees to drilling fields	50,665	40,003
Leasing and rent	16,097	20,781
Other	102,829	98,275
Total cost of services	**2,221,207**	**2,151,336**

Note 13. Stockholders' equity

Common and treasury stock

Number of shares	**Year ended December 31, 2013**	**Year ended December 31, 2012**
Authorized and issued common stock, par value 0.01 US dollar each	146,865,243	146,865,243
Treasury stock	(53,875)	(77,857)
Issued and outstanding common stock, par value 0.01 US dollar each	**146,811,368**	**146,787,386**

The movement of treasury stock was as following:

Number of shares held in treasury as of December 31, 2011	**105,781**
Directors fees	(27,924)
Number of shares held in treasury as of December 31, 2012	**77,857**
Number of shares purchased	876,370
Exercise of incentive compensation plan	(875,260)
Directors fees	(25,092)
Number of shares held in treasury as of December 31, 2013	**53,875**

Dividends and dividends limitations

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

Retained earnings of the Company's Russian subsidiaries were RUB 47.3 billion and RUB 36.4 billion, respectively as of December 31, 2013 and 2012, pursuant to the statutory financial statements, which at the US dollar exchange rates as of December 31, 2013 and 2012 amount to USD 1,444 million and USD 1,199 million, respectively.

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

Note 13. Stockholders' equity (continued)

Dividends and dividends limitations (continued)

At the Board of Directors meeting on December 10, 2013, dividends were declared for 2013, in the amount of USD 0.92 per share of common stock. Dividends payable by the Company of USD 135 million were included in "Accounts payable and accrued liabilities" in the consolidated balance sheet as of December 31, 2013.

At the Board of Directors meeting on December 12, 2012, dividends were declared for 2012, in the amount of USD 0.70 per share of common stock. Dividends payable by the Company of USD 103 million were included in "Accounts payable and accrued liabilities" in the consolidated balance sheet as of December 31, 2012. During the year ended December 31, 2013 this dividend was fully paid.

Earnings per share

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

	Year ended December 31, 2013	**Year ended December 31, 2012**
Net income available for common stockholders	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 stock incentive program (refer to Note 18)	-	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

Note 14. Commitments and contingencies

Commitments

Insurance

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

Litigation and claims

On April 9, 2012 China Petrochemical International Company Limited (CPIC) filed a demand for arbitration with the Arbitration Institute of the Stockholm Chamber of Commerce against Cyprus Oilfield Holdings Limited (COHL), a Group company. The arbitration involved a contract for the purchase of five drilling rigs from CPIC which COHL terminated for failure to deliver the rigs on time and in accordance with specifications. On March 7, 2014 the arbitration tribunal found against COHL and awarded CPIC USD 29.7 million in damages, USD 1.3 million for additional work, USD 0.1 million in lost profits, USD 0.9 million as penalty and reimbursement of a USD 6.2 million performance bond from CPIC which COHL had exercised, with accrued interest (at a commercial rate determined by the tribunal) and certain other costs. The Group accrued a liability for the total amount of USD 50.9 million in the consolidated financial statements as of December 31, 2013 included in "Accounts payable and accrued liabilities".

Note 14. Commitments and contingencies (continued)

Litigation and claims (continued)

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

Environmental obligations

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

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

Taxation

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

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

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

Note 15. Related party transactions

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

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

Note 15. Related party transactions (continued)

The Company's General Counsel, Douglas Stinemetz, is a partner with The Stinemetz Law Firm. During year ended December 31, 2013 and 2012 the firm billed the Company for costs and expenses of USD 3.9 million and USD 2.0 million, respectively. Mr. Stinemetz is not otherwise paid for his services as the Company's General Counsel.

Long-term loans from stockholders were USD 50 million as of December 31, 2013 and December 31, 2012 (refer to Note 8). Interest expense of USD 2.9 million was recognized and paid on these loans during the years ended December 31, 2013 and 2012.

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).

Note 16. Segment information

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

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

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

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

As of and for the year ended December 31, 2013

	On-shore drilling services (CIS other than the Caspian Sea)	**Off-shore drilling services (Caspian Sea)**	**Consolidated**
Total revenues	3,300,393	187,537	3,487,930
Net income	363,856	68,226	432,082
Total assets	2,967,815	753,918	3,721,733
Goodwill	42,595	62,100	104,695

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

Note 16. Segment information (continued)

As of and for the year ended December 31, 2012

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

Note 17. Concentration of credit risk and sales

A significant proportions of the Group's operations which exceeded 10 percent of the Group's revenue are with LUKOIL Group companies and with Rosneft Group companies. As such the Group has significant concentrations of credit risk with these Groups.

Included in the Group's revenues and accounts receivables are the following transactions and balances with the major Customers:

	2013	2012
Revenues from LUKOIL Group for the year ended December 31	2,302,686	2,054,724
Revenues from Rosneft Group for the year ended December 31	659,004	691,829
Accounts receivable from LUKOIL Group as of December 31, 2013 and 2012	221,354	260,781
Accounts receivable from Rosneft Group as of December 31, 2013 and 2012	74,426	84,813

Note 18. Incentive Compensation Plan

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

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

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

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

The Starting Price was determined at the beginning of each year based on an average quoted market price of the Company's shares on the London Stock Exchange ("LSE") for the last 20 trading days of the preceding year.

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

Note 18. Incentive Compensation plan (continued)

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

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

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

The participants could only receive GDRs, each representing one ordinary share of the Company. Therefore, the plan was equity classified. The Group recognized USD 2.1 million of compensation expense during the six month period ended June 30, 2012. As of December 31, 2012, USD 21 million was recognized on the Company's balance sheet as an increase in additional paid-in capital.

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

In 2013 the Company introduced a new compensation plan to certain members of management effective January 1, 2013. The period of validity of the award is indefinite. The participants are eligible to receive cash awards and/or share awards (at the election of the Company) if the Company achieves a target increase in its earnings per share (EPS). The target EPS is set annually by the Board of Directors of the Company. Awards are payable to the Participants based on a percentage of their respective annual salary. The percentage ranges from 75% to 250% based on the grade level of management and on the range of EPS performance actually achieved between the target levels.

If the performance conditions are satisfied and provided that the Participant is still employed up to and through the vesting date, Awards are exercisable in three years from the date of grant, with the first 20% of such awards vesting immediately, next 30% and the remaining 50% vesting annually on each of the following two anniversaries thereafter.

The rights to compensation under this plan vest at December 31 of each award year if the participants are still employed or otherwise in good standing with the Company.

The grant date fair value of the plan for 2013 EPS performance was estimated at USD 12.4 million based on expected EPS performance assumed by management based on historical trends. Based on the actual performance the fair value was revalued as of December 31, 2013 and equals to USD 15.0 million.

Related to this plan the Company recorded USD 6.4 million during the year ended December 31, 2013 as compensation expense. As of December 31, 2013 USD 3.0 million and USD 4.7 million related to this plan are included in "Accounts payable and accrued liabilities" and "Other non-current liabilities" of the consolidated balance sheets, respectively. The Company has approximately USD 7.3 million of unrecognized compensation expense as of December 31, 2013 that will be accrued up to December 31, 2015.

Note 19. Subsequent events

The Company has evaluated subsequent events from the balance sheet date through March 24, 2014, the date at which the financial statements were available to be issued, and determined there are no items to disclose, other than described in Note 14.