EURASIA DRILLING COMPANY LIMITED

Consolidated Financial Statements

(prepared in accordance with US GAAP)

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

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Independent Auditors' Report

The Board of Directors
Eurasia Drilling Company Limited:

We have audited the accompanying consolidated balance sheets of Eurasia Drilling Company Limited and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our 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 subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

ZAO KPMG

ZAO KPMG

April 16, 2012

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

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

	Note	2011	2010
Assets			
Current assets			
Cash and cash equivalents	3	509,781	629,466
Accounts receivable, net	4	348,082	235,360
Inventories	5	214,434	145,633
Taxes receivable	13	33,146	34,960
Deferred income tax assets	13	5,057	11,407
Other current assets	9	42,719	20,241
Total current assets		**1,153,219**	**1,077,067**
Property, plant and equipment	6	1,286,125	765,184
Long-term accounts receivable	7	2,181	6,838
Deferred income tax assets	13	2,833	1,422
Goodwill	8, 18	105,399	32,727
Other non-current assets	9	48,672	70,830
Total assets		**2,598,429**	**1,954,068**
Liabilities and stockholders' equity			
Current liabilities			
Accounts payable and accrued liabilities		407,411	258,706
Advances received		3,766	20,295
Short-term debt and current portion of long-term debt	11	175,217	117,550
Deferred income tax liabilities	13	5,340	478
Taxes payable	13	69,030	54,257
Total current liabilities		**660,764**	**451,286**
Long-term debt	12	578,117	286,367
Accrued pension liability	14	11,216	6,889
Deferred income tax liabilities	13	49,376	24,744
Total liabilities		**1,299,473**	**769,286**
Stockholders' equity	17		
Common stock		1,469	1,469
Treasury stock, at cost		(2,244)	(13,148)
Additional paid-in capital		680,198	691,535
Retained earnings		787,250	578,989
Accumulated other comprehensive loss		(167,717)	(74,063)
Total stockholders' equity		**1,298,956**	**1,184,782**
Total liabilities and stockholders' equity		**2,598,429**	**1,954,068**

W. Richard Anderson
CFO of Eurasia Drilling Company Limited

April 16, 2012

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

	Note	2011	2010
Revenues			
Drilling and related services		2,720,112	1,798,881
Other sales and services		32,305	13,275
Total revenues		**2,752,417**	**1,812,156**
Cost of services, excluding depreciation and taxes	16	(1,898,246)	(1,195,891)
General and administrative expenses, excluding depreciation and taxes		(144,614)	(106,920)
Taxes other than income taxes		(118,850)	(72,547)
Depreciation		(215,168)	(142,000)
(Loss) gain on disposal of property, plant and equipment		(1,362)	6,344
Impairment loss	18	(1,296)	(7,096)
Income from operating activities		**372,881**	**294,046**
Interest expense		(52,342)	(15,125)
Interest income		11,485	7,993
Currency transaction loss		(11,054)	(7,355)
Gain on business exchange transaction	18	32,284	557
Other income (expenses)		6,495	(951)
Income before income taxes		**359,749**	**279,165**
Income tax expense	13	(82,512)	(71,812)
Net income		**277,237**	**207,353**
Basic earnings per share of common stock (US dollars)	17	1.89	1.45
Diluted earnings per share of common stock (US dollars)	17	1.89	1.44

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

	Common stock	Treasury stock, at cost	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income/ (loss), net of tax	Total Stockholders' equity
Balances as of December 31, 2009	**1,469**	**(58,332)**	**528,163**	**596,340**	**(65,482)**	**1,002,158**
Net income	-	-	-	207,353	-	**207,353**
Other comprehensive income (loss):						
Foreign currency translation loss	-	-	-	-	(7,510)	**(7,510)**
Pension benefits:						
Prior service cost	-	-	-	-	(1,535)	**(1,535)**
Actuarial gain	-	-	-	-	464	**464**
Comprehensive income						**198,772**
Sale of common stock	-	54,956	162,548	-	-	**217,504**
Purchase of treasury stock	-	(13,148)	-	-	-	**(13,148)**
Disposal of treasury stock	-	-	4,200	-	-	**4,200**
Exercise of incentive compensation plan	-	3,376	(3,376)	-	-	**-**
Dividends declared	-	-	-	(224,704)	-	**(224,704)**
Balances as of December 31, 2010	**1,469**	**(13,148)**	**691,535**	**578,989**	**(74,063)**	**1,184,782**
Net income	-	-	-	277,237	-	**277,237**
Other comprehensive income (loss):						
Foreign currency translation loss	-	-	-	-	(91,604)	**(91,604)**
Pension benefits:						
Prior service cost	-	-	-	-	(561)	**(561)**
Actuarial loss	-	-	-	-	(1,489)	**(1,489)**
Comprehensive income						**183,583**
Disposal of treasury stock	-	481	-	-	-	**481**
Purchase of treasury stock	-	(5,114)	-	-	-	**(5,114)**
Incentive compensation plan	-	-	4,200	-	-	**4,200**
Exercise of incentive compensation plan	-	15,537	(15,537)	-	-	**-**
Dividends declared	-	-	-	(68,976)	-	**(68,976)**
Balances as of December 31, 2011	**1,469**	**(2,244)**	**680,198**	**787,250**	**(167,717)**	**1,298,956**

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

	Note	2011	2010
Cash flows from operating activities			
Net income		**277,237**	**207,353**
Adjustments for non-cash items:			
Depreciation		215,168	142,000
Accrued interest expense		2,586	2,893
Deferred income taxes		26,214	8,767
Loss (gain) on disposal of property, plant and equipment		1,362	(6,344)
(Gain) loss on disposal of subsidiary		(32,284)	391
Impairment loss	18	1,296	7,096
Decrease in allowance for doubtful accounts receivable		(1,806)	(947)
Foreign currency exchange rate difference (unrealized)		8,097	3,862
Incentive plan		4,200	4,200
All other items – net		369	(485)
Changes in operating assets and liabilities:			
Accounts receivable		(98,111)	(41,080)
Inventories		(60,468)	(27,383)
Taxes receivable		14,948	3,197
Other current assets		(30,071)	(6,646)
Accounts payable and accrued liabilities		103,319	42,015
Advances received		(16,964)	(16,839)
Taxes payable		11,723	(1,351)
Other current liabilities		(1,086)	1,854
Net cash provided by operating activities		**425,729**	**322,553**
Cash flows from investing activities			
Purchases of property, plant and equipment		(417,873)	(224,970)
Change in restricted cash	9	17,919	(58,807)
Proceeds from sale of property, plant and equipment		14,034	8,190
Disposal of subsidiary, net of cash disposed	18	95,374	767
Loans issued		-	(7,238)
Loan principal collections		1,021	-
Acquisition of subsidiaries, net of cash acquired	18	(559,340)	(43,132)
Net cash used in investing activities		**(848,865)**	**(325,190)**
Cash flows from financing activities			
Proceed from issuance of short-term debt		90,000	-
Principal repayments of short-term debt		(90,000)	-
Proceeds from issuance of long-term debt		465,649	255,193
Principal repayments of long-term debt		(67,808)	(40,037)
Repayment of capital lease obligations		-	(538)
Dividends paid		(45,387)	(212,786)
Proceeds from sale of treasury stock		-	217,504
Purchase of treasury stock		(5,114)	(13,148)
Net cash provided by financing activities		**347,340**	**206,188**
Effect of exchange rate changes on cash		(43,889)	(7,809)
Net (decrease) increase in cash and cash equivalents		**(119,685)**	**195,742**
Cash and cash equivalents at beginning of period		629,466	433,724
Cash and cash equivalents at end of period	3	**509,781**	**629,466**
Supplemental disclosures of cash flow information			
Interest paid		45,550	11,910
Income tax paid		53,454	57,145

Note 1. Organization and environment

The primary activities of Eurasia Drilling Company Limited (the "Company") and its subsidiaries (together, the "Group") include providing exploratory and developmental drilling and oil and gas field services to companies operating within the Russian Federation, Kazakhstan, 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, 2011 and 2010 OOO Burovaya Kompaniya Eurasia had on-shore operating branches in Kogalym, Perm, Usinsk and Zhirnovsk (Volgograd Region) in the Russian Federation.

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

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

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

In June 2010, the Group acquired a 100% interest in OOO Meridian which performs workover services in the Komi region (refer to Note 18).

In February 2011 the Group acquired a 100% interest in Caspian Sea Ventures International Limited (CSVI). The acquired company is the owner of a jack-up drilling rig operating in the Turkmen waters of the Caspian Sea. (refer to Note 18).

In April 2011 the Group acquired a 100% interest in OOO Sibirskaya Geophisicheskaya Company (OOO SGC) and 100% in ZAO Samatlorsky KRS (ZAO SKRS). The acquired companies perform drilling and workover services in West Siberia. (refer to Note 18).

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 22).

Note 1. Organization and environment (continued)

Business and economic environment

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

Basis of preparation

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

Note 2. Summary of significant accounting policies

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

Principles of consolidation

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

Use of estimates

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

Acquisitions

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

Note 2. Summary of significant accounting policies (continued)

Functional and reporting currency

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

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

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

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

- Items in the statement of 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 loss.

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

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

Cash and cash equivalents

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

Cash with restrictions on immediate use

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

Note 2. Summary of significant accounting policies (continued)

Accounts receivable

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

Inventories

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

Property, plant and equipment

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

Buildings	15 - 30 years
Machinery and equipment	2 - 35 years
Vehicles	5 - 10 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 the consolidated statement of income 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 the consolidated statements of income.

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 the consolidated statement of income 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 the consolidated statement of income 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 units-of-delivery method (a modification of the percentage-of-completion method) of accounting for contracts. The units-of-delivery method recognizes as revenue the contract price of units of a basic production product delivered during a period and as the cost of earned revenue the costs allocable to the delivered units; costs allocable to undelivered units are reported in the balance sheet as inventory or work in progress.

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

In January 2010, the FASB issued ASU No. 2010-06, *"Improving Disclosures about Fair Value Measurements,"* which requires reporting entities to make new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and to present separately information about purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. This ASU also clarifies existing fair value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. The Group fully adopted the requirements of ASU No. 2010-06 starting from the first quarter of 2011. This adoption did not have a material impact on the Group's results of operations, financial position or cash flows.

Recent accounting pronouncements

In December 2011, the FASB issued ASU No. 2011-12, *"Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05."* This ASU defers changes that relate to the presentation to reclassification adjustments out of accumulated other comprehensive income in ASU No. 2011-05, *"Presentation of Comprehensive Income,"* until the FASB is able to reconsider those paragraphs. Entities should continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU No. 2011-05. ASU No. 2011-12 is effective at the same time as the ASU No. 2011-05: for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. The Group will apply the provisions of ASU No. 2011-12 starting from the first quarter of 2012 and does not expect any material impact on its results of operations, financial position or cash flows.

Note 2. Summary of significant accounting policies (continued)

Recent accounting pronouncements (continued)

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

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

In June 2011, the FASB issued ASU No. 2011-05, *"Presentation of comprehensive income,"* which amends Topic 220 of the Codification. This ASU increases the prominence of other comprehensive income in financial statements. Under this ASU, an entity will have the option to present the components of net income and comprehensive income in either one or two statements. The ASU eliminates the option in US GAAP to present other comprehensive income in the statement of changes in equity. ASU No. 2011-05 is effective for public entities for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. The Group will apply the provisions of ASU No. 2011-05 starting from the first quarter of 2012. As this is a disclosure item only the Group does not expect any material impact on its results of operations, financial position or cash flows.

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

Change in accounting estimate

During 2011 the Company assessed its estimates of the useful life of drilling pipe. Management revised its original estimates which were 2-4 years and currently estimates that its drilling pipe's useful life is 2-3 years. The effect of reflecting this change in accounting estimate on the 2011 financial statements is decrease in net income by USD 12.9 million.

Note 3. Cash and cash equivalents

Cash and cash equivalents include the following:

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

Note 4. Accounts receivable, net

Accounts receivable include the following:

	As of December 31, 2011	As of December 31, 2010
Trade accounts receivable	354,621	243,899
Advances given	8,062	8,737
	362,683	252,636
Allowance for doubtful accounts	(14,601)	(17,276)
Total accounts receivable, net	**348,082**	**235,360**

Note 5. Inventories

Inventories include the following:

	As of December 31, 2011	As of December 31, 2010
Materials for drilling and workover	190,727	127,918
Work in progress	23,707	17,715
Total inventories	**214,434**	**145,633**

Note 6. Property, plant and equipment

Property, plant and equipment include the following:

	As of December 31, 2011	As of December 31, 2010
Machinery and equipment	1,524,661	964,134
Buildings	28,654	38,112
Vehicles	23,231	34,712
	1,576,546	1,036,958
Less: accumulated depreciation	(515,930)	(379,477)
Construction in progress	92,142	40,146
Advances given for property, plant and equipment	133,367	67,557
Total property, plant and equipment	**1,286,125**	**765,184**

Note 7. Long-term accounts receivable

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

	Stated interest rates	As of December 31, 2011	As of December 31, 2011
Long-term accounts receivable denominated in Russian rubles	0.00%	2,181	6,047
Long-term accounts receivable denominated in US dollars	6.00%	-	791
Total long-term accounts receivable		**2,181**	**6,838**

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

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

As these interest rates were below market rates at the date of origination these long-term accounts receivable have been recorded on the balance sheet by discounting the initial amount over the period it is to be repaid using market interest rates of 12.24%-15% and 9.91% for Russian ruble and US dollar loans, respectively, estimated by management to be the rate applicable to the Group for borrowings of a similar nature.

Note 8. Goodwill

The movement in goodwill was as following:

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

Note 9. Other current and non-current assets

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

The Group had additional restricted cash of USD 1.4 and USD 6.1 million included in other current assets as of December 31, 2011 and December 31, 2010, respectively. The amount of USD 1.4 as of December 31, 2011 represents a guarantee issued for a subcontractor. The amount of USD 6.1 million as of December 31, 2010 consists of a bid bond in the amount of USD 1.0 million and a guarantee issued for a subcontractor in the amount of USD 5.1 million (refer to Note 20).

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

Note 10. Obligations under capital leases

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

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

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

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

Note 11. Current portion of long-term debt

Current portion of long-term debt includes the following:

	As of December 31, 2011	As of December 31, 2010
Current portion of long-term debt (note 12)	175,217	117,274
Short-term capital lease obligations (note 10)	-	276
Total current portion of long-term debt	**175,217**	**117,550**

Note 12. Long-term debt

Long-term debt includes the following:

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

Note 12. Long-term debt (continued)

Stockholders

Long-term loans from stockholders as of December 31, 2011 represent loans denominated in US dollars which bear interest at 5.8%-8.6% and mature on or before December 31, 2014.

Long-term loans from stockholders as of December 31, 2010 represented loans denominated in US dollars which bore interest at 8.6% and matured on December 31, 2011.

Debt of the Company's subsidiaries

Alfa-Bank

Long-term debt with Alfa-Bank with outstanding balances of USD 231.0 million and USD 254.3 million as of December 31, 2011 and December 31, 2010, respectively, is denominated in Russian rubles and bears interest at 8.4% per annum.

Raiffeisenbank

Long-term debt with Raiffeisenbank with an outstanding balance of USD 220.0 million as of December 31, 2011 is denominated in USD and bears interest at 5.65% per annum. This debt is secured by the shares of a newly acquired company CSVI (refer to Note 18).

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.

OAO Sberbank of Russia

Long-term debt with OAO Sberbank of Russia with an outstanding balance of USD 62.1 million as of December 31, 2011 is denominated in Russian rubles and bears interest at 7.7% per annum.

Long-term debts with OAO Sberbank of Russia with an outstanding balance of USD 31.4 million as of December 31, 2011 are denominated in Russian rubles and bear interest at LIBOR plus 4.1% per annum.

Long-term debt is secured by property, plant and equipment with a carrying amount of USD 50.4 million as of December 31, 2011 (2010: USD 53.2 million).

ZAO UniCredit Bank

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

Note 12. Long-term debt (continued)

Individual

Long-term debt from an individual represents a loan denominated in US dollars which bears interest at a stated rate of 0% and matures on May 1, 2012. This relates to the acquisition of the new workover company OOO Meridian (refer to Note 18). This loan was recorded at fair value based on the effective interest rate estimated by the management at the acquisition date, which was 13% per annum.

This debt is secured by the shares of OOO Meridian.

LUKOIL Group companies

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

As of December 31, 2011 the Group had two unused lines of credit with ZAO UniCredit Bank. The first line of credit is denominated in Russian rubles and at the currency exchange rate as of December 31, 2011 equals to USD 90.7 million with the availability period of 1,440 days. The second line of credit is denominated in Russian rubles and at the currency exchange rate as of December 31, 2011 equals to USD 16.3 million with the availability period of 1,500 days. Both lines of credit are intended for issuing or extending unsecured commercial letters of credit for the purpose of acquisition of the drilling rigs. At year end both lines of credit were undrawn.

Maturities of long-term debts outstanding at December 31, 2011 are as follows:

2012	2013	2014	2015	2016	2017 and thereafter	Total
175,217	202,883	118,398	67,692	33,846	155,298	753,334

Note 13. 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 Groups' operations outside the Russian Federation are subject to the following rates of income tax:

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

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

Note 13. Taxes (continued)

Income taxes (continued)

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

The Company and its subsidiaries file standalone income tax returns in each country in which they operate. Income tax returns are open for inspection by the tax authorities in Russia for tax years 2009-2011, in Turkmenistan for 2010-2011, in Kazakhstan for 2009-2011 and Cyprus for 2005-2011.

Until January 1, 2012, there were no provisions in the tax legislation of the Russian Federation to permit the Group to reduce taxable profits of a Group company by offsetting tax losses of another Group company against such profits. Tax losses may be fully or partially used to offset taxable profits in the same company in any of the ten years following the year of loss.

Starting from January 1, 2012, if certain conditions are met, taxpayers will be able to pay income tax as a consolidated taxpayers' group ("CTG"). This allows taxpayers to offset taxable losses generated by certain participants of a CTG against taxable profits of other participants of the CTG. During 2012, certain Group companies are going to meet the legislative requirements and pay income tax as a CTG.

Losses generated by a taxpayer before joining a CTG are not available for offset against taxable profits of other participants of the CTG. However, if a taxpayer leaves a CTG, such losses again become available for offset against future profits generated by the same taxpayer. The expiration period of the losses is extended to take account of any time spent within a CTG when the losses were unavailable for use.

	Year ended December 31, 2011	Year ended December 31, 2010
Current income tax expense	56,298	63,045
Deferred income tax expense	26,214	8,767
Total income tax expense	**82,512**	**71,812**

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

	As of December 31, 2011	As of December 31, 2010
Deferred income tax assets – current	5,057	11,407
Deferred income tax assets – non-current	2,833	1,422
Deferred income tax liabilities - current	(5,340)	(478)
Deferred income tax liabilities – non-current	(49,376)	(24,744)
Net deferred income tax liability	**(46,826)**	**(12,393)**

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

Note 13. Taxes (continued)

Income taxes (continued)

	As of December 31, 2011	As of December 31, 2010
Inventories	3,979	4,038
Accrued pension liability	2,236	1,378
Property, plant and equipment	2,056	1,422
Accounts payable and accrued liabilities	1,810	5,852
Accounts receivable	757	2,252
Other current assets	203	570
Long-term accounts receivable	33	173
Long-term debt	-	290
Deferred income tax assets	**11,074**	**15,975**
Property, plant and equipment	(50,995)	(26,450)
Withholding tax	(4,325)	-
Accounts receivable	(2,374)	(917)
Inventories	(206)	(12)
Long-term debt	-	(135)
Other current liabilities	-	(854)
Deferred income tax liabilities	**(57,900)**	**(28,368)**
Net deferred income tax assets	**(46,826)**	**(12,393)**

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, 2011 and 2010.

The Company has not recognized deferred income taxes on USD 789 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 35 million.

The Company changed its intercompany dividend policy starting December 31, 2011 and recognized deferred income tax on 20% of the undistributed earnings of its Russian subsidiary OOO Burovaya Kompaniya Eurasia earned during the reporting period and on 20% of the undistributed earnings of its other Russian subsidiaries from its on-shore segment and on 30% of the undistributed earnings of its Russian subsidiaries from its off-shore segment. The remaining balances of retained earnings of these companies is considered to be reinvested indefinitely. Management of the Company has the intention and the ability not to distribute these retained earnings.

Note 13. Taxes (continued)

Income taxes (continued)

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

	Year ended December 31, 2011	Year ended December 31, 2010
Income before income taxes	359,749	279,165
Notional income tax at Russian statutory rate 20%	71,950	55,833
Increase in income tax due to:		
Non-deductible items, net	8,957	7,461
Regional rate differences	(967)	(1,255)
Withholding tax	4,325	8,103
Foreign rate differences	(1,753)	1,670
Total income tax expense	**82,512**	**71,812**

Taxes receivable include the following:

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

Taxes payable include the following:

	As of December 31, 2011	As of December 31, 2010
Value added tax	45,442	33,138
Property tax	6,988	3,139
Social taxes and contributions	5,843	7,859
Income taxes payable	3,181	1,942
Personal income tax	2,844	6,559
Other taxes	4,732	1,620
Total taxes payable	**69,030**	**54,257**

Note 14. Pension benefits

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

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

Note 14. Pension benefits (continued)

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

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, 2011 and 2010. The amount was determined primarily based on a formula including past pensionable service and relative salaries as of December 31, 2003.

Liabilities for former LUKOIL employees in respect of their pensions funded via LUKOIL-GARANT were included in the PBO and in assets as December 31, 2010 in the same amount equal to USD 3.8 million. This amount was excluded from liabilities and assets on January 1, 2011 by applying curtailment on liabilities and divestiture on asstes due to the fact that these pension obligations were fully funded.

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

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

Note 14. Pension benefits (continued)

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

	2011	2010
Benefit obligations		
Benefit obligations as of January 1	14,883	11,558
Financial support to future pensioners	1,830	-
Actuarial loss (gain)	1,667	(785)
Service cost	1,107	797
Plan amendments	941	1,794
Interest cost	954	1,037
Curtailment	(3,759)	-
Benefits paid	(1,554)	(686)
Effect of exchange rate changes	(898)	(100)
Jubilee benefits	-	1,268
Benefit obligations as of December 31	**15,171**	**14,883**
Plan assets		
Fair value of plan assets as of January 1	7,994	7,770
Employer contributions	1,290	515
Return on plan assets	65	347
Other changes in fair value of individual pension accounts	-	(230)
Divestitures	(3,759)	-
Benefits paid	(1,554)	(652)
Effect of exchange rate changes	(81)	(60)
Interest income on individual pension accounts	-	304
Fair value of plan assets as of December 31	**3,955**	**7,994**
Funded status	(11,216)	(6,889)
Amounts recognized in the consolidated balance sheet as of December 31, 2011 and 2010		
Accrued pension liability	(11,216)	(6,889)

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

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

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

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

Note 14. Pension benefits (continued)

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

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

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

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

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

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

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

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

Note 14. Pension benefits (continued)

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 two types of Level 1 investments: securities with fixed yield and equity securities. The securities with fixed yield include mainly high yield corporate bonds. Maturities range from one to three years.

Components of net periodic benefit cost were as follows:

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

Total employer contributions for 2012 are expected to be approximately USD 0.1 million.

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

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

	2012	2013	2014	2015	2016	5-year period 2012-2016	5-year period 2017-2021
Pension benefits	1,123	431	398	482	660	3,094	3,258
Lump sum payments upon retirement, death and disability	2,434	1,016	1,126	1,285	1,475	7,336	8,015
Total expected benefits to be paid	**3,557**	**1,447**	**1,524**	**1,767**	**2,135**	**10,430**	**11,273**

Note 15. Fair value of financial instruments

The fair values of all financial instruments are approximately equal to their carrying values as disclosed in the consolidated financial statements. Fair values were determined based on discounted cash flows using estimated market interest rates for similar financial arrangements.

Note 16. Cost of services

Cost of services includes the following:

	Year ended December 31, 2011	Year ended December 31, 2010
Services of subcontractors	914,551	488,950
Wages and salaries	425,143	324,924
Materials	307,796	218,916
Fuel and energy	131,051	79,530
Transportation of employees to drilling fields	28,085	23,358
Leasing and rent	25,376	10,891
Other	66,244	49,322
Total cost of services	**1,898,246**	**1,195,891**

Note 17. Stockholders' equity

Common and treasury stock

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

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

During 2010 the Group awarded 718,868 shares of common stock held as treasury stock to certain top-managers as a part of its incentive plan (refer to Note 23).

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

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

The movement of treasury stock during 2011 was as following:

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

Note 17. Stockholders' equity (continued)

Dividends and dividends limitations

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

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

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

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

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

Earnings per share

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

	Year ended December 31, 2011	Year ended December 31, 2010
Net income available for common stockholders	277,237	207,353
Weighted average number of outstanding shares	146,768,307	143,270,265
Basic earnings per share of common stock (US dollars)	1.89	1.45
Contingent shares of stock incentive program (refer to Note 23)	-	522,060
Weighted average number of outstanding shares, after dilution	146,768,307	143,792,325
Diluted earnings per share of common stock (US dollars)	1.89	1.44

Note 18. Business combinations

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

Note 18. Business combinations (continued)

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

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

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

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

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

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

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

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

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

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

Note 18. Business combinations (continued)

In June 2010, the Group acquired a 100% interest in OOO Meridian for USD 12.2 million which will be paid in three installments ending May 1, 2012. The fair value of the consideration comprised USD 11.0 million as of the date of acquisition, of which USD 6.4 million was paid before December 31, 2011. The remaining amount of USD 3.4 million was recorded as loan to individual (refer to Note 12).

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

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

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

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

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

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

Note 19. 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

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

Note 19. Commitments and contingencies (continued)

Commitments (continued)

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 20. Related party transactions

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

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

Note 20. Related party transactions (continued)

Long-term loans from stockholders were USD 50 million and USD 70 million as of December 31, 2011 and December 31, 2010, respectively (refer to Note 12). Interest expense of USD 6 million and USD 6 million was recognized and paid on these loans during the year ended December 31, 2011 and 2010, respectively.

In October 2010 the Company originated a bank guarantee with a value of $5.1 million (refer to Note 9) in favor of a subcontractor in consideration for an option to acquire an interest in an exploration project from a company controlled by related parties. The bank guarantee and the option expired in October 2011 without being exercised and at no cost to the Company.

Note 21. Segment information

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

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

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

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

For the year ended December 31, 2011

	On-shore drilling services (CIS other than the Caspian Sea)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues	2,562,815	189,602	2,752,417
Net income	219,287	57,950	277,237
Total assets	2,180,772	417,657	2,598,429
Goodwill	43,272	62,127	105,399

For the year ended December 31, 2010

	On-shore drilling services (CIS)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues	1,699,432	112,724	1,812,156
Net income	179,532	27,821	207,353
Total assets	1,843,745	110,323	1,954,068
Goodwill	32,727	-	32,727

Note 22. Concentration of credit risk and sales

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

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

	2011	2010
Revenues for the year ended December 31	1,690,626	1,290,911
Accounts receivable as of December 31	192,569	134,970

Note 23. Incentive Compensation Plan

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

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

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

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

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

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

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

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

The grant date fair value of the plan was estimated at USD 21 million by an independent consulting firm. The Company has approximately USD 4.2 million of unrecognized compensation expense as of December 31, 2011 that will be accrued up to December 31, 2012.

Note 23. Incentive Compensation Plan (continued)

The participants may only receive GDRs, each representing one ordinary share of the Company. Therefore, the plan is equity classified. The Group recognized USD 4.2 million of compensation expense during for the year ended December 31, 2011. As of December 31, 2011, USD 16.8 million was recognized on the Company's balance sheet as an increase in additional paid-in capital.

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

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

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

Note 24. Subsequent events

The Company has evaluated subsequent events from the balance sheet date through April 16, 2012, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.