

# EURASIA DRILLING COMPANY LIMITED

## Interim Consolidated Financial Statements

(prepared in accordance with US GAAP)

As of and for the six-month period ended June 30, 2011

(unaudited)

These interim consolidated financial statements were prepared by Eurasia Drilling Company Limited in accordance with US GAAP and have not been audited by our independent auditor. If these financial statements are audited in the future, the audit could reveal differences in our consolidated financial results and we can not assure that any such differences would not be material.

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## Independent Accountants' Report

The Board of Directors of  
Eurasia Drilling Company Limited:

We have reviewed the accompanying consolidated balance sheet of Eurasia Drilling Company Limited and subsidiaries ("the Company") as of June 30, 2011, and the related consolidated statements of income, stockholders' equity and comprehensive income, and cash flows for the six-month periods ended June 30, 2011 and 2010. This interim financial information is the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying interim financial information for them to be in conformity with accounting principles generally accepted in the United States of America.

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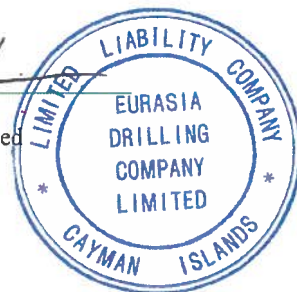
August 22, 2011

**Eurasia Drilling Company Limited**  
**Interim Consolidated Balance Sheets**  
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	As of June 30, 2011 (unaudited)	As of December 31, 2010
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents	4	533,607	629,466
Accounts receivable, net	5	417,352	235,360
Inventories	6	213,574	145,633
Taxes receivable		48,003	34,960
Deferred income tax assets		7,697	11,407
Other current assets	9	29,811	20,241
<b>Total current assets</b>		<b>1,250,044</b>	<b>1,077,067</b>
Property, plant and equipment	7	1,246,757	765,184
Long-term accounts receivable		5,299	6,838
Deferred income tax assets		2,012	1,422
Goodwill	8, 16	148,568	32,727
Other non-current assets	9	113,136	70,830
<b>Total assets</b>		<b>2,765,816</b>	<b>1,954,068</b>
<b>Liabilities and stockholders' equity</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		334,174	258,706
Advances received		20,949	20,295
Short-term debt and current portion of long-term debt	10	270,640	117,550
Deferred income tax liabilities		2,204	478
Taxes payable		79,049	54,257
<b>Total current liabilities</b>		<b>707,016</b>	<b>451,286</b>
Long-term debt	11	627,900	286,367
Accrued pension liability		8,178	6,889
Deferred income tax liabilities		33,831	24,744
<b>Total liabilities</b>		<b>1,376,925</b>	<b>769,286</b>
<b>Stockholders' equity</b>	15		
Common stock		1,469	1,469
Treasury stock, at cost		-	(13,148)
Additional paid-in capital		678,099	691,535
Retained earnings		729,590	578,989
Accumulated other comprehensive loss		(20,267)	(74,063)
<b>Total stockholders' equity</b>		<b>1,388,891</b>	<b>1,184,782</b>
<b>Total liabilities and stockholders' equity</b>		<b>2,765,816</b>	<b>1,954,068</b>

  
W. Richard Anderson  
CFO of Eurasia Drilling Company Limited

August 22, 2011



**Eurasia Drilling Company Limited**  
**Interim Consolidated Statements of Income**  
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	For the six months ended June 30, 2011 (unaudited)	For the six months ended June 30, 2010 (unaudited)
<b>Revenues</b>			
Drilling and related services		1,254,715	853,572
Other sales and services		10,567	8,441
<b>Total revenues</b>		<b>1,265,282</b>	<b>862,013</b>
Cost of services	14	(864,732)	(555,368)
Selling, general and administrative expenses		(63,142)	(54,659)
Taxes other than income taxes		(70,536)	(45,698)
Depreciation		(93,412)	(67,127)
(Loss) gain on disposal of property, plant and equipment		(3,392)	5,790
<b>Income from operating activities</b>		<b>170,068</b>	<b>144,951</b>
Interest expense		(21,133)	(7,629)
Interest income		3,753	6,531
Currency transaction gain (loss)		1,745	(1,870)
Gain on business exchange transaction	16	32,861	-
Other income		149	55
<b>Income before income taxes</b>		<b>187,443</b>	<b>142,038</b>
Current income taxes		(25,959)	(29,234)
Deferred income taxes		(10,883)	(7,994)
<b>Total income tax expense</b>	3	<b>(36,842)</b>	<b>(37,228)</b>
<b>Net income</b>		<b>150,601</b>	<b>104,810</b>
Basic earnings per share of common stock (US dollars)	15	1.03	0.75
Diluted earnings per share of common stock (US dollars)	15	1.03	0.75

**Eurasia Drilling Company Limited**  
**Interim Consolidated Statements of Stockholders' Equity and Comprehensive Income (unaudited)**  
(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 Stock- holders' equity
<b>Balance as of December 31, 2009</b>	<b>1,469</b>	<b>(58,332)</b>	<b>528,163</b>	<b>596,340</b>	<b>(65,482)</b>	<b>1,002,158</b>
Comprehensive income:						
Net income	-	-	-	104,810	-	104,810
Other comprehensive income:						
Foreign currency translation loss	-	-	-	-	(29,457)	(29,457)
Comprehensive income	-	-	-	-	-	75,353
Sale of treasury stock	-	54,956	162,548	-	-	217,504
Incentive compensation plan	-	-	2,100	-	-	2,100
Exercise of incentive compensation plan	-	3,376	(3,376)	-	-	-
Dividends declared	-	-	-	(179,000)	-	(179,000)
<b>Balance as of June 30, 2010</b>	<b>1,469</b>	<b>-</b>	<b>689,435</b>	<b>522,150</b>	<b>(94,939)</b>	<b>1,118,115</b>
<b>Balance as of December 31, 2010</b>	<b>1,469</b>	<b>(13,148)</b>	<b>691,535</b>	<b>578,989</b>	<b>(74,063)</b>	<b>1,184,782</b>
Comprehensive income:						
Net income	-	-	-	150,601	-	150,601
Other comprehensive income:						
Foreign currency translation gain	-	-	-	-	53,796	53,796
Comprehensive income	-	-	-	-	-	204,397
Disposal of treasury stock	-	481	-	-	-	481
Purchase of treasury stock	-	(2,869)	-	-	-	(2,869)
Incentive compensation plan	-	-	2,100	-	-	2,100
Exercise of incentive compensation plan	-	15,536	(15,536)	-	-	-
<b>Balance as of June 30, 2011</b>	<b>1,469</b>	<b>-</b>	<b>678,099</b>	<b>729,590</b>	<b>(20,267)</b>	<b>1,388,891</b>

**Eurasia Drilling Company Limited**  
**Interim Consolidated Statements of Cash Flows**  
(All amounts in thousands of US dollars, unless otherwise noted)

	Note	For the six months ended June 30, 2011 (unaudited)	For the six months ended June 30, 2010 (unaudited)
<b>Cash flows from operating activities</b>			
<b>Net income</b>		<b>150,601</b>	<b>104,810</b>
Adjustments for non-cash items:			
Depreciation		93,412	67,127
Accrued interest expense		1,469	1,770
Deferred income taxes		10,883	7,994
Loss (gain) on disposal of property, plant and equipment		3,392	(5,790)
Gain on business exchange transaction and sale of subsidiary		(32,861)	(970)
Allowance for doubtful accounts receivable		18	4,123
Foreign currency exchange rate difference (unrealized)		(167)	(644)
Incentive plan		2,100	2,100
All other items – net		(595)	(373)
Changes in operating assets and liabilities:			
Accounts receivable		(118,961)	(45,577)
Inventories		(35,857)	(25,249)
Taxes receivable		1,167	10,187
Other current assets		(9,029)	(9,470)
Accounts payable and accrued liabilities		54,926	9,389
Advances received		(970)	(15,544)
Taxes payable		12,314	7,036
Other liabilities		(6,832)	(1,320)
<b>Net cash provided by operating activities</b>		<b>125,010</b>	<b>109,599</b>
<b>Cash flows from investing activities</b>			
Purchases of property, plant and equipment including advances		(171,023)	(60,220)
Change in restricted cash	9	(43,713)	(59,092)
Proceeds from sale of property, plant and equipment		13,830	8,140
Sale of subsidiary, net of cash disposed		95,009	754
Principal collections		1,048	-
Acquisition of subsidiaries, net of cash acquired		(557,750)	(23,781)
<b>Net cash used in investing activities</b>		<b>(662,599)</b>	<b>(134,199)</b>
<b>Cash flows from financing activities</b>			
Proceeds from issuance of short-term debt		90,000	-
Proceeds from issuance of long-term debt		398,508	-
Principal repayments of long-term debt		(18,925)	(23,201)
Repayment of capital lease obligations		(293)	(275)
Dividends paid		(45,387)	(212,786)
Proceeds from sale of treasury stock		-	217,589
Purchases of treasury stock		(2,869)	-
<b>Net cash used in financing activities</b>		<b>421,034</b>	<b>(18,673)</b>
Effect of exchange rate changes on cash		20,696	(7,281)
<b>Net decrease in cash and cash equivalents</b>		<b>(95,859)</b>	<b>(50,554)</b>
Cash and cash equivalents at beginning of period		629,466	433,724
<b>Cash and cash equivalents at end of period</b>	<b>4</b>	<b>533,607</b>	<b>383,170</b>
<b>Supplemental disclosures of cash flow information</b>			
Interest paid		16,203	4,429
Income tax paid		25,203	11,969

See accompanying notes to these interim consolidated financial statements and independent accountants' review report. 6

## Note 1. Basis of Financial Statement presentation

The accompanying interim consolidated financial statements and notes thereto of Eurasia Drilling Company Limited (the "Company) and its subsidiaries (together, the "Group) have not been audited by independent auditors, except for the balance sheet as of December 31, 2010. In the opinion of the Company's management, the interim consolidated financial statements include all adjustments and disclosures necessary to present fairly the Group's financial position, results of operations and cash flows for the interim periods reported herein. These adjustments were of a normal recurring nature.

These interim consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America ("US GAAP") applicable to interim financial reporting. These financial statements should be read in conjunction with the Group's December 31, 2010 annual consolidated financial statements. The interim consolidated financial statements have been prepared following the accounting policies applied and disclosed in the December 31, 2010 consolidated financial statements.

The results for the six-month period ended June 30, 2011 are not necessarily indicative of the results expected for the full year.

### *Functional and reporting currency*

The functional currency of the Company and its subsidiaries, except for OOO Burovaya Kompaniya Eurasia, OOO Kliver, OOO KWWD, OOO UWWD, OOO Meridian, OOO SGC, ZAO SKRS and TOO BKE Kazakhstan Burenie, is the US dollar. The functional currency of OOO Burovaya Kompaniya Eurasia, OOO Kliver, OOO KWWD, OOO UWWD, OOO Meridian, OOO SGC, ZAO 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.

The closing exchange rate as of June 30, 2011 and December 31, 2010 was 28.0758 and 30.4769 Russian rubles to one US dollar, respectively.

## Note 2. Recent accounting pronouncements

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 financial statements. The ASU eliminates the option in U.S. 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 is evaluating the effect of the adoption of ASU No. 2011-05 and 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 U.S. 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 U.S. 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 is evaluating the effect of the adoption of ASU No. 2011-04 and does not expect any material impact on its results of operations, financial position or cash flows.



**Note 2. Recent accounting pronouncements (continued)**

In April 2011, the FASB issued ASU No. 2011-02, "*A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*," which amends Topic 310 of Codification. This ASU provides additional guidance in considering whether 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 is evaluating effect of adoption of ASU No. 2011-02 and does not expect any material impact on its results of operations, financial position or cash flows.

**Note 3. Income taxes**

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 for the periods ended June 30, 2011 and 2010 were taxed in the Russian Federation.

The Group's effective income tax rates for the periods ended June 30, 2011 and 2010 differ from the statutory income tax rate primarily due to the incurrence of costs that are either not tax deductible or only deductible to a certain limit.

Effective tax rate decreased to 19.7% in the six-month period ended 30 June, 2011 from 26.2% in the six-month period ended 30 June, 2010 primarily due to the fact that in the six-month period ended 30 June, 2010 a 5% foreign withholding tax was applied on intercompany dividends declared and paid in the amount of RUB 5.0 billion which at the US dollar exchange rate as of June 30, 2010 amounted to USD 160.3 million. Additionally, in the six-month period ended June 30, 2011 the Group realized non-tax gain of USD 32.9 million on business exchange transaction (refer to Note 16).

The Company changed its intercompany dividend policy starting July 1, 2010 and recognized deferred income tax on 20% of the undistributed earnings of its Russian subsidiary OOO Burovaya Kompaniya Eurasia earned during the reporting period. The remaining earnings of OOO Burovaya Kompaniya Eurasia and other Russian subsidiaries are considered to be reinvested indefinitely.

The Group's accounting policy is to record penalties and interest related to unrecognized tax benefit as components of income tax expense.

**Note 4. Cash and cash equivalents**

Cash and cash equivalents include the following:

	As of June 30, 2011	As of December 31, 2010
Cash held in banks - Russian rubles	316,903	76,451
Short-term deposit - Russian rubles	116,330	154,730
Cash held in banks - US dollars	100,161	357,911
Short-term deposit - US dollars	45	40,033
Other	168	341
<b>Total cash and cash equivalents</b>	<b>533,607</b>	<b>629,466</b>

**Note 5. Accounts receivable, net**

Accounts receivable include the following:

	As of June 30, 2011	As of December 31, 2010
Trade accounts receivable	426,231	243,899
Advances given	9,776	8,737
	436,007	252,636
Allowance for doubtful accounts	(18,655)	(17,276)
<b>Total accounts receivable, net</b>	<b>417,352</b>	<b>235,360</b>

**Note 6. Inventories**

Inventories include the following:

	As of June 30, 2011	As of December 31, 2010
Materials for drilling and workover	186,287	127,918
Work in progress	27,287	17,715
<b>Total inventories</b>	<b>213,574</b>	<b>145,633</b>

**Note 7. Property, plant and equipment**

Property, plant and equipment include the following:

	As of June 30, 2011	As of December 31, 2010
Machinery and equipment	1,468,869	964,134
Buildings	43,200	38,112
Vehicles	47,763	34,712
	1,559,832	1,036,958
Less: accumulated depreciation	(474,270)	(379,477)
Construction in progress	21,624	40,146
Advances given for property, plant and equipment	139,571	67,557
<b>Total property, plant and equipment</b>	<b>1,246,757</b>	<b>765,184</b>

**Note 8. Goodwill**

The movement in goodwill was as following:

<b>Goodwill as of December 31, 2010</b>	<b>32,727</b>
Goodwill acquired	147,977
Goodwill disposed	(30,557)
Cumulative translation adjustment	(1,579)
<b>Goodwill as of June 30, 2011</b>	<b>148,568</b>

**Note 9. Restricted Cash**

The Group had restricted cash of USD 103.7 million and USD 61.7 million included in other non-current assets as of June 30, 2011 and December 31, 2010, respectively. This amount collateralizes the Company's issuance of commercial letters of credit.

The Group had restricted cash of USD 2.4 million and USD 6.1 million included in other current assets as of June 30, 2011 and December 31, 2010, respectively. This amount consists of a bid bond in the amount of USD 1 million as of June 30, 2011 and December 31, 2010 and a guarantee issued for a subcontractor in the amount of USD 1.4 million and USD 5.1 million as of June 30, 2011 and December 31, 2010, respectively.

**Note 10. Short-term debt and current portion of long-term debt**

Short-term debt and current portion of long-term debt includes the following:

	As of June 30, 2011	As of December 31, 2010
Short-term debt	90,000	-
Current portion of long-term debt (note 11)	180,325	117,274
Short-term capital lease obligations	315	276
<b>Total short-term debt and current portion of long-term debt</b>	<b>270,640</b>	<b>117,550</b>

Short-term debt represents the following:

	Currency	Maturity	Stated interest	As of June 30, 2011
ZAO UniCredit Bank	USD	October 10, 2011	LIBOR01+1.6%	90,000
<b>Total short-term debt</b>				<b>90,000</b>

## Note 11. Long-term debt

Long-term debt includes the following:

Lender	Final maturity date	As of June 30, 2011	As of December 31, 2010
<i>Debt of the Company</i>			
Loan from stockholders	2011	70,000	70,000
<i>Debt of the Company's subsidiaries</i>			
Raiffeisen Bank	2016	220,000	-
Alfa Bank	2013	276,038	254,291
8.4% Russian ruble bonds, maturing 2018	2018	178,089	-
OA O Sberbank of Russia	2013	45,478	50,275
ZAO UniCredit Bank	2012	7,361	11,866
Individual	2012	3,392	6,392
Loans from Lukoil Group companies			
OOO LUKOIL-West Siberia	2011	3,984	7,078
OOO Lukoil-Perm	2041	1,065	1,000
OA O Tebukneft	2010	275	282
OA O Uhtaneft	2015	77	78
<b>Total long-term debt</b>		<b>805,759</b>	<b>401,262</b>
Current portion of long-term debt		(180,325)	(117,274)
Long-term lease obligation		2,466	2,379
<b>Total non-current long-term debt</b>		<b>627,900</b>	<b>286,367</b>

### *Stockholders*

Long-term loans from stockholders represent loans denominated in US dollars which bear interest at 8.60% and mature on December 31, 2011. These loans were received for the purpose of financing the purchases of property, plant and equipment.

### *Debt of the Company's subsidiaries*

#### *Alfa-Bank*

Long-term debt with Alfa-Bank with outstanding balances of USD 276.0 million and USD 254.3 million as of June 30, 2011 and December 31, 2010, respectively, is denominated in Russian rubles and bears interest at 8.4% per annum.

#### *Raiffeisen Bank*

Long-term debt with Raiffeisen Bank with an outstanding balance of USD 220.0 million as of June 30, 2011 is denominated in USD and bears interest at 5.65% per annum. This debt is secured by the shares of newly acquired company CSVI (refer to Note 16).

#### *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.

#### *OA O Sberbank of Russia*

Long-term debts with OA O AKB Sbergatelny Bank with an outstanding balance of USD 45.5 million as of June 30, 2011 are denominated in Russian rubles and bear interest at LIBOR plus 4.1% per annum.

**Note 11. Long-term debt (continued)**

*ZAO UniCredit Bank*

Long-term debt with ZAO UniCredit Bank with an outstanding balance of USD 7.4 million as of June 30, 2011 is denominated in Russian rubles and bear interest at 8.95% per annum.

*Loan from Individual*

Long-term debt from an individual represents a loan denominated in US dollars which bears stated interest at 0% and mature on May 1, 2012. This relates to the acquisition of the new workover company OOO Meridian (refer to Note 16). This loan has been recorded at fair value based on the effective interest rate estimated by the management to be applicable to the Company 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 of subsidiaries, denominated in Russian rubles, represent various borrowings from LUKOIL Group Companies. This long-term debt has been recorded at fair value based on effective interest rates estimated by management to be applicable to the Company at the acquisition date, which on average was 12.66% per annum.

Long-term debt of subsidiaries is secured by property, plant and equipment with a carrying amount of USD 57.9 million as of June 30, 2011 (December 31, 2010: USD 59.02 million).

Maturities of long-term debts outstanding at June 30, 2011 are as follows:

July 1, 2011 to June 30, 2012	July 1, 2012 to December 31, 2012	2013	2014	2015 and thereafter	2016 and thereafter	Total
180,325	75,484	201,588	67,830	67,726	212,806	805,759

**Note 12. Pension benefits**

Components of net periodic benefit cost were as follows:

	For the six months ended June 30, 2011	For the six months ended June 30, 2010
Interest cost	549	486
Service cost	427	402
Less expected return on plan assets	(397)	(358)
Amortisation of prior service benefit	82	(65)
Recognised actuarial gain	(22)	(6)
<b>Total net periodic benefit cost</b>	<b>639</b>	<b>459</b>

**Note 13. Fair value of financial instruments**

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

**Note 14. Cost of services**

Cost of services includes the following:

	For the six months ended June 30, 2011	For the six months ended June 30, 2010
Services of subcontractors	389,936	208,961
Wages and salaries	202,360	159,310
Materials	155,098	102,482
Fuel and energy	62,500	42,221
Transportation of employees to drilling fields	14,864	11,764
Leasing and rent	7,739	4,247
Other	32,235	26,383
<b>Total cost of services</b>	<b>864,732</b>	<b>555,368</b>

**Note 15. Stockholders' equity**

*Common stock*

	As of June 30, 2011	As of December 31, 2010
Authorized and issued common stock, par value 0.01 US dollar each	146,865,243	146,865,243
Treasury stock	-	(455,797)
<b>Issued and outstanding common stock, par value 0.01 US dollar each</b>	<b>146,865,243</b>	<b>146,409,446</b>

The movement of treasury stock was as following:

<b>Number of shares held in treasury as of December 31, 2010</b>	<b>455,797</b>
Number of shares purchased	82,419
Exercise of incentive compensation plan	(522,060)
Directors fees	(16,156)
<b>Number of shares held in treasury as of June 30, 2011</b>	<b>-</b>

*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 26.7 billion and RUB 19.9 billion, respectively as of June 30, 2011 and December 31, 2010, pursuant to the statutory financial statements, which at the US dollar exchange rates as of June 30, 2011 and December 31, 2010 amount to USD 950 million and USD 654 million, respectively.

**Note 15. Stockholders' equity (continued)**

*Dividends and dividends limitations (continued)*

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

	<b>For the six months ended June 30, 2011</b>	<b>For the six months ended June 30, 2010</b>
Net income available for common stockholders	150,601	104,810
Weighted average number of outstanding shares	146,728,649	139,395,511
Basic earnings per share of common stock (US dollars)	1.03	0.75
Contingent shares of stock incentive program (Note 21)	-	588,585
Weighted average number of outstanding shares, after dilution	146,728,649	139,984,096
Diluted earnings per share of common stock (US dollars)	1.03	0.75

**Note 16. 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 262.0 million paid in cash. Caspian Sea Ventures Limited is the owner of a jack-up drilling rig operating in the Turkmen waters of the Caspian Sea. The purpose of the acquisition was to increase the Group's share in the Caspian offshore drilling market.

At the date of acquisition the Group preliminary allocated USD 61.6 million to goodwill, USD 194.2 million to property, plant and equipment, USD 5.5 million to cash, USD 10.9 million to current assets and USD 10.2 million to current liabilities. A third-party appraisal firm has been engaged to assist the Group in the process of determining the fair value of the acquired company. The Group expects the valuation process will be finalized in the second half of 2011.

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 16.9 million and USD 13.3 million, respectively, are included in the Group's consolidated statement of income for the six months ended June 30, 2011.

The revenue and net income of the acquired company for the six month ended June 30, 2011 are USD 21.0 million (June 30, 2010: USD 13.1 million) and USD 17.2 million (June 30, 2010: USD 9.8 million), respectively.



#### Note 16. Business combinations (continued)

On April 28, 2011 the Group acquired a 100% interest in OOO Sibirskaya Geophysicheskaya 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 onshore drilling market and to diversify its client base.

At the date of acquisition the Group preliminary allocated USD 86.4 million to goodwill, USD 175.9 million to property, plant and equipment, USD 40.0 million to cash, USD 81.9 million to accounts receivable, USD 15.3 million to inventory, USD 51.9 million to current liabilities and USD 2.0 million to long-term deferred tax liability. A third-party appraisal firm has been engaged to assist the Group in the process of determining the fair value of the acquired companies. The Group expects the valuation process will be finalized in the second half of 2011.

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 79.0 million and USD 2.8 million, respectively, are included in the Group's consolidated statement of income for the six months ended June 30, 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 income statement 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.

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 consideration comprised USD 11.0 million as of the date of acquisition, of which USD 6.4 million was paid before June 30, 2011. The remaining amount of USD 3.4 million was recognized as loan from individual (refer to Note 11).

OOO Meridian performs well workover in 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.



#### **Note 16. Business combinations (continued)**

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 17. Commitments and contingencies**

##### ***Commitments***

##### *Commitments for provision of drilling services*

In 2009 the Group signed a three-year agreement for drilling services with OAO LUKOIL. Under this agreement the Group will provide drilling services to the LUKOIL Group and precise terms of rendering of such services will be set by signing annual well construction contracts with the LUKOIL Group starting from January 1, 2010 through December 31, 2012. The estimated level of drilling to be performed by the Group during this three-year period was agreed at a minimum of 6.7 million meters. The prices for drilling services under these contracts will be reviewed on an annual basis based on market prices.

The Group estimates that drilling services of at least USD 707 million will be provided by the Group during the remaining 6 months of 2011.

##### ***Contingencies***

##### *Insurance*

The insurance industry in the Russian Federation, Kazakhstan and Turkmenistan is in a developing state and many forms of insurance protection common in other parts of the world are not yet generally available. 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 17. Commitments and contingencies (continued)

### *Contingencies (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. 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 system in the Russian Federation, Kazakhstan and Turkmenistan is relatively new and is 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. In the Russian Federation a tax year remains open 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.

Within the Russian Federation 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 legislations, official pronouncements and court decisions. However, the interpretations of the relevant authorities could differ and the effect on these interim consolidated financial statements, if the authorities were successful in enforcing their interpretations, could be significant.

## Note 18. 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 six months ended June 30, 2011 and 2010 the firm billed the Company for costs and expenses of USD 1.6 million and USD 0.7 million, respectively. Mr. Stinemetz is not otherwise paid for his services as the Company's General Counsel.

**Note 18. Related party transactions (continued)**

Long-term loans from stockholders were USD 70 million as of June 30, 2011 and December 31, 2010 (refer to Note 11). Interest expense of USD 3 million and USD 3 million was recognized and paid on these loans during the 6 months ended June 30, 2011 and 2010, respectively.

**Note 19. Segment information**

Presented below is information about the Group's operating and geographical segments for the periods ended June 30, 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 CIS and the Caspian Sea.

Segment detailed information is summarized as follows:

***For the six month period ended June 30, 2011***

	On-shore drilling services (CIS)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues	1,158,620	106,662	1,265,282
Net income	105,733	44,868	150,601
Total assets	2,351,415	414,401	2,765,816
Goodwill	86,957	61,611	148,568

***For the six month period ended June 30, 2010***

	On-shore drilling services (CIS)	Off-shore drilling services (Caspian Sea)	Consolidated
Total revenues	811,775	50,238	862,013
Net income	91,440	13,370	104,810
Total assets	1,480,788	90,680	1,571,468
Goodwill	38,837	-	38,837

**Note 20. 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
Sales for the six months ended June 30	762,169	594,263
Accounts receivable as of June 30, 2011 and December 31, 2010	195,588	134,970

## Note 21. 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 6.3 million of unrecognized compensation expense as of June 30, 2011 that will be accrued up to December 31, 2012.

The participants may only receive GDRs, each representing one ordinary share of the Company. Therefore, the plan is equity classified. The Group recognized USD 2.1 million of compensation expense during six month period ended June 30, 2011. As of June 30, 2010, USD 14.7 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 June 30, 2011 no incentive plan award is expected for contingent shares of stock incentive program.

**Note 22. Subsequent events**

The Company has evaluated subsequent events from the balance sheet date through August 22, 2011, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.