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

The following report represents management's discussion and analysis of EDC's financial condition and results of operations for the six-month period ending June 30, 2014 and is intended to help our shareholders and other users of our financial statements better understand our operations and attendant financial results and current financial condition. This information is provided as a supplement to, and should be read in conjunction with, our reviewed 2014 Interim Consolidated Financial Statements and the accompanying notes, prepared in accordance with US GAAP. This discussion should not be considered all inclusive as it does not necessarily include all changes regarding general economic, political, governmental and environmental events. As used in this report, "Company", "we," "us," "our," and "EDC" means Eurasia Drilling Company Limited and, where the context requires, includes our subsidiaries.

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

Nature of operations

We are the largest provider of onshore drilling services in Russia, as measured by the number of metres drilled, according to REnergyCo. We also provide offshore drilling services in the Caspian Sea and are the largest provider of such services in the sectors where we operate, based on the number of jack-up drilling rigs, according to Wood Mackenzie. We offer our onshore integrated well construction services and workover services to local and international oil and gas companies primarily in Russia and our offshore drilling services to Russian and international oil and gas companies in the Russian, Kazakh and Turkmen sectors of the Caspian Sea. In addition, we provide onshore drilling services in Iraq. Our total land fleet consists of 699 rigs consisting of 261 onshore drilling and sidetracking rigs and 438 workover rigs. Our offshore fleet consists of three jack-up rigs with an additional one under construction.

For the six-month period ended June 30, 2014, we had total revenue of US$1,551 million, EBITDA of US$402 million and net income of US$201 million, compared to total revenue of US$1,695 million, EBITDA of US$440 million and net income of US$217 million for the six-month period ended June 30, 2013.

Our business is currently organized into two main divisions: onshore and offshore drilling services. For the six-month ended June 30, 2014, we had total revenue of US$1,452 million from our onshore division and total revenue of US$98 million from our offshore division.

For the six-month period ended June 30, 2014, we had an estimated market share of approximately 28% of the onshore drilling services market in Russia, as measured by the number of metres drilled, according to CDU-TEK. Our onshore fleet of 257 land drilling and sidetracking rigs is located in all major Russian oil and gas producing regions, including Western Siberia, Volga-Urals and Timan-Pechora. In all these regions we have well-established land support bases. We have expanded our Russian onshore drilling business organically since acquiring substantially all of LUKOIL's onshore drilling assets in 2004. Since our entry into the onshore drilling services market, we have transformed the business from an in-house cost center to a major independent oilfield service provider with sound finances and materially improved operating efficiency. Our onshore drilling services include the construction of production, exploration and appraisal oil and gas and certain other types of wells, including vertical, deviated and horizontal wells, ranging from a depth of approximately 1,200 to more than 6,400 metres. In addition, we provide a wide range of onshore workover and sidetracking services. As of June 30, 2014 our total workover fleet consisted of 438 workover rigs.

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

Our customers as of June 30, 2014 include a number of major Russian and international oil and gas companies operating in Russia, such as LUKOIL, GAZPROMNEFT, ROSNEFT, REPSOL, RUSVIETPETRO, TOMSKNEFT, TOMSKGAZPROM and others.

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

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

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

General overview

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

The oilfield services market in Russia is robust and it is arguably the most stable land market of any size in the world. Back in 2009, onshore drilling activity (as measured by wells or metres drilled) fell only around 6%, as compared to 2008, which was substantially less than the reductions in drilling activity experienced in the world’s other large markets. Following the global recession, oil prices stabilised in 2010 and remained stable at historically high levels in 2011-2013, giving oil and gas companies confidence to increase their CAPEX budgets. Since 2009 to 2013, Russian drilling market has been steadily growing by 10% on average allowing the country to meet its oil production targets.

During the first half of 2014 drilling volumes in Russia have been lower than in 2013. This last occurred at the beginning of 2010 as a result of the economic crisis. The total drilling volumes were down 7.1% or 0.7 million metres. This decline in total metres drilled was mitigated by a significant increase in horizontal drilling volumes which were up by 63% during the first half of 2014 compared to the corresponding period of 2013. Among E&P companies, GAZPROMNEFT, ROSNEFT, LUKOIL, SLAVNEFT, and BASHNEFT accounted for the major increase in horizontal drilling.

Approximately 80% of Russia's oil production is coming from mature fields where the decline rates are significant. Compensating for output declines absorbs more than 80% of upstream oil and gas spending based on IEA estimates[1]. More investments are required every year to combat natural decline rates in these fields to maintain production levels. The shift towards more complex and higher cost drilling techniques such as horizontal drilling is among these investments.

Russia's oil production continued to grow by approximately 1% during the first half of 2014 as compared to the corresponding period of 2013. The increase, as has been the case for the past several years, is driven by the contribution from greenfields coming on stream in Eastern Siberia, Timan-Pechora, the Caspian, and Sakhalin. The output from mature fields continues to decline.

During the reporting period, the oil prices have been supportive, remaining robust at more than US $100 per barrel, due to geopolitical uncertainties & risks. But these uncertainties resulted in a weaker ruble which negatively affects our reported results of operations. In addition, E&P companies continue to re-evaluate their spending so as to target higher drilling efficiencies and to review their strategy regarding in-house drilling capabilities.

Operations review

The first six months of 2014 were both challenging and exciting for the business as we faced the issues listed above. These issues required us to quickly redeploy a significant portion of our land drilling fleet. This was done with a minimum disruption to our continuing clients.

Onshore business

Our first half 2014 onshore operating results include:

- Drilling output of 2.763 million metres, 9.1% below the output achieved in the corresponding period of 2013 (3.039 million metres);
- Horizontal metres drilled during 1H 2014 were up 22.8% compared to 1H 2013 and account for 22% of total metres drilled compared to 16% during 1H 2013;
- Exploration drilling volumes increased by 12.5% during the first half of 2014 compared to the corresponding period of 2013;
- The share of our largest customer, LUKOIL, increased to 63% of our total metres drilled during the first half of 2014, as compared to 57% during the corresponding period of 2013;
- The share of GAZPROMNEFT, which became our second largest customer, increased to 18% of our total metres drilled during the first half of 2014, as compared to 11% during the corresponding period of 2013;
- The share of ROSNEFT decreased to 11% of our total metres drilled during the first half of 2014, as compared to 24% during the corresponding period of 2013;
- Our rig moving crew count increased by 8.5% period-over-period;
- Our market share was approximately 28% based on metres drilled onshore in Russia during 1H 2014;
- Signed a long-term agreement with GAZPROMNEFT for well construction and sidetracking services for a three year period;

[1] IEA, World Energy Investment Outlook, Special Report, Executive Summary, 2014 Edition, page 1

- Signed a Framework Agreement with BENTEC for the rig manufacturing in the Company's minority owned drilling rig production facility located in Kaliningrad;
- Sidetracking activity decreased by 9.2% compared to the corresponding period of 2013 with 108 well sidetracks performed during the first half of 2014.

Our Russian onshore drilling volumes decreased by 9.1% compared to the volumes achieved during the first half of 2013 while horizontal drilling was up 22.8%. The decrease in metres drilled is attributable to a number of factors including an increased number of rig moves between customers with some over very long-distances; increased horizontal and exploration drilling which are inherently more time consuming; increase in average depth of the wells drilled, and unfavorable weather conditions. All these factors led to lower metres drilled period-over-period and was also in line with total Russian drilling market dynamics. Our Western Siberian operations continue to contribute the majority of our drilling volumes but were marked with a 15% decline in metres drilled during the first half of 2014 compared to the corresponding period of 2013. However, Volga-Urals and Timan-Pechora operations demonstrated 12% and 6% increases in meters drilled period-over-period, respectively.

Lower total meters drilled were mitigated by the significant increase in the share of horizontal drilling volumes in our portfolio to 23% during the first half of 2014 from 16% during the corresponding period of 2013. On average a horizontal well takes twice as long to drill than drilling a deviated well. We accounted for approximately 30% of the horizontal metres drilled for LUKOIL, ROSNEFT and GAZPROMNEFT, estimated on the basis of CDU TEK data. We have also seen a significant 26% increase in horizontal drilling for our other customers.

The Russian E&P market is fairly concentrated where 81% of all the volumes are drilled by four large E&P companies, ROSNEFT, SURGUTNEFTEGAS, LUKOIL and GAZPROMNEFT. The leaders of decreased drilling activity among these E&P companies were SURGUTNEFTEGAS (-18%) and ROSNEFT (-1.6%)[2]. We are not providing well construction to SURGUTNEFTEGAS, as the company has its own drilling rig fleet that covers its drilling needs. Early in 2014 ROSNEFT, which used to be our second largest customer, decided to expand its own in-house fleet. To date, ROSNEFT acquired two independent drilling companies, namely OOO Orenburg Drilling Company and eight companies involved in drilling operations in Russia and Venezuela from Weatherford International plc (transaction closed August 1, 2014). These transactions shrank the size of the market available to independent competition. In recent years, LUKOIL, GAZPROM, GAZPROMNEFT, BASHNEFT, and TNK-BP (before the acquisition by ROSNEFT) sold their in-house drilling fleets. LUKOIL and GAZPROMNEFT, our two largest customers, continued to increase their total drilling volumes during the first six months of 2014.

Our customer mix continues to evolve given the changes described above. The share of ROSNEFT in our portfolio decreased to 11% of our total metres drilled during the first half of 2014, as compared to 24% during the corresponding period of 2013. In EDC's portfolio ROSNEFT's drilling volumes were down 58% as we relocated 17 rigs mostly to LUKOIL and GAZPROMNEFT during the first six months of 2014. Despite this significant decrease in ROSNEFT's volumes, during the first half of 2014 we drilled 29% more horizontal metres compared to the corresponding period of 2013 for them. Most of these volumes were drilled in Western Siberia, which accounts for the bulk of ROSNEFT's total oil production. This increase in horizontal drilling was made possible by our ability to provide capable crews and rigs. We will continue to reallocate rigs from ROSNEFT's fields to our other customers during the balance of 2014.

[2] TNK-BP's drilling volumes are consolidated to ROSNEFT's drilling volumes starting 2Q 2013.

Our cooperation with our main customer, LUKOIL, continues to be strong as we operate under long-term Framework Agreements that govern minimum volume commitments and indicative pricing ranges. The current and third three year Agreement (2013 to 2015) includes greater flexibility regarding fleet deployment and contract structures. Pursuant to the new Agreement, depending on the complexity of the drilling, our services are provided either on a general contractor "turn-key" basis or on a day rate basis. Completion services which are a part of the well construction service that we provide, pursuant to the new framework agreement, are contracted separately, given the increased complexity of such services. We drilled 1.738 million metres for LUKOIL during the first half of 2014, a moderate 0.5% increase over the first half of 2013. The majority of our drilling activity for LUKOIL, approximately 80% of total metres drilled, was done in Western Siberia, while there was a slight decrease in metres drilled in this area compared to the corresponding period of 2013. In 2014 we were awarded two new drilling contracts on the Vinogradova and Imilorskoye fields in the Khanty - Mansiysk Region, which are LUKOIL’s most prospective fields in this area. The decrease in drilling activity in Western Siberia during the first half of 2014 was offset by the significant growth in drilling volumes in Volga-Urals and Timan-Pechora. The moderate increase in total drilling volumes with LUKOIL was mitigated by 22.5% increase in horizontal drilling period-over-period. LUKOIL’s share in total metres drilled increased by 6 percentage points to 63% during the first half of 2014 compared to the corresponding period of 2013.

Our cooperation with GAZPROMNEFT continues to evolve as we were awarded our inaugural long-term Framework Agreement for well construction and sidetracking operations. The Agreement covers a three-year period, beginning January, 2014, and includes a pricing formula and minimum guaranteed number of active rigs for onshore drilling and sidetracking services in Russia. It’s our strategic priority to diversify our customer base in Russia while building long-term relationships with our clients. During the first half of 2014 metres drilled for GAZPROMNEFT in our portfolio increased by 49% to 499 million metres drilled compared to the corresponding period of 2013. We placed an additional 9 rigs with GAZPROMNEFT during the first half of 2014. As a consequence of this progress GAZPROMNEFT has become our second largest customer. In addition, there was an increase in horizontal drilling activity of 13% period-over-period. Most of the growth comes from intensified drilling activity in Western Siberia and the Volga-Urals regions. In 2012 we were awarded a drilling contract on the Novopostovskoe field in the Yamalo-Nenetsk Region, one of GAZPROMNEFT’s greenfield projects, where we continued to drill during 1H 2014 and moved one additional rig to this field. Overall the share of GAZPROMNEFT in our drilling volumes increased to 18% during the first half of 2014, compared to 11% during the first half of 2013. EDC provided a sizable 34% of GAZPROMNEFT's total drilling volumes in Russia, according to REnergyCo during 1H 2014. We are expanding collaboration in geographies of strategic importance to this customer.

During the first half of 2014 our largest customers (LUKOIL, GAZPROMNEFT and ROSNEFT) accounted for approximately 59% of Russia’s total drilling volumes, based on CDU TEK. We also continue to work for smaller oil and gas companies such as Pechoraneft, Samaranafta, Rusvietpetro, Russneft and others.

The first half of 2014 was characterized by abnormally high rig moving activity. It was driven by rig relocation from ROSNEFT’s fields and the start of the new drilling projects such as LUKOIL’s Imilorskoye, Vinogradovo and Paykihinskoe fields. The longest rig move we performed to date was a move of 2,200 km from Vankor field to Novoportovskoe field. During the first quarter of 2014 our rig moving crew count increased by 26% period-over-period and since most of rig relocations were finalized by May 2014, the rig moving crew then count decreased.

The availability of rigs is one of the keys to being a successful drilling company. Our rig fleet as of June 30, 2014 totaled 261 onshore drilling and sidetracking rigs. The rig count was higher than that as of June 30, 2013 in the amount of 257 rigs as we put into operation more rigs than we have yet to retire. During the first half of 2014 we put into operation 8 onshore drilling rigs with capacity ranging from 200 to 450 tonnes and retired 2 stationary drilling rigs. We are expecting the delivery of a total of 14 new modern rigs and retirement of 15 rigs in 2014. In addition, as we continue to deliver on our rig modernization plan, we expect to order a further 16 new drilling rigs during 2014 with delivery times in 2014/2016.

Our rigs are located in most major oil and gas provinces of Russia and we continue to invest in modernisation of our rig fleet. Management believes that the effective age of our rig fleet is less than Russia's average of 16 years, as per Douglas Westwood estimates. As per management estimations, the average age of our rig fleet as of December 31, 2013 was 13 years old with 50% of our rigs being less than 10 years old. Besides new rig additions, our rig modernization program involves upgrade of the existing rigs that improves the average age of our fleet. During the first half of 2014 we performed 5 rig upgrades which were started in 2014 and are planning to upgrade a further 8 existing rigs in 2014/2015.

Our rigs are capable of drilling a wide range of oil and gas wells, including vertical, deviated, horizontal, and extended-reach wellbores up to 6,400 metres (21,000 feet) in total length. More than half of our rigs are configured for pad drilling, the method that we believe will continue to dominate future developments due to Russia's geography.

In Russia, as in the rest of the world, unexploited oil and gas reserves increasingly occur in more challenging environments, both geographically and geologically. The services market in Russia is evolving toward higher technological content and advanced techniques. As technology applications advance, so do the costs of bringing a barrel of hydrocarbons to market. To justify the higher costs, technologies must deliver greater efficiency and production potential to the oil and gas producers. To satisfy this requirement, and to ensure the stability and further growth of oil production in Russia, we forecast an increasing requirement for new modern rigs. We continue to deliver on our five year rig fleet upgrade and modernisation plan, developed in 2010, according to which 30 new rigs are expected for 2014/2016 delivery. The drilling rigs that we are ordering are produced by Russian and Chinese manufacturers at prices significantly lower than the peak prices suffered in 2008, with considerably shorter lead times.

Our onshore workover and sidetracking operations continue to be an important part of our business. Our workover fleet as of June 30, 2014 totaled 438 workover rigs, as compared to 419 rigs the previous year. The increase is due to the purchase of new workover rigs which are intended to replace older workover rigs due for retirement later this year. Growth in our total workover jobs performed during the first half of 2014 has been quite steady with workover count increasing 4.6%. Sidetracking count decreased 9.2% due to increased mobile rig movement between projects.

We commenced drilling operations in Iraq in June 2012 by acquiring three land drilling rigs from an existing drilling contractor and added a fourth rig in Iraq later in 2012. We manage our operations through two offices and a rig yard in Iraq. We operate four single well drilling rigs capable of drilling wells of up to 5,000 metres in depth. During the first half of 2014 two rigs were employed by international oil and gas companies while the other two were undergoing planned refurbishment and recertification.

Offshore business

Our first half of 2014 offshore operating results include:

- Most of the first quarter 2014 our *ASTRA* jack-up was on a paid stand-by and later in the quarter the rig completed one well for LUKOIL and commenced drilling a well for KNK in the Russian sector of the Caspian Sea in the second quarter;
- Our *SATURN* jack-up rig continued its operations for PETRONAS Carigali (Turkmenistan) Sdn Bhd (Petronas) in the Turkmen waters of the Caspian Sea; one sidetrack well was drilled and a second was begun;
- We drilled and completed two wells on LUKOIL's Yuri Korchagin field platform in the Caspian Sea including one extended-reach horizontal development well and commenced drilling of another extended-reach horizontal development well;

- The new-build *NEPTUNE* jack-up commenced drilling for Dragon Oil in Turkmen waters of the Caspian Sea;
- Fabrication of our fourth new-build jack-up, *MERCURY*, continued on schedule during 1H 2014.

Our offshore operations remained strong during the first half 2014. Our crews remained active on LUKOIL's Yuri Korchagin field platform, drilling two wells including one challenging extended reach development (ERD) well and commencing drilling of another extended-reach horizontal development well. ERD on Yuri Korchagin is expected to continue. To date the longest ERD well drilled by us offshore on this field was 8.3 km.

Our *ASTRA* jack-up, after a paid stand-by, was deployed in the Russian waters of the Caspian Sea drilling for LUKOIL; during 1H 2014 one well was drilled. Once it completed operations for LUKOIL, the *ASTRA* commenced drilling for KNK in Russian waters of the Caspian Sea.

Our *SATURN* jack-up continues operations for Petronas in Turkmenistan, and at the end of 2012 we signed a multiyear contract extension with Petronas for drilling offshore Turkmenistan. Effective from January 9, 2013, *SATURN* is contracted for a three-year period. The award marks a continuation of several previous multi-year contracts, as *SATURN* has been contracted to Petronas since 2003, working almost entirely throughout this period in Turkmenistan. In June 2012 the *SATURN* achieved a major milestone of working continuously for five years without a Lost Time Incident (LTI). During 1H 2014 the *SATURN* continued to operate without any LTIs. During the first half of 2014 the *SATURN* completed one sidetrack well and commenced drilling another one.

Our *NEPTUNE* jack-up underwent final commissioning during the 3Q 2013 and in 4Q 2013 moved to a drilling site in the Cheleken Contract Area, Turkmenistan in the Caspian Sea and began mobilization for drilling. The LeTourneau designed Super 116E hull and related components were pre-fabricated by Lamprell in its Sharjah facility, while the remaining component fabrication, final assembly, and commissioning were performed at a shipyard in the Caspian Sea. The new build jack-up is designed to operate in water depths of up to 350 feet, and has a rated drilling depth of 30,000 feet. At the end of 2013 Dragon Oil plc awarded us a three year contract for the provision and management of new-build jack-up rigs *NEPTUNE* and *MERCURY*. *NEPTUNE* is also contracted for a five-year period by a LUKOIL-led consortium for drilling in Russian waters of the Caspian Sea once the planned activity with Dragon Oil plc is complete. During the 1H 2014 the *NEPTUNE* commenced drilling for Dragon oil in the Turkmen waters of the Caspian Sea.

In April 2012 we ordered a 4th jack-up rig *MERCURY* for our Caspian Sea operations from Lamprell; this rig will be another LeTourneau Super 116E like *NEPTUNE*. Assembly of *MERCURY's* new-build jack-up first blocks commenced in a shipyard in the Caspian Sea during 2013. The elevating and lowering system has been almost fully rigged up. Currently the starboard and port air winches as well as HP and LP piping are being tested. Rigging up of the derrick and a helicopter deck has been completed. Installation of cranes is still in progress. This rig is planned for late 2014 delivery. *MERCURY* will provide well drilling services to Dragon Oil plc in the Cheleken Contract Area, Turkmenistan in the Caspian Sea according to the three year contract replacing *NEPTUNE* for the remainder of the term.

Non-US GAAP Measure

Reconciliation of Net Income to EBITDA

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA), a non-GAAP financial measure, is computed with reference to the Company's net income for the six-month periods ended June 30, 2014 and 2013 as follows (in thousands of US dollars):

	Six-month period ended June 30,	
	2014 (unaudited)	2013 (unaudited)
	(in thousands of US$)	
Net Income	**201,115**	**216,741**
Income tax expense	59,006	64,507
Gain on disposal of PP&E	(279)	(295)
Currency transaction loss/(gain)	570	(1,987)
Interest income	(13,515)	(6,206)
Interest expense	27,709	31,252
Depreciation	127,038	136,496
EBITDA	**401,644**	**440,508**

Our EBITDA in dollar terms decreased by US$ 38.9 million during the 2014 Interim Period as compared to the coresponding period of 2013. This dollar decrease is mostly attributable to 11% ruble depreciation in 2014 (average exchange rate in 1H 2014 was 34.98 compared to 31.01 in 1H 2013). EBITDA margin was almost flat at 25.9% compared to 26.0% achieved during 1H 2013. The sustained EBIDTA margin was attributable to a number of factors including contribution to EBITDA from new-build jack-up *NEPTUNE* that commenced drilling in 2014, lower amount of pass-through costs, increased higher-value horizontal drilling and sustained cost controls by our management team. Among the factors that constrained the EBITDA margin expansion were significant rig redeployment resulting from changes in the customer mix and unfavorable weather conditions.

OUTLOOK

Global oil prices remained strong during the first half 2014 with Urals blend crude averaging slightly over $107 per barrel flat versus the first half of 2013 when it was slightly over $109 per barrel.

In the Russian market, most commentators confirm that the fundamental growth in drilling intensity will need to continue further in 2014 and beyond to maintain the ~1% growth in annual production. Most E&P companies have continued to expand their capital budgets, and the weaker Ruble having a positive effect on budgets. Russian crude oil production in 1H 2014 increased compared to 1H 2013 despite total drilling volumes decreasing by 7% versus the first half of 2013, this was offset by a 63% increase in horizontal metres drilled (source CDU TEK). We expect the growth in horizontal wells to slow in the second half of 2014 but it will still remain well above the total horizontal metres drilled last year.

We continue to make significant capital expenditures to keep our fleet age low and drilling efficient. During 2014 our utilization remains high as confirmed by our ability to place all the rigs released from ROSNEFT with other customers. Our drilling efficiency measure in metres drilled per crew per day decreased 11% June 2014 compared to 2013 due to the reduction in total metres drilled, the increase in long distance rig moves and the increase of horizontal metres drilled as a percentage of the total. Pricing for drilling services in 2014 is more favourable than in 2013 as most of our customers compensated us for inflation of costs such as energy, personnel and transportation.

For 2014 we expect our total onshore drilling volumes to be lower than that in 2013 due to client mix changes. However we expect our total revenues to be positively affected by increasing horizontal metres, inflationary price increases, and the full year contribution from our new jack-up *NEPTUNE*, but the reported US Dollar revenue will be impacted negatively should the Ruble depreciate further. The EBITDA margin will be flat or better versus 2013 as we continue to improve utilisation, achieve further operating efficiencies and benefit from the strong market environment in the offshore Caspian Sea.

The Company's customer mix will continue to evolve as drilling activity with ROSNEFT declines and activity with GAZPROMNEFT, LUKOIL and others continues to increase throughout the remainder of the year.

EDC's second new build jack-up *MERCURY* is expected to be delivered on time and will add a full year of revenue starting 2015.

Our international drilling activity with 4 rigs in northern Iraq has been challenged by the risks associated with the expansion of the so-called Islamic State in Syria & Iraq. Drilling activity is expected to continue all year but at a slower pace with low rig utilisation until the geopolitical situation stabilises.

The recent geopolitical tensions between US, EU and Russia have had limited impact to date on our activities in Russia. Based on discussions with our US and EU suppliers, they are able to continue to supply with the drilling equipment as we do not operate in the currently sanctioned domains which cover deep water, arctic offshore & shale production projects. However, our future growth may suffer if the sanctions are extended to the other areas and, specifically, if our clients are unable to expand into shale drilling at the levels currently envisaged.

Certain Factors Affecting our Results of Operations

Macroeconomic Factors Affecting Oil Companies' Capital Expenditure Programs

Our results of operations are subject to the business cycles of our customers in the oil and gas sector and, more specifically, on their planned capital expenditure programs and their ability to execute them. Oil and gas companies rely on their cash flows from operating activities to finance significant portions of their capital expenditures. Such cash flows depend heavily on the global prices for crude oil and natural gas, which affect the prices that our customers receive for sales of their products. Accordingly, oil and gas companies' budgets are normally based on assumptions of expected crude oil and natural gas prices for the relevant periods. Lower prices may reduce the amount of oil and gas that our customers can produce economically or reduce the economic viability of projects, both planned and in development. A substantial or extended decline in crude oil and natural gas prices could result in lower capital expenditures by our customers, and, consequently, lead to a reduction in the number of wells they commission to be drilled. Fluctuations in our customers' capital expenditures have caused the results of our drilling operations to vary from year to year.

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

Change in Mix of Services

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

For example, in 1H 2014 we drilled 604,146 metres utilizing horizontal drilling techniques, representing 23% of our total drilling volumes, while in 1H 2013 our horizontal drilling operations were 492,126 metres, or approximately 16% of total drilling volumes. Unexploited oil and gas reserves in Russia increasingly occur in more challenging environments, both geographically and geologically, and drilling is getting increasingly complex. "Easy to access" reservoirs that were intensively developed during past decades are no longer capable of delivering appropriate flow rates using conventional drilling techniques. As existing brownfield resources deplete, particularly in such mature oil production provinces as Western Siberia and Volga Urals, the period of sustainable production growth from conventional oil is ending and oil companies are being pushed to develop less explored regions where the complexity of drilling and, accordingly, its costs, are usually higher. Additionally, Russia's strategic goal to maintain oil production at least at current levels is driving higher drilling complexity as oil becomes harder to extract from maturing brownfields. Looking forward we see an increase in horizontal drilling as our customers report higher flow rates from wells drilled horizontally. In many instances vertical wells are not economically feasible due to low flow rates. The horizontal drilling technique is especially beneficial when used to drill reservoirs with a greater horizontal dimension than vertical thickness. Douglas-Westwood estimates that horizontal drilling could improve initial well flow rates by two to seven times in some reservoirs.

Our margins are also affected by the level of pass-through third party services in our expenses and revenue. Under most of our onshore drilling contracts, we act as a general contractor and are contractually responsible for managing all aspects of the drilling process, including certain services we do not perform ourselves. Therefore, historically, some of the revenue has related to pass-through third party services and products sold to our customers with little or no related mark-up (such as, for example, telemetry and technology services for horizontal drilling). The corresponding payments we make to third party service providers are recorded under services of subcontractors. In 2012 and during 1H 2013, we experienced a decrease in pass-through services with our largest customer, LUKOIL-West Siberia, as they began to contract for telemetry services directly with third party providers starting in May 2012 as well as due to certain other non-recurring factors. During 1H 2014, we experienced a further decrease in pass-through services as we decreased amount of work for ROSNEFT in their Western Siberian fields.

Productivity

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

Over the medium-term to long-term we expect our productivity to improve due to the ongoing implementation and utilization of more advanced drilling technologies and the application of new standards to our drilling operations. Advanced crew training and application of innovative technologies have allowed us to both improve rates of penetration and reduce non-productive time. Examples of technological advancements include wider usage of polycrystalline diamond compact drill bits, introduction of new generation drilling motors, optimization of bottom-hole assembly and mud programs/properties, and real-time drilling navigation. The use of top-drives and four-step drilling mud cleaning systems on our high specification rigs further improves penetration rates and efficiency in the increasingly challenging wells we are drilling.

During the last several years we have witnessed a number of factors that could moderate the rate of productivity improvement when measured on a per meter basis. All these factors can be broadly described as changing the mix of services that we provide to our customers. Horizontal wells are inherently more time consuming to drill than comparable deviated wells. Our productivity as measured in metres drilled per crew per day decreased by 11% during 1H 2014 as compared to the corresponding period 2013 on the back of a 22.8% increase in horizontal drilling. Another factor that affects our crew productivity is seasonality described in more detail below.

Seasonality and Extreme Weather Conditions

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

Operating Capacity

Our revenue growth can be negatively affected by the number of drilling rigs and drilling crews available to us. Our ability to increase our onshore business or maintain its current level depends on our ability to procure a sufficient number of new drilling rigs and modernize our existing ones. Following the stabilization of the global economy, we witnessed the recovery of demand for drilling services in Russia. Importantly, since the wells we drill are getting deeper we anticipate increased demand for heavier rigs. In 2010, we developed a five-year plan for the delivery of new rigs pursuant to which we ordered 22 new drilling rigs in 2012 and 2013 with the delivery in 2013/2014. These new purchases were either for heavy rigs, i.e., 320 ton hook load, equivalent to 1,500 horsepower or greater, or medium rigs with 250 ton hook load. In the next three years, we expect to purchase up to 30 new onshore rigs as part of our rig fleet upgrade and modernization plan. As of December 31, 2013, approximately 24% of our drilling rigs were in the heavy class.

At the end of 2013 we believed we had sufficient operating capacity with the addition of the new rigs to our drilling fleet and our increased drilling productivity to drill approximately 7.3 million metres on an annual basis.

Additionally, our results of operations can be affected by the amount of capital expenditures we are required to undertake in order to modernize and renovate our drilling rig fleet periodically and to satisfy applicable equipment certification requirements. As of December 31, 2013, approximately 37% of our drilling rigs were more than 20 years old, compared to the Russian average of 59% of rigs that were over 20 years old, according to Douglas Westwood (as of December 31, 2012).

Foreign Currency Fluctuations

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

The Group has currency exposure on the carrying amount of the rig fleet, which is reflected as a Russian ruble asset in the accounting records of the Group's Russian subsidiaries and then translated into US dollars in the Group's audited consolidated financial statements. A strengthening of the Russian ruble against the US dollar means a higher US dollar carrying amount of the Group's rig fleet and vice versa. At the same time, as of June 30, 2014, 76.6% of our long and short-term debt was denominated in US dollars. Accordingly, the translation effect of the assets is not balanced by a similar translation effect of the liabilities. However, our projected dollar based cash flows, principally from our offshore operations, are expected to reduce our dollar denominated debt as it matures.

Revenue

We generate our revenue primarily from the sale of onshore drilling services, as well as from offshore drilling services and certain other services.
The following table sets forth a breakdown of our revenue by type of services provided and as a percentage of total revenue for the period indicated.

	Six-month period ended June 30,			
	2014 (unaudited)		2013 (unaudited)	
	(in thousands of US$, except percentages)			
Drilling and related services	1,549,226	99.9%	1,682,545	99.2%
Other sales and services	1,456	0.1%	12,918	0.8%
Total Revenue	**1,550,682**	**100%**	**1,695,463**	**100%**

Our revenue from drilling and related services represented approximately 99.9% and 99.2% of our total revenue during the six-month period ended June 30, 2014 and 2013, respectively. Related services include our workover and sidetracking operations.

A significant portion of our revenue from drilling and related services is derived from LUKOIL, which, for the six-month period ended June 30, 2014, accounted for approximately 72.0% of our total revenue. We provide our onshore drilling services to LUKOIL on the basis of long-term three-year onshore drilling services framework agreement (the "Framework Agreement"), under which we are required to provide a guaranteed scope of drilling and well construction services to LUKOIL through the end of 2015. Pursuant to the Framework Agreement, EDC enters into annual contracts with companies in the LUKOIL group which contain detailed information on the numbers and locations of the wells to be drilled during the relevant year, as well as the basis on which our services are provided. Depending on the complexity of the drilling, our services are provided either on a general contractor "turn-key" basis or on a day rate basis. Completion services which are a part of the well construction service that we provide are contracted separately, given the increased complexity of such services.

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

In 2014 we signed a long-term three-year onshore drilling and sidetracking services framework agreement with GAZPROMNEFT, which includes a pricing formula and minimum guaranteed number of active rigs.

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

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

Cost of Services, Excluding Depreciation and Taxes

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

	Six-month period ended June 30,			
	2014 (unaudited)		**2013 (unaudited)**	
	(in thousands of US$, except percentages)			
Cost of services, excluding depreciation and taxes,	**988,605**	**100%**	**1,085,640**	**100%**
Services of subcontractors	422,237	42.7%	448,986	41.4%
Wages and salaries	248,005	25.1%	260,818	24.0%
Materials	130,190	13.2%	198,035	18.2%
Fuel and energy	95,703	9.7%	100,224	9.2%
Transportation of employees to drilling fields	29,416	3.0%	23,405	2.2%
Leasing and rent	5,898	0.6%	8,309	0.8%
Other	57,156	5.7%	45,863	4.2%

Services of Subcontractors

Under most of our onshore drilling contracts, we act as a general contractor and are contractually responsible for managing all aspects of the drilling process, including certain services we do not perform ourselves. In our onshore division, services contracted from third parties include subcontracting for technological services, transportation services, preparatory services, well facility services, petrophysical services, well services, drilling motor and drilling navigation services, cementing services, and drilling bit services. Subcontractor services was the largest component of our cost of services, excluding depreciation and taxes, for the six-month period ended June 30, 2014 and 2013. Services of subcontractors include certain reimbursable services the cost of which is passed through to our customers at little or no mark-up. The reimbursements for such services that we receive from our customers are recorded as revenue.

Wages and Salaries

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

Materials

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

Fuel and Energy

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

Transportation of Employees to Drilling Fields

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

Leasing and Rent

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

Other

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

Results of Operations

The table below sets forth a summary of our operating results in dollars and as a percentage of total revenue for the periods indicated. In absolute terms, all of our first half 2014 operating results set forth below were affected by the 11.3% depreciation of the Russian ruble against the US dollar during the six-month period ended June 30, 2014 as compared to 1H 2013.

	Six-month period ended June 30,			
	2014 (unaudited)		**2013 (unaudited)**	
	(in thousands of US$, except percentages)			
Total revenue	**1,550,682**	**100%**	**1,695,463**	**100%**
Cost of services, excluding depreciation and taxes	(988,605)	(63.8%)	(1,085,640)	(64.0%)
General and administrative expenses, excluding depreciation and taxes	(80,107)	(5.2%)	(82,095)	(4.8%)
Taxes other than income taxes	(82,111)	(5.3%)	(88,574)	(5.2%)
Depreciation	(127,038)	(8.2%)	(136,496)	(8.1%)
Gain/(loss) on disposal of property, plant and equipment	279	0.0%	295	0.0%
Income from operating activities	**273,100**	**17.6%**	**302,953**	**17.9%**
Interest expense	(27,709)	(1.8%)	(31,252)	(1.8%)
Interest income	13,515	0.9%	6,206	0.4%
Currency transaction (loss)/gain	(570)	(0.0%)	1,987	0.1%

Other income/(expenses)	1,785	0.1%	1,354	0.1%
Income before income taxes	**260,121**	**16.8%**	**281,248**	**16.6%**
Income tax expense	(59,006)	(3.8%)	(64,507)	(3.8%)
Net income	**201,115**	**13.0%**	**216,741**	**12.8%**

Revenue

Revenue decreased by US$144.8 million, or 8.5%, to US$1,550.7 million for the six-month period ended June 30, 2014 from US$1,695.5 million in the comparable 2013 period. The decrease was due to 11.3% depreciation of the Russian ruble against the US dollar as of 1H 2014 as compared to 1H 2013. Increase in high-value complex horizontal drilling and higher revenue from our offshore segment as our new jack-up *NEPTUNE* commenced operations in March 2014 were netted off by changes in our client mix and related increase in rig redeployment.

Cost of Services, Excluding Depreciation and Taxes

Cost of services, excluding depreciation and taxes, decreased by US$97.0 million, or 8.9%, to US$988.6 million for the 2014 Interim Period from US$1,085.6 million for the comparable 2013 period. Cost of services, excluding depreciation and taxes, as a percentage of total revenue decreased from 64.0% for H1 2013 to 63.8% for H1 2014. The decrease in absolute terms was due to depreciation of the Russian ruble. A slight decrease as a percentage of total revenue despite higher transportation costs due to increase in rigs redeployment was primarily attributable to efforts by the Group's management to control costs.

For the six-month period ended June 30, 2014, services of subcontractors were US$422.2 million, or 42.7% of total cost of services, excluding depreciation and taxes, as compared to US$449.0 million, or 41.4% of total cost of services, excluding depreciation and taxes, for 1H 2013. The decrease in absolute terms was due to ruble depreciation. The increase as a percentage of total cost of services, excluding depreciation and taxes, was due to increased transportation costs related to rigs redeployment caused by changes in the client mix and to a greater extent due to significant decrease in the share of materials in total cost of services, excluding depreciation and taxes, as to be described further below, causing the relative share of other constituents of our cost of services, excluding depreciation and taxes, to increase.

Wages and salaries for 1H 2014 were US$248.0 million, or 25.1% of total cost of services, excluding depreciation and taxes, as compared to US$260.8 million, or 24.0% of total cost of services, excluding depreciation and taxes, for comparable period in 2013. The decrease in absolute terms was driven by ruble depreciation which was partially netted off by annual salary indexation and formation of additional drilling crew for our offshore operations on Neptune. The increase in wages and salaries as a percentage of total cost of services, excluding depreciation and taxes, resulted from a decrease in the share of reimbursable materials in total cost of services, excluding depreciation and taxes, as described above, causing the relative share of other constituents of our cost of services, excluding depreciation and taxes, to increase.

During the first half of 2014, cost of materials was US$130.2 million, or 13.2% of total cost of services, excluding depreciation and taxes, as compared to US$198.0 million, or 18.2% of total cost of services, excluding depreciation and taxes, for the six-month period ended June 30, 2013. The decrease in both absolute terms and a percentage of total cost of services, excluding depreciation and taxes, was primarily caused by decrease in reimbursable pass-through materials (casing pipe) as a result of declining activity with ROSNEFT.

Fuel and energy costs for the six-month period ended June 30, 2014 were US$95.7 million, or 9.7% of total cost of services, excluding depreciation and taxes, compared to US$100.2 million, or 9.2% of total cost of services, excluding depreciation and taxes, for 2013. The decrease in absolute terms due to ruble depreciation was partially netted off by higher prices for the fuel and energy. The increase as a percentage of total cost of services, excluding depreciation and taxes, resulted from a decrease in the share of reimbursable materials in total cost of services, excluding depreciation and taxes, as described above, causing the relative share of other constituents of our cost of services, excluding depreciation and taxes, to increase.

Expenses relating to the transportation of employees to field locations for 1H 2014 were US$29.4 million, or 3.0% of total cost of services, excluding depreciation and taxes, compared to US$23.4 million, or 2.2% of total cost of services, excluding depreciation and taxes, for 1H 2013. The increase both in absolute terms and as a percentage of the total cost of services, excluding depreciation and taxes, was primarily caused by change in the client mix, redeployment of rigs and as a result of new pad locations.

Leasing and rent costs for 1H 2014 were US$5.9 million, or 0.6% of total cost of services, excluding depreciation and taxes, compared to US$8.3 million, or 0.8% of total cost of services, excluding depreciation and taxes, for the six-month period ended June 30, 2013. The decrease in both absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was due to the discontinuance of certain leases and rent in respect of drilling equipment.

Other expenses amounted to US$57.2 million, or 5.8%, of our total cost of services, excluding depreciation and taxes, for 1H 2014, as compared to US$45.9 million, or 4.2% of our total cost of services, excluding depreciation and taxes, for 1H 2013. The increase both in absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was primarily driven by increase in insurance costs due to increase in more complex drilling and arrival of new drilling rigs.

General and Administrative Expenses, Excluding Depreciation and Taxes

General and administrative expenses, excluding depreciation and taxes, decreased by US$2.0 million, or 2.4%, to US$80.1 million for the six-month period ended June 30, 2014, as compared to US$82.1 million for 1H 2013. As a percentage of total revenue, General and administrative expenses, excluding depreciation and taxes, increased to 5.2% for 1H 2014 from 4.8% for 1H 2013. This increase was primarily attributable to annual salary indexation and organizational restructuring in some of the subsidiaries.

Taxes Other Than Income Taxes

Taxes other than income taxes include various local taxes, such as social, property, road, and other small regional taxes. Taxes other than income taxes decreased by US$6.5 million, or 7.3%, to US$82.1 million for 1H 2014, as compared to US$88.6 million for 1H 2013. Taxes other than income taxes as a percentage of total revenue slightly increased from 5.2% in 1H 2013 to 5.3% in the comparable period in 2014. The decrease in absolute terms due to ruble depreciation was partially netted off by the increase due to annual salary indexation.

Depreciation

Depreciation decreased by US$9.5 million, or 6.9%, to US$127.0 million for the six-month period ended June 30, 2014 as compared to US$136.5 million for 1H 2013. As a percentage of total revenue, depreciation slightly increased from 8.1% in 1H 2013 to 8.2% in 1H 2014. The decrease in absolute terms due to ruble depreciation was partially netted off by Neptune depreciation since commencing operations in 2014.

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

Gain on the disposal of property, plant and equipment amounted to US$0.3 million for both 1H 2014 and 2013.

Income from Operating Activities

Income from operating activities decreased by US$29.9 million, or 9.9%, to US$273.1 million for 1H 2014, as compared to US$302.3 million for 1H 2013. The decrease in absolute terms was due to the ruble depreciation. As a percentage of total revenue, income from operating activities just slightly decreased from 17.9% for 1H 2013 to 17.6% in 1H 2014. This was primarily due to change in the client mix and rig redeployment.

Interest Expense

Interest expense decreased by US$3.5 million, or 11.3%, to US$27.7 million for the six-month period ended June 30, 2014, compared to US$31.3 million for 1H 2013. The decrease in interest expense was primarily attributable to the lower weighted average interest rate on our debt. Also 1H 2013 interest expense included some additional fees related to early repayment of our US$220 million Raiffeisenbank facility.

Interest Income

Interest income increased by US$7.3 million, or more than doubled, to US$13.5 million for 1H 2014 from US$6.2 million in 1H 2013. This increase was primarily due to higher average daily cash balances during 1H 2014 as compared to 1H 2013.

Currency Transaction Gain/(Loss)

Currency transaction loss amounted to US$0.6 million for the six-month period ended June 30, 2014, as compared to a gain of US$2.0 million in 1H 2013 due to the fluctuations in the ruble/USD exchange rates.

Other Income/(Expenses)

Amounts in this category represent unusual income or expense not resulting from our ordinary course of business activities. In 1H 2014 we recognized income in the amount of US$1.8 compared to $US1.4 million during 1H 2013.

Income Before Income Taxes

Income before income taxes decreased by US$21.1 million, or 7.5%, to US$260.1 million for the six-month period ended June 30, 2014, compared to US$281.2 million for 1H 2013. The decrease in income before income taxes was attributable to the ruble depreciation and factors described in more detail above.

Income Tax Expense

Income tax expenses decreased by US$5.5 million, or 8.5%, to US$59.0 million for 1H 2014, compared to US$64.5 million for 1H 2013. The decrease was due primarily to a lower tax base. Our effective tax rate just slightly decreased to 22.7% in 1H 2014 from 22.9% in 1H 2013. The decrease in effective tax rate is attributable to fewer non-deductible expenses in 1H 2014 compared to 1H 2013.

Net Income

As a result of the foregoing factors, net income decreased by US$15.6 million, or 7.2%, to US$201.1 million for 1H 2014, compared to US$216.7 million for 1H 2013.

Liquidity and Capital Resources

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

Cash flows

The table below shows our net cash flows from operating, investing and financing activities for the six-month periods ended June 30, 2014 and 2013.

	Six-month period ended June 30,	
	2014 (unaudited)	**2013 (unaudited)**
	(in thousands of US$)	
Net cash provided by operating activities	254,837	215,587
Net cash used in investing activities	(222,380)	(173,385)
Net cash (used in) provided by financing activities	(196,196)	365,560

Operating Activities

Net cash provided by operating activities amounted to US$254.8 million for the six-month period ended June 30, 2014, as compared to US$215.6 million for 1H 2013. This increase in cash flows provided by operating activities is caused by the fact that in 1H 2013 US$95 million was put in bank deposits with original maturity exceeding 3 month.

Investing Activities

Net cash used in investing activities amounted to US$222.4 million for 1H 2014, as compared to US$173.4 million for 1H 2013. Investing activities during 1H 2013 were positively impacted by return of restricted cash in the amount of US$45.4 million as collateral for issuance of commercial letter of credit to Lamprell which was replaced by an irrevocable renewable bank guarantee of the same amount from UniCredit Bank. Capital expenditures during the six-month period ended June 30, 2014 amounted to US$222.0 (including US$52.7 million offshore capital expenditures) as compared to US$224.5 (including US$54.2 million offshore capital expenditures) in 1H 2013. There were no strategic acquisitions in either of the six-month periods ending June 30, 2014 and 2013.

Financing Activities

Net cash used by financing activities amounted to US$196.2 million for the six-month period ended June 30, 2014, compared to net cash provided by financing activities in the amount of US$365.6 million for 1H 2013. During both periods, dividends were paid, treasury shares were purchased and certain debt was redeemed in accordance with its terms. During 1H 2013, we raised US$600 million through a eurobond offering and US$210.8 million through a new credit line facility with UniCredit Bank, and made an early repayment to Raiffeisenbank in the amount of US$220 million. During 1H 2014 we drew down the remaining US$16.2 million from our UniCredit facility and received US$5.8 million from BNP Paribas for financing new drilling rig purchases. Also, in the beginning of 2014 we paid down a US$10 million loan to one of the stockholders.

Liquidity

As of June 30, 2014 we had cash and cash equivalents of US$599.4 million compared to US$777.8 million at December 31, 2013.

	At June 30, 2014 (unaudited)	At December 31, 2013
	(in thousands of US$)	
Cash held in banks – Russian rubles	259,378	231,178
Short term deposit – Russian rubles	190,262	285,770
Cash held in banks – mostly US dollars	99,653	249,630
Short term deposit – US dollars	50,044	11,113
Other	75	101
Total cash and cash equivalents	**599,412**	**777,792**

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

Capital Expenditures

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

For the period ended June 30, 2014 and for the year ended December 31, 2013 advances given for property, plant and equipment amounted to the following:

	At June 30, 2014 (unaudited)	At December 31, 2013
	(in thousands of US$)	
Advances given for property, plant and equipment	42,139	90,493

The amounts represent cash advances for property, plant and equipment purchased but for which we have not yet taken delivery. The decrease in advances given for property, plant, and equipment in the six-month period ended June 30, 2014 was attributable to the arrival of onshore drilling equipment.

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

	At June 30, 2014 (unaudited)	At December 31, 2013
	(in thousands of US$)	
Construction in progress	364,417	494,735

The decrease in construction in progress in the six-month period ended June 30, 2014 was due to putting into service our first new-build jack-up rig, *NEPTUNE*. In the first half of 2014 we made one instalment payment to Lamprell in the amount of US$45.4 million for the construction of our second new-build jack-up rig, *MERCURY*.

Capital Resources

For the six-month period ended June 30, 2014 and for the year ended December 31, 2013 our short-term and long-term debt amounted to the following:

	At June 30, 2014 (unaudited)	At December 31, 2013
	(in thousands of US$)	
Current portion of long-term debt	111,088	104,394
Non-current long-term debt	1,029,055	1,010,086

As of June 30, 2014 (unaudited), our loans and borrowings were comprised of the following:

Long-term debt	Final maturity date	Currency	Interest Rate	Outstanding debt *(in thousands of US$)*	Security
Debt of the Company					
ZAO UniCredit Bank	2017	USD	LIBOR + 3.3%	227,000	Property, plant and equipment
Loans from stockholders	2014	USD	5.8%	40,000	None
Debt of our subsidiaries					
Bank loans					
OAO Sberbank of Russia	2014	RUB	7.7%	9,912	None
BNP PARIBAS SA	2019	RUB	LIBOR + 4%	5,755	None
Eurobonds	2020	USD	4.875%	600,000	None
Russian ruble bonds	2018	RUB	8.4%	148,674	None
OOO Rushong-hua	2016	RUB	5%-6.3%	108,802	None
Total long-term debt				**1,140,143**	
Total non-current long-term debt				**1,029,055**	

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

The following table summarizes the principal maturities of our long-term debt, including its current portion, as of June 30, 2014 (unaudited). Long-term debt also includes remaining instalment payments for onshore rigs. We expect to meet our debt payment requirements with cash flows from our operations and other financing arrangements.

	Payments due by period						
	Total	July 1, 2014 to June 30, 2015	July 1, 2015 to December 31, 2015	2016	2017	2018	2019 and thereafter
	(in thousands of US$)						
Contractual Obligations							
Long-term debt	1,140,143	111,088	37,491	129,918	103,451	157,042	601,153

Our long-term debt and overdraft lines are secured by certain property, plant and equipment with a carrying amount of US$242.5 million as of June 30, 2014. At the same time, our secured debt represented approximately 20% of our total long and short-term debt.

As of June 30, 2014, our short-term and long-term capital lease obligations were nil.

Off-Balance Sheet Arrangements

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

Overview of Other Matters

Dividend Policy and Year-End 2013 Dividend Declaration

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

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

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

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

Treasury Shares

In February 2014, we announced that we may buy back up to US $200 million of our GDRs commencing April 2, 2014 for a period of six months. Since then 1,574,773 GDRs were purchased. Also during 1H 2014 5,790 shares were transferred to Directors in lieu of cash for their services. As of June 30, 2014 there were 1,747,858 shares held in treasury.

Earnings per Share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding during the reporting periods.

The calculation of earnings per share for the first six months of 2014 and 2013 was as follows:

	Six-month period ended June 30, 2014 (unaudited)	Six-month period ended June 30, 2013 (unaudited)
Net income available for common stockholders	201,115	216,741
Weighted average number of outstanding shares	146,454,798	146,792,115
Basic earnings per share of common stock (US dollars)	1.37	1.48

Basic earnings per share were US$1.37 in the first six months of 2014, compared to US$1.48 in 1H 2013. This decrease in earnings per share was attributable to the decrease in net income by 7.2% in 1H 2014 compared to 1H 2013.

Related Party Transactions

Shareholder Loans

In the period from November 2006 through March 2007 the Company entered into loan agreements with its shareholders to partially fund the investment programme of our onshore drilling services division and the purchase of our offshore drilling services business. The aggregate principal amount of such loans was US$40 million and US$50 million as of June 30, 2014 and December 31, 2013 respectively. These loans are denominated in US dollars and bear interest at 5.8% per annum with the maturity date on or before December 31, 2014.

US$1.4 million interest was recognised on these loans during the six-month period ended on June 30, 2014 and 2013. Management believes the terms of these loans are no more onerous than those that would have been negotiated in an arms-length negotiation.

Legal Services

The Company's General Counsel, Douglas Stinemetz, is a partner with The Stinemetz Law Firm (the Firm). During the six-month period ended June 30, 2014 and 2013 the Firm billed EDC for costs and expenses of US$1.4 million and US$1.9 million, respectively. All services were billed at a discount to the Firm's normal billing rates, while expenses were billed at their actual cost. In addition the amounts paid to The Stinemetz Law Firm include considerable third party expenses and charges for the services of other lawyers. Mr. Stinemetz is not otherwise paid for his services as the Company's General Counsel. Management believes the amounts paid for these legal services are no more onerous than those that would have been negotiated in an arms-length negotiation for a similar level of service and expertise.

Transactions with the Associate Company

In 1H 2014 the Group issued a short-term loan of US$0.6 million to an associate company OOO Kliver. The loan was denominated in Russian rubles, bore interest at 10% and was fully paid back as of June 30, 2014. Additionally during 1H 2014 the Group acquired equipment from OOO Kliver in the total amount of US$15.0 million. As of June 30, 2014 accounts payable to OOO Kliver amounted to US$1.0 million.

Quantitative and Qualitative Disclosures about Market Risk

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

Credit Risks

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

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

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

	2014 (unaudited)	2013
	(in thousands of US$)	
LUKOIL revenue for the six-month period ended June 30	1,116,375	1,118,943
ROSNEFT revenue for the six-month period ended June 30	126,340	295,973
LUKOIL accounts receivable as of June 30, 2014 and December 31, 2013	311,085	221,354
ROSNEFT accounts receivable as of June 30, 2014 and December 31, 2013	39,645	74,426

The LUKOIL Group made up approximately 72.0% and 66.0% of our sales for the periods ended June 30, 2014 and 2013, respectively. The ROSNEFT Group made up approximately 8.1% and 17.5% of our sales for the periods ended June 30, 2014 and 2013, respectively. In order to reduce exposure to this credit risk we have been increasing our business with other, unrelated, customers and continue to monitor our account receivable balances closely. We perform periodic credit checks on our customers and, as a result, did not have any material bad debt expense from our operations during the six-month periods ended June 30, 2014 and 2013. Our allowance for doubtful accounts stood at US$10.6 million at June 30, 2014, which amount was considered adequate. Our cash and cash equivalents are placed with major banks of Russia, Switzerland, Austria and the United Kingdom.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our long-term and short-term debt. The table below presents scheduled long-term debt maturities in US dollars and related weighted-average interest rates as of June 30, 2014:

	Scheduled Maturity (in millions of US$, except percentages)							Fair Value
	July 1, 2014 to June 30, 2015	July 1, 2015 to December 31, 2015	2016	2017	2018	2019 and Thereafter	Total	June 30, 2013
Total long term debt	111.1	37.5	129.9	103.5	157.0	601.2	1,140.1	1,118.8
Fixed rate	110.5	11.7	27.9	1.4	155.9	600.0	907.4	886.1
Average interest rate	5.6%	5.5%	5.5%	5.6%	5.6%	4.9%		
Variable rate*	0.6	25.8	102.0	102.1	1.1	1.2	232.7	232.7
Average interest rate	3.7%	3.7%	3.7%	3.7%	4.4%			

* Based on the LIBOR rate at the end of 2014 Interim Period, which rate may fluctuate in later periods.

Currency Risk

We are exposed to foreign currency exchange rate risks. The currency giving rise to these risks is primarily the Russian ruble. We use the Russian ruble for the majority of our operations, while the US dollar is our reporting currency. Foreign exchange gains and losses result from converting monetary and certain non-monetary assets and liabilities denominated in the Russian ruble into US dollar amounts at each balance sheet date. This includes any borrowings in a foreign currency. As of June 30, 2014 we had US$267.4 million of a total of US$1,140.1 million of our long and short-term debt denominated in the Russian ruble. As of December 31, 2013 we had US$253.7 million of a total of US$1,114.5 million of our long and short-term debt denominated in the Russian ruble. In addition, the results of our operations are impacted by transactions entered into in currencies other than the Russian ruble, and a fluctuation in the Russian ruble versus US dollar exchange rates will result in a change in the recognized revenue and expenses associated with such transactions. Furthermore, while the majority of our revenue are denominated in the Russian ruble, some of our costs, including some of those associated with purchases of foreign manufactured land and offshore drilling rigs, are denominated in the US dollar and other currencies. Any significant foreign currency exchange rate fluctuations (both short- and long-term) could have a material adverse effect on our business, financial condition and results of operations.