



Geared for

Growth

Eurasia Drilling Company Limited Annual Report 2012

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REPORT](#)



User guide

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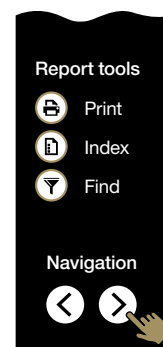


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	3,237,333	2,766,
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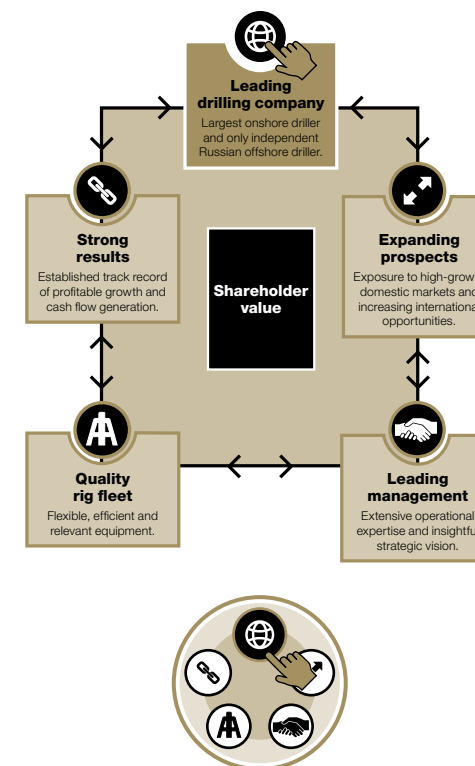
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Geared for growth

Eurasia Drilling Company is the largest provider of onshore drilling services in Russia and the CIS, and the only independent Russian offshore drilling contractor.

Our clear vision and strong focus on what we do best have consistently resulted in superior returns for our shareholders and maximum value for our customers.

With industry-leading growth since our inception, we have unrivalled market penetration in Russia and growth ambitions on a global scale.

No.1

We are the largest land drilling company in Russia and the CIS, and the only Russian independent offshore contractor

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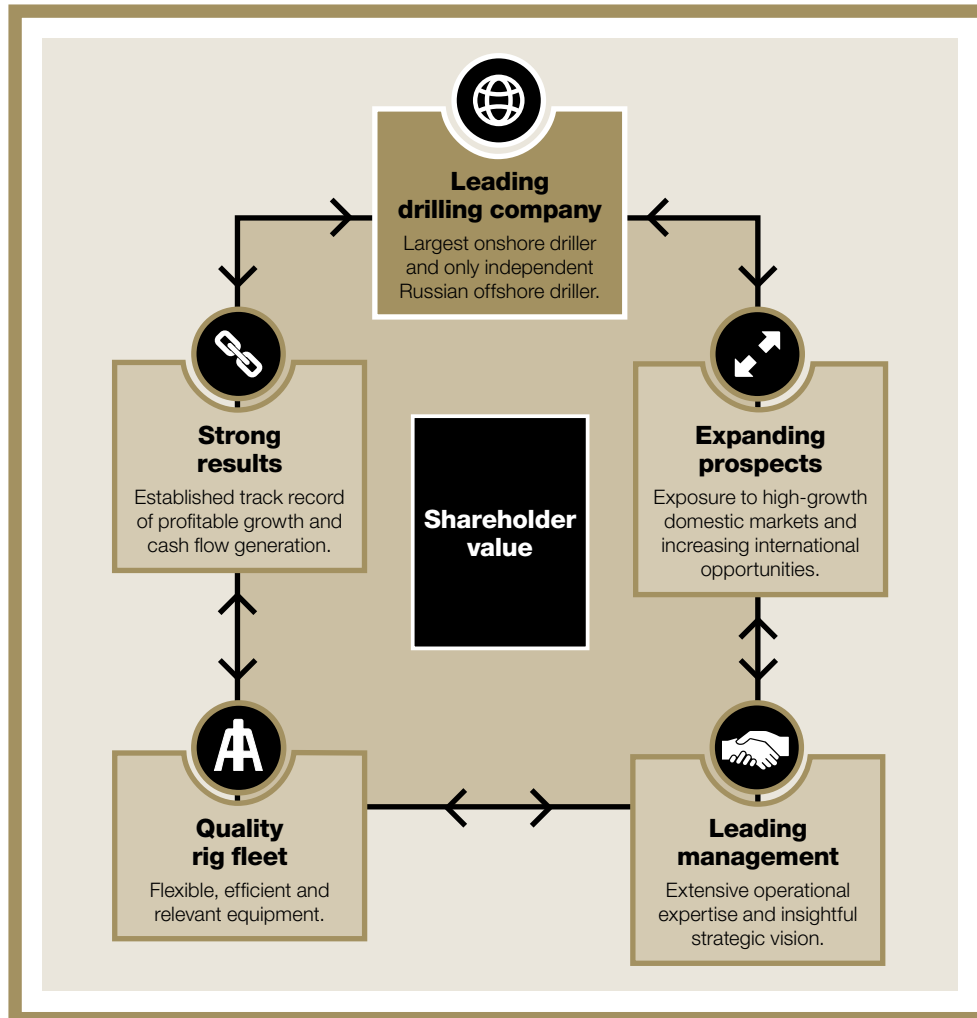
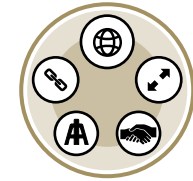
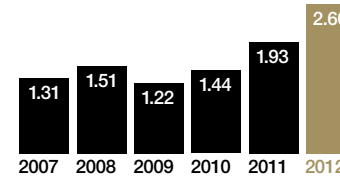


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EDC EPS US \$ per share



Our drivers for growth

- 1 Leadership** – we have a market-leading position in terms of our innovation and scale.
- 2 Secure fundamentals** – we have capable rigs and competent people to deliver leading service across our core Russian market.
- 3 Markets** – we have numerous growth opportunities across our core and developing markets.
- 4 Value for customers** – we invest in service delivery to, and partnering with, our customers to give them what they need.
- 5 Efficiency** – we have a long track record of driving operational efficiencies.
- 6 Commitment to shareholder returns** – we deliver strong free cash flow due to our leadership position and prudent financial management.



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Leading drilling company



People and rigs are our business

Our total fleet of 672 rigs including onshore drilling, workover and sidetracking rigs and offshore jack-up rigs enabled our highly professional, results-oriented 23,000 personnel to deliver over 2,000 wells to our customers in 2012.



Onshore

Our onshore drilling services division provides integrated well construction services, as well as workover and sidetracking services to national and international oil & gas companies, primarily in Russia. We also provide drilling services in Iraq starting July 2012.



Offshore

Our offshore drilling services division provides drilling, workover and sidetracking of oil & gas wells in the Russian, Kazakh and Turkmen sectors of the Caspian Sea, serving international and Russian E&P companies.



Operational headquarters



Regional/branch office



Support base



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Expanding prospects



Market overview – Russia onshore

The Russian economy is highly dependent on the oil & gas industry, with more than 40% of state revenues derived directly from hydrocarbon production.

Provision of onshore drilling services to oil & gas companies in Russia is our primary business focus. The Russian oilfield services market, among the largest in the world, has proven to be resilient throughout the economic cycle.

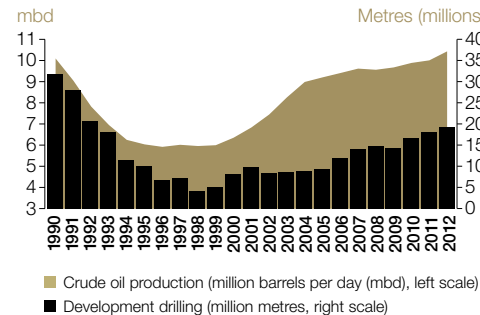
Russian oil industry dynamics

- According to BP's *Statistical Review of World Energy*, Russia's oil production amounted to approximately 10.6 billion barrels per day in 2012, an increase of 1.2% vs. 2011, making Russia the world's second-largest oil producer.

Russian drilling market

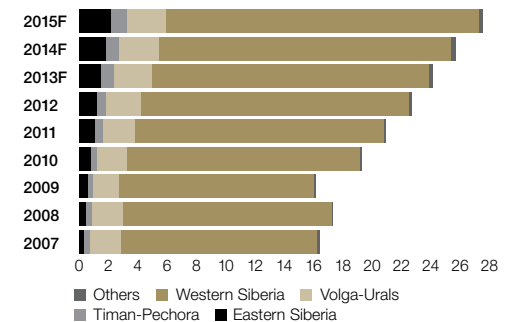
- Russian drilling volumes, based on metres drilled, increased at a compound annual growth rate (CAGR) of approximately 6.7% between 2007 and 2012 and similar CAGR is forecast by commentators in the coming years.
- Drilling volumes in Western Siberia will dominate the drilling market for many years to come, but the growth rate in drilling will be even higher in greenfield areas.
- As drilling depths rise, the marginal cost of drilling increases non-linearly, (everything else being equal) pushing up the overall cost faster than the increase in metres. In addition exploration drilling, which is inherently more expensive than development drilling in brownfield areas, is forecast to increase over the next few years.
- It is possible growth could be faster in later years if recently announced initiatives to drill horizontal shale wells in Russia come to pass.

Russia's crude oil production and development drilling



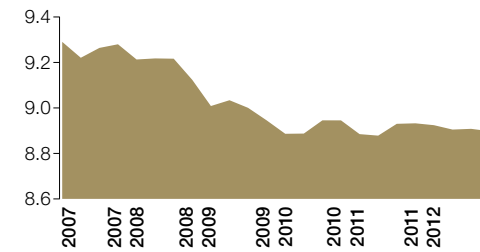
Source: *Russian Upstream and Oilfield Services Industry 2013* by REnergyCo

Russian onshore market by metres drilled millions



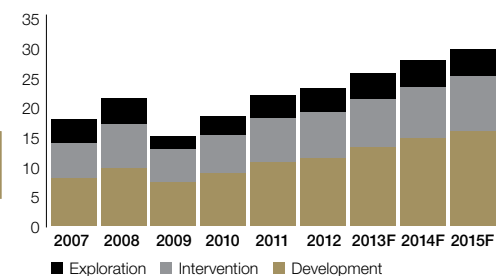
Source: *Russian Upstream and Oilfield Services Industry 2013* by REnergyCo

Russia's brownfield oil production dynamics mbd



Source: CDUTEK, Sberbank CIB

Russian oilfield services market US \$ billions



Source: *Russian Upstream and Oilfield Services Industry 2013* by REnergyCo

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Expanding prospects *continued*



Offshore market – we operate the largest jack-up drilling rig fleet in the Caspian Sea

Market overview – offshore prospects

ASTRA



SATURN



NEPTUNE & MERCURY



EDC also provides offshore rig management services



LSP-1 ice-resistant fixed platform on LUKOIL's Yuri Korchagin field in the Caspian Sea

Capacity

Our jack-up rigs are capable of drilling to depths of up to 9,000 metres, and most are equipped with 15,000 psi pressure control equipment (BOPs).

Scope

Our jack-up drilling rigs are capable of drilling in a wide range of water depths, from a minimum of 3.8 metres to a maximum of 107 metres (350 ft), covering a large portion of the oil & gas prospects in the Caspian Sea.

Ability

We operate in culturally diverse environments, strictly following best international practices. We have drilled in the Russian, Kazakh and Turkmen sectors of the Caspian for LUKOIL, PETRONAS, Dragon Oil, Shell, ConocoPhillips and others.

Skill

We have a proven track record and qualified personnel to assist our customers with their extended-reach drilling (ERD) projects. The longest ERD well drilled by us offshore in 2012 was 7.4km at the Yuri Korchagin field for LUKOIL.

Aware

Our rigs have been specifically designed to meet strict 'zero discharge' environmental protection requirements.

Results

Most discoveries in the Russian sector of the Caspian Sea were drilled by the ASTRA, including the V. Filanovsky and Yuri Korchagin fields.

Drilling in the Caspian is set to increase ...

- The Caspian Sea accounts for approximately 3% of the world's oil reserves.
- Drilling activity in the Caspian Sea is set to increase substantially over the next few years, fuelled by a mix of exploration, appraisal and development drilling across the entire region
- Over the past eight years, about 154 wells have been drilled in the Caspian Sea using mobile offshore rigs (as opposed to platform rigs, or land rigs on artificial islands).*
- The forecasts are that, assuming sufficient rigs are available, the number of wells will increase by at least a 39%, to 214 or more, over the next eight years to 2020.*

* Source: Wood Mackenzie, September 2012



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Leading management



Extensive operational expertise and insightful strategic vision

Our management team is both highly experienced in operational terms as well as having significant strategic vision. Both these elements were demonstrated by a set of strong operational and financial results.

The prospects for our business are increasing and expanding. We are well placed to benefit from the growth in Russian domestic markets as every effort is made to preserve and increase production levels.

Our leadership team is committed to supporting this growth, through expanding the number of talented people across all levels of our business.

Our ability to attract and retain the most talented individuals in the industry is one of our key competitive advantages and a necessary condition for our plans to develop the business over the longer term. We are committed to further strengthening our team by working to recruit, retain and motivate the best people in the industry. This includes embedding innovative incentive and training programmes across our operations.

Our commitment to high levels of safety is embedded into all elements of our operations. Lost time incidents have been historically below the International Association of Drilling Contractors average. This safety culture is a core principle and clear leadership in this area will enable us to make further progress towards our goal of being an incident-free business.

With approximately 23,000 colleagues, people are key to our business. We have long recognised that they are our most important asset. Our field teams are supported by leadership teams that collaborate with our customers to push the boundaries of value-added technology to find drilling solutions that deliver increased returns for our customers. As a result we are able to deliver the highest standards of innovation and service that our customers expect. This has included deploying industry-leading horizontal drilling technology and the deployment of the most modern and efficient jack-up rigs operating in the Caspian Sea.

We measure leadership success against the five objectives we set in 2007: organic growth and efficiency improvement, selective expansion into closely related services, secure access to land rig manufacturing capacity, further growing our customer base and develop into offshore drilling. The leadership team has made good progress against all of these objectives. Since our IPO in 2007 our market share has increased from 20% to 29% in 2012, while EBITDA has grown from US \$314 million to US \$790 million in 2012. Revenues increased from US \$1.5 billion to US \$3.2 billion in 2012.

People

With approximately 23,000 colleagues, people are key to our business. We have long recognised that they are our most important asset.

Talent

To be prepared for growth, we continue to concentrate on the processes and systems needed to ensure we attract the best talent.

Safety

The health, safety and security of everyone who works for us are essential to the success of our business.



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Quality onshore rig fleet



Broad

EDC owns and operates a fleet of 257 land drilling and sidetrack rigs and 413 land workover and well service rigs as of 31 December 2012 – the largest fleet in the eastern hemisphere.

Mobile

We also own and operate the largest fleet of mobile drilling rigs in Russia, with 46 chassis/truck-mounted rigs suitable for sidetracking and off-pad in-fill drilling.

Flexible

Our rigs are capable of drilling a wide range of oil & gas wells, including vertical, deviated, horizontal and extended-reach wellbores up to 6,400 metres (21,000 feet) total length.

Current

Since inception EDC has purchased over 50 new drilling rigs and has fully retrofitted over 20 rigs within our legacy fleet. We have also added more than 40 modern rigs through acquisition, and retired 20 older rigs.

Efficient

Over two-thirds of our drilling and sidetrack rigs are powered by electricity, using less energy and producing fewer CO₂ emissions than mechanically powered models.

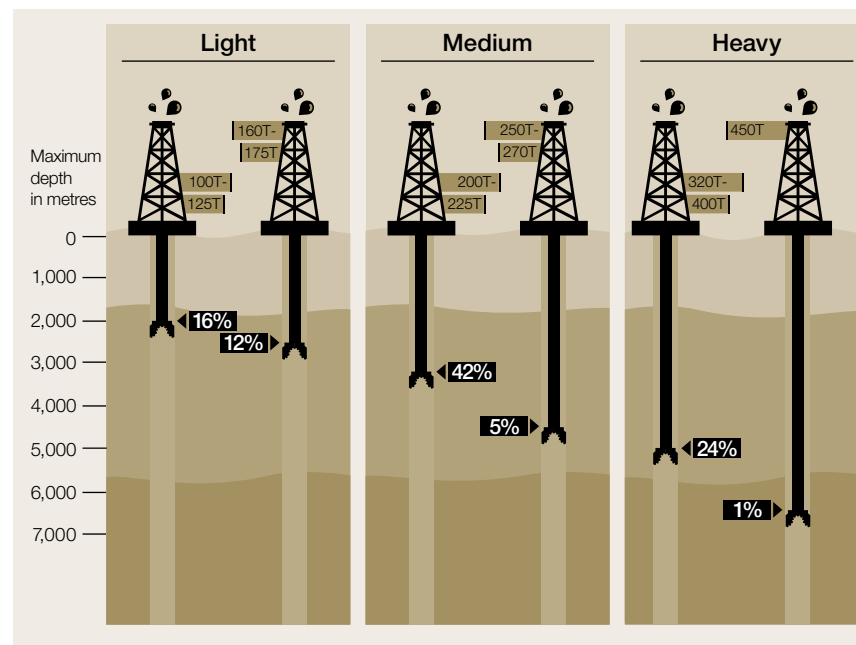
Relevant

Future developments will be dominated by cluster drilling on multiple-well pads. EDC owns the fleet of the future, with more than half our rigs configured for pad drilling.

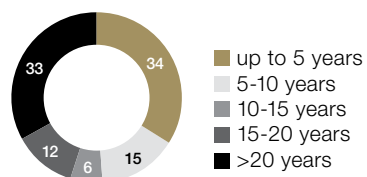
EDC has a rig fleet modernisation programme in place which is focused on:

- Refurbishment of medium pad/cluster drilling rigs, which account for approximately 58% of our total rigs. These rigs will be the 'workhorses' of West Siberia far into the future.
- Replacement of light stationary rigs with mobile units which are used for sidetracking, smaller field development.
- Replacement of heavy stationary rigs with predominantly heavy pad/cluster drilling rigs best suited for deeper plays, extended-reach drilling and complex wells.

EDC land drilling fleet %

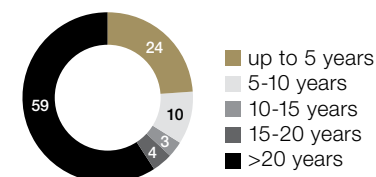


EDC fleet by age category %



Source: Company data

Russian fleet by age category %



Source: Douglas Westwood, 2012



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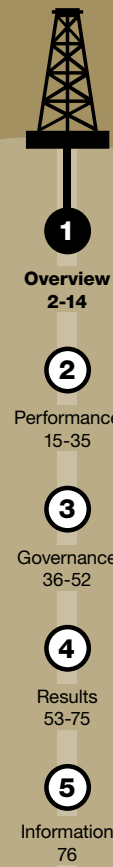
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Strong results



Financial highlights

“We are pleased to have delivered another record year of performance which was a result of exceptional execution. We achieved record Revenue, Net Income and EBITDA in 2012 on the back of strong demand for our services and our proven reputation as a reliable service provider.”

W. Richard Anderson
EDC's Chief Financial Officer

Revenues

+17%

US \$3,237 million (2011: US \$2,767 million)

EBITDA

+31%

US \$790 million (2011: US \$603 million)

Diluted EPS

+34%

US \$2.59 per share (2011: US \$1.93 per share)

Capital expenditures

+55%

US \$620 million (2011: US \$400 million)

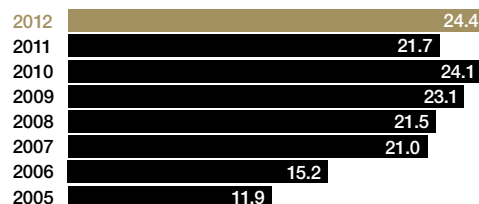
Dividend

+49%

US \$0.70 per share (2011: US \$0.47 per share)

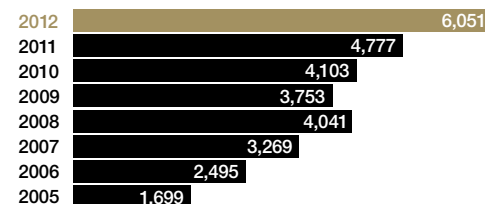
Performance

EBITDA margin %



Our EBITDA margins have remained at impressive levels. Increasing efficiency and modernisation of our rig fleet have been the primary drivers of this growth.

Metres drilled '000s



From 2005 to 2012 we achieved a 20% compound annual growth rate in metres drilled. Our growth was all organic until 2011, when we made two value-accretive acquisitions.

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Strong results *continued*



Operational highlights

“Outstanding performance in all our business segments enabled us to achieve another year of record financial and operational results in 2012. We continued to invest in technology and our people which allows us to provide continuously better services to our customers. In 2012 we achieved our highest rig fleet utilisation rate ever and our crew’s operating efficiency was the best in our history. We also completed several strategic initiatives to strengthen our onshore and offshore businesses.”

Alexander Yu. Djaparidze
Chief Executive Officer

Strategic

- Our market share increased to approximately 29% based on metres drilled onshore in Russia during 2012, up from 25% in 2011
- In September 2012 EDC signed a multi-year contract extension with PETRONAS for drilling offshore in Turkmenistan, effective from 9 January 2013
- In April 2012 we contracted Lamprell to build our fourth jack-up drilling rig, the *MERCURY*, for our operations in the Caspian Sea
- In July 2012 we acquired two onshore drilling rigs in Iraq and later in the year added two more rigs, which are contracted to international customers

Operational

- Drilled a record 6.051 million metres onshore in 2012
- Horizontal metres drilled in 2012 were down by about 2% to 862,000 metres
- Exploration drilling volumes were up 26% during 2012 compared to 2011
- Share of our largest customer, LUKOIL, was 57% of our total metres drilled during 2012 compared to 55% in 2011
- Share of Rosneft in our total drilling volumes increased to 24% in 2012 compared to 19% in 2011
- *ASTRA* jack-up drilling rig fully employed in Kazakh and Russian waters of the Caspian Sea
- Modules of our third jack-up rig, the new-build *NEPTUNE*, were shipped to the Caspian Sea from Lamprell’s shipyard in the UAE during 2012
- Continued operations on LUKOIL’s Yuri Korchagin field platform in the Caspian Sea drilling six wells, including five extended-reach horizontal development wells

Metres drilled

+27%

Our Russian onshore drilling volumes increased 27% compared to 2011

Horizontal drilling volumes

14%

Horizontal drilling volumes contributed 14% to total drilling volumes in 2012



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Chairman's statement

In 2012 EDC consolidated its leadership position in the Russian drilling market.



The Earl of Clanwilliam
Chairman

In 2012 we consolidated our leadership position in the Russian drilling industry, registering a market share of 29% in the onshore drilling market, up 4% on 2011, and sustaining our dominant position in the Caspian Sea offshore, where we operate two of the three available jack-up rigs. We continued to focus on delivering value-accretive growth, and in 2012 we ordered a fourth offshore jack-up rig, *MERCURY*, due for delivery in Q4 2014. We also made our first ex-CIS investment, acquiring four onshore rigs in northern Iraq. We are now not only the largest land oil & gas drilling company in the eastern hemisphere but also the number one in sidetracking and the workover business as well.

The results are amply demonstrated in our financial performance for the year, delivering strong growth in all key financial indicators:

- Our revenue increased by 17% to US \$3.24 billion.
- Our EBITDA increased by 31% to US \$790 million and we achieved an EBITDA margin of 24.4%, a record for the Company.
- Our net income increased by 35% to US \$382 million.
- Our dividend increased by 49% to US \$0.70 per share.

In addition to the two acquisitions mentioned above, we invested US \$470 million in our onshore drilling assets, further strengthening EDC's market-leading onshore drilling fleet in Russia. Our fleet has an average life of approximately 12 years and can drill to an average depth of 3,500 metres, relative to an average life of 16 years and average depth of 3,100 metres for the Russian fleet in total. All this was done while keeping our balance sheet conservatively geared (with a net debt to EBITDA of 0.5x at year-end) and maintaining a high credit rating from our credit rating agencies (BB+ with a stable outlook from S&P).

A key achievement in the past 12 months has been the negotiation of new long-term framework agreements with some of our key customers. We have secured a new onshore drilling three-year framework agreement with our largest customer, LUKOIL, affording us visibility on revenues and greater flexibility as we undertake to drill more complex and more challenging wells. We have obtained a three year agreement with PETRONAS which guarantees full utilisation of the *SATURN* jack-up rig until the end of 2015. We also signed a three-year onshore drilling agreement with TNK-BP in 2012 for the provision of our services in the Volga-Urals region.

Our success in increasing profitability on a sustainable basis owes as much to improved productivity as it does to delivering volume and revenue growth. The addition of rig crews from Schlumberger and the focus on improved performance has allowed us to improve rig utilisation in 2012 to 85% from 77% in the previous year. Our excellent rig crews delivered an 8% increase in metres drilled per crew per day, continuing the consistent trend in performance improvement enjoyed since the Company was formed.

Our share price appreciated by a market-beating 55% in 2012 and reached an all-time high of US \$42 per Global Depository Receipt (GDR) in May 2013. Our delivery of strong and consistent revenue growth, EBITDA margin expansion and robust returns on capital employed is being recognised by the market and reflected in the sector-leading multiples we currently enjoy relative to our peers. However, we do not take this recognition for granted and the Board and management team remained focused on maintaining the strong foundation of prudence, governance and responsibility that is at the heart of EDC.

On the safety front the Company's Total Reported Incident Rate for 2012 was once again lower than that of the industry as a whole. We maintain a bonus programme that incorporates safety performance directly into the bonus computation for all of our senior managers. The Board is very focused on ensuring that safety and responsibility remain cornerstones on which our success is built.

We conducted our first Capital Markets Days in London and New York in November 2012, which were well attended, providing greater visibility on the medium-term prospects for our business and wider access to our management team.

We are committed to full and open engagement with our shareholders and other stakeholders at EDC. Our recently issued revenue, EBITDA margin and capital expenditure guidance for 2013 have been well received by our investors. We expect 2013 to be yet another record year for EDC, establishing a new baseline by which we will measure our future success.

As in prior years I wish to thank our Board for its guidance and considerable suggestions and in particular Victor Kalyuzhnyi, who resigned September 2012, for his valued contributions over his three year tenure. I wish to also thank our management for its dedication and long hours, our employees for their hard work and attention to details of successful service delivery, and our vendors, clients and shareholders for their continued support. I am proud to be associated with such a fine Company as EDC.

The Earl of Clanwilliam
Chairman
21 June 2013

\$3,237

Revenues increased by 17% in 2012 to US \$3,237 million

 [More information on www.eurasiadrilling.com](http://www.eurasiadrilling.com)



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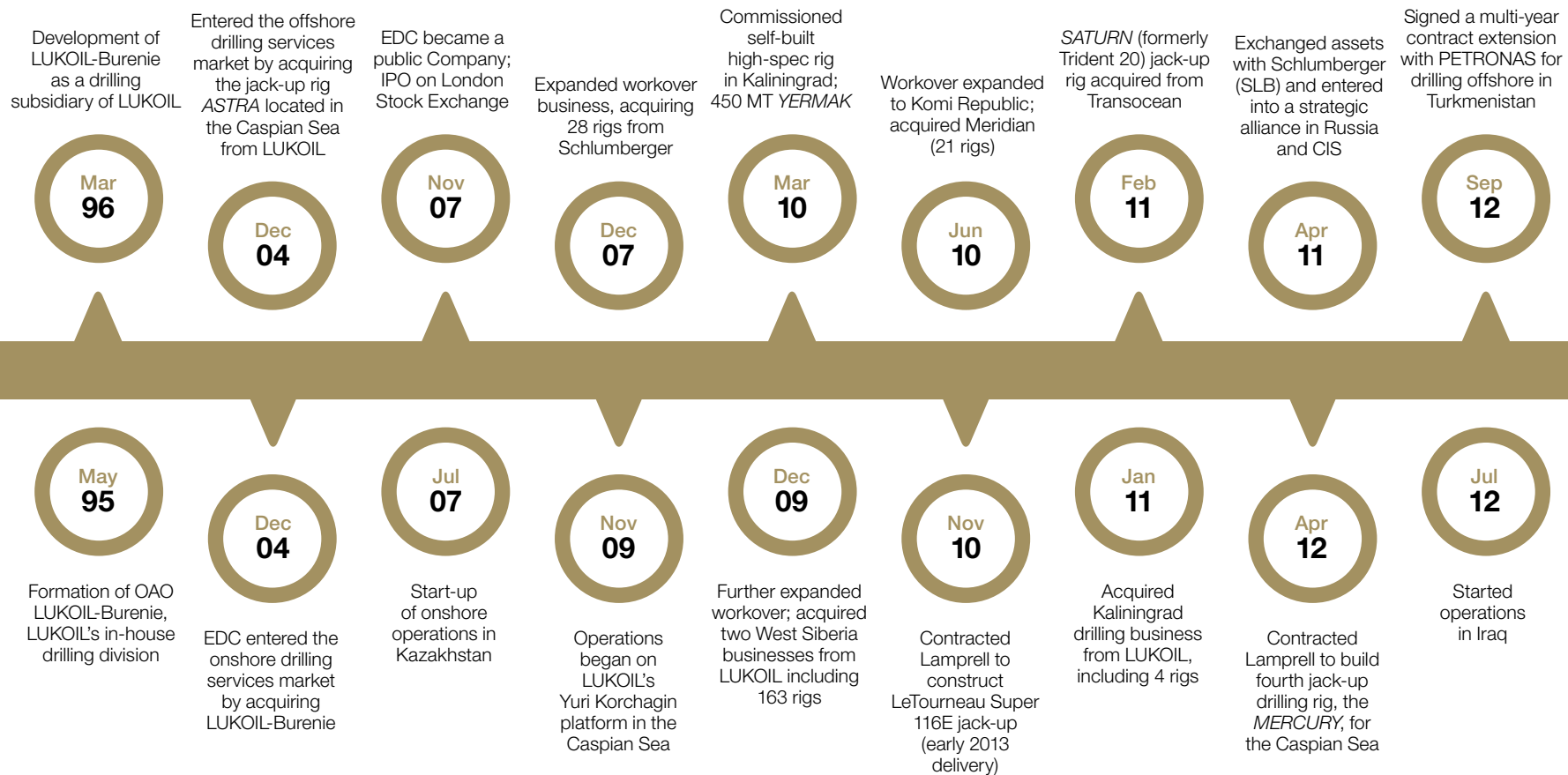
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EDC history

Through our history, EDC's impressive growth has been achieved primarily through organic means; more recently it has been supported by strategic acquisitions.



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Chief Executive's strategic review

Our financial and operational performance hit new highs in 2012, sustaining our leadership in the international drilling industry.



Alexander Yu. Djaparidze
Chief Executive Officer

In 2012 we continued to extend our lead as the premier oil & gas drilling company in the eastern hemisphere – our financial and operational performance now puts us at the top of the league tables among all service companies, worldwide.

Following the two significant acquisitions we made in 2011, we turned our attention in 2012 to full integration of our new acquisitions, continued organic growth and productivity improvement. I am happy to report that we have outperformed our original expectations in each of these initiatives. The rigs and crews we acquired from Schlumberger in 2011 have raised the bar in terms of drilling performance across the Company and the strategic alliance we forged with Schlumberger has deepened our relationship with Rosneft, now the world's largest listed oil company, based on production and reserves. We increased onshore drilling volumes in 2012 by over 16%, excluding the contribution from the acquired Schlumberger assets, well ahead of market growth of just under 10%. We improved rig utilisation in 2012 to 85% from 77% in 2011 and our crews drilled 8% more metres per day than in 2011.

There were other notable achievements in 2012 and further acquisitions which bolstered our portfolio and enhanced our growth prospects. We were awarded a drilling contract on GazpromNeft's Novoportovskoye field in the Yamal-Nenets region, one of Russia's largest remaining greenfield sites. We drilled five challenging extended-reach wells on LUKOIL's Yuri Korchagin field in the Caspian Sea, with the longest reaching an impressive 7.4km. Further progress was made on the construction of our third jack-up rig, *NEPTUNE*, on schedule for delivery in the Caspian Sea in Q3 2013. Our confidence in the strength of the Caspian Sea jack-up market resulted in our ordering a fourth jack-up rig, *MERCURY*, which is scheduled for delivery in Q4 2014. Finally, we made history by

completing EDC's first investment outside the CIS, acquiring four onshore drilling rigs in northern Iraq, all of which are contracted to international oil & gas companies.

In 2012 we did the following:

- increased our onshore drilling output by 27% to 6.1 million metres;
- increased our drilling for Rosneft to 24% of our total drilling;
- increased our exploration drilling volumes by 26%;
- increased our onshore drilling market share to 29%, from 25% in 2011;
- acquired four onshore drilling rigs in northern Iraq;
- continued to build our new offshore jack-up drilling rig, *NEPTUNE*, due for delivery in the Caspian Sea in Q3 2013;
- ordered our fourth offshore jack-up drilling rig, *MERCURY*, due for delivery in the Caspian Sea in Q4 2014;
- continued to evaluate new opportunities for growth among our service lines;
- negotiated a new three-year framework agreement with LUKOIL for work beginning in 2013.

We believe that the outlook for our core onshore and offshore drilling businesses is very bright. Onshore drilling volumes continued to grow strongly in 2012, registering a 10% increase versus 2011 for the market as a whole and we expect volumes to continue rising at close to this rate in future years. This is consistent with the historical experience of other large, mature oil-producing basins in other parts of the world. Related to this is the fact that our clients' drilling is becoming deeper and their technology needs more complicated. To meet this need we have been buying significant numbers of newer and heavier drilling rigs equipped with the latest top drives, mud-handling systems and pumps.

Further progress

- In 2012 we continued to extend our lead as the premier oil & gas drilling company in the eastern hemisphere – our financial and operational performance now puts us at the top of the league tables among all service companies, worldwide.
- Following the two significant acquisitions we made in 2011, we turned our attention in 2012 to full integration of our new acquisitions, continued organic growth and productivity improvement.



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Chief Executive's strategic review *continued*

Our five-year alliance with Schlumberger, who we believe to be the best supplier of non-drilling oilfield services in Russia, allows us to drill the most sophisticated wells in the most challenging of geological and logistical environments. But to be clear, the bulk of our business will be centred in brownfield areas for the foreseeable future. This is evidenced by the new three-year framework agreement we negotiated with LUKOIL which requires us to drill 7.5 million metres for them over the next three years – mostly in brownfield areas, but, significantly, allowing us much more flexible pricing when drilling more technically challenging wells in greenfield areas. Our logistical footprint – repair facilities, laydown yards, warehouses and workshops – affords us an unbeatable advantage in these core areas.

We expect to be able to out-compete other drilling companies in Russia for many years to come.

The competitive landscape remains constructive in our core areas. While the onshore market contains other competent drilling companies, the overall market growth has been robust enough to minimise destructive pricing trends for our services. We think this trend will continue as the other large public drilling companies, all of which are North American-focused, are not demonstrating any desire to make an aggressive entry into the Russian market. The offshore market looks particularly attractive. We are building two new jack-up drilling rigs to add to the two we already have. We expect all of these rigs to work at day-rates among the highest in the world for their rig classes in 2013 and in following years.

We celebrated five years as a publicly listed company in 2012 and conducted our first Capital Markets Day events in London and New York, affording our shareholders a deeper insight into our business, our management team and our perspectives on the medium-term prospects for our Company. I introduced medium-term targets for revenues, EBITDA margins and returns on capital at the events and I believe we have the assets, resources and management at EDC to successfully deliver against these targets. I have also asked the Board to prepare and present a new long-term management incentive scheme linking the compensation of our top managers to growth in our underlying earnings. Our share price reached an all-time high of US \$42 per GDR in May 2013, reflecting our success in delivering value-accretive growth, and we are now the second-largest publicly listed drilling company in the world by market capitalisation.

While the past year has been one of success and notable achievement, it has also been marked with a moment of sadness. We lost a great friend and great servant of the Company, Kim Kruschwitz, in January 2013 and I dedicate this Annual report to his memory. Kim played an important role in the success we have enjoyed since he joined the Company in 2008 and he will be missed by all of us at EDC.

It has been a rewarding experience for me to see our management team perform over the past few years. They have set industry-leading goals for themselves every year and have consistently performed at or above these levels. It looks like 2013 will be another such year. I am confident the future will be bright for all those associated with EDC.

Alexander Yu. Djaparidze
Chief Executive Officer
21 June 2013

29%

Our market share onshore Russia based on metres drilled in 2012

 [More information on www.eurasiadrilling.com](http://www.eurasiadrilling.com)



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01 Increasing our market share

- Pursue value-accretive acquisition of in-house and/or independent drilling companies.
- Continue to invest in fleet expansion and upgrades.
- Leverage our installed base and industry-leading efficiency to increase market share with existing customers.

02 Diversifying our customer base

- Continue to differentiate ourselves from our competitors in our domestic markets.
- Evaluate other strategic opportunities outside Russia and the CIS.
- Target acquisition of businesses with new customer portfolios.

03 Expanding offshore drilling

- Commission new offshore drilling assets in response to market developments.
- Consolidate the market through acquisition of existing assets where possible.
- Develop offshore extended-reach drilling capability.

04 Expanding and improving workover capacity

- Consolidate all the workover assets under one entity within the EDC Group to ensure brand identity.
- Target selected acquisitions of additional workover and sidetracking capacity.

05 Broadening our technology platform

- Expand and improve drilling fleet capability.
- Develop and promote strategic partnerships with global technology leaders.



- ✓ Assets acquired from Schlumberger (SLB) in April 2011 added 4% to our drilling market share on a full-year basis in 2012.
- ✓ We increased metres drilled for our second-largest customer, Rosneft, by 60% in 2012 compared to 2011.
- ✓ In 2012, roughly one in three wells in Russia were drilled by our rigs and crews.

- ✓ Transaction with SLB contributed markedly to our customer diversification: SLB assets work primarily for Rosneft and TNK-BP.
- ✓ The SATURN jack-up drilling rig acquired from Transocean in February 2011 is on a long-term contract with PETRONAS Carigali, a new customer for us offshore.
- ✓ In 2012 LUKOIL accounted for 57% of our total metres drilled, as compared to 77% in 2007 (EDC's IPO year).
- ✓ Commenced drilling in Iraq in July 2012 for international E&P companies.

- ✓ We contracted Lamprell to build two new LeTourneau Super 116E jack-up rigs for the Caspian (Q3 2013 and late 2014 delivery).
- ✓ We acquired the SATURN jack-up rig from Transocean in February 2011, and we retained the majority of the rig crew.
- ✓ During 2012 we continued extended-reach drilling on LUKOIL's Yuri Korchagin platform, where EDC is employed as the drilling contractor.

- ✓ In 2009 and 2010 we added 184 workover and well servicing rigs to our fleet through acquisition.
- ✓ SLB transaction added 34 workover rigs in 2011 and in 2012 we further expanded our total workover fleet to 413 rigs.

- ✓ We ordered 11 new high-spec drilling rigs in 2012, due to be delivered in 2013.
- ✓ Strategic alliance with Schlumberger provides access to best-in-class services.



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Management's discussion and analysis of financial condition and operational results

The following report represents management's discussion and analysis of EDC's financial condition and operational results for the 12-month period ending 31 December 2012 and is intended to help our shareholders and other users of our financial statements better understand our operations and attendant financial results and current financial condition.

This information is provided as a supplement to, and should be read in conjunction with, our audited 2012 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 & gas companies primarily in Russia and our offshore drilling services to Russian and international oil & 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 670 rigs: 257 onshore drilling and sidetracking rigs and 413 workover rigs. Our offshore fleet consists of two jack-up rigs with an additional two under construction.

For the year ended 31 December 2012, we had total revenue of US \$3,237 million, EBITDA of US \$790 million and net income of US \$382 million, compared to total revenue of US \$2,767 million, EBITDA of US \$603 million and net income of US \$283 million for the year ended 31 December 2011 and total revenue of US \$1,822 million, EBITDA of US \$437 million and net income of US \$207 million for the year ended 31 December 2010.

Our business is currently organised into two main divisions: onshore and offshore drilling services. For the year ended 31 December 2012, we had total revenue of US \$3,071 million from our onshore division and total revenue of US \$166 million from our offshore division.

For the year ended 31 December 2012, we had an estimated market share of approximately 29% of the onshore drilling services market in Russia, as measured by the number of metres drilled, compared to 25% for the year ended 31 December 2011, according to REnergyCo. Our onshore fleet of 253 land drilling and sidetracking rigs is located in all major Russian oil & gas producing regions, including Western Siberia, Volga-Urals, Eastern Siberia 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 onshore drilling services, we have transformed the business from an in-house cost centre 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 & 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 31 December 2012 our total workover fleet consisted of 413 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 include a number of major Russian and international oil & gas companies operating in Russia, such as LUKOIL, Rosneft, Gazprom Neft, TNK-BP, Rusvietpetro, Pechoranef, Russneft and Tomskneft.

We entered the international drilling market outside the CIS for the first time in the second half of 2012. We acquired three land drilling rigs from an existing drilling contractor and late in 2012 added a fourth rig in Iraq. All four rigs are contracted to international oil & gas companies Afren, Gulf Keystone, HKN and Marathon Oil.



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Expanding prospects

For the year ended 31 December 2012, we were the largest offshore drilling contractor operating in the jack-up market of the Russian, Kazakh and Turkmen sectors of the Caspian Sea. In these sectors there are three jack-up rigs currently operating and we own two of them, the *ASTRA* and *SATURN* jack-up rigs, according to Wood Mackenzie. We entered the offshore drilling business in 2006 by acquiring the *ASTRA* jack-up rig from LUKOIL. Since 2009, we have provided our drilling services on LUKOIL's marine ice-resistant fixed platform LSP-1 on the Yuri Korchagin field in the Russian sector of the Caspian Sea. In 2011, we acquired our second jack-up rig, the *SATURN*, from Transocean. Our offshore drilling services division constructs oil & gas exploration and production wells in waters with depths of up to 107 metres. In addition, we have two new-build jack-up rigs that are in the process of being constructed by Lamprell plc, the *NEPTUNE* and the *MERCURY* rigs, with delivery scheduled for the third quarter of 2013 and the fourth quarter of 2014, respectively.

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

General overview

Demand for drilling services depends on a variety of factors, including worldwide demand for oil & 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 & gas reserves. Our operational results depend on the levels of activity in Russia and the countries of the Caspian Sea, and the prices of crude oil and

natural gas in Russia. To date most of our drilling activities have been in oil provinces rather than gas provinces. This business mix may slowly change over time if we obtain new clients whose activities are more heavily weighted to drilling natural gas wells.

The oilfield services market in Russia is robust and it is arguably the most stable land market of any size in the world. Onshore drilling activity (as measured by wells or metres drilled) fell in 2009 as compared to 2008 by only around 6%, which was substantially less than the reductions in drilling activity experienced in the world's other large markets. Following the global recession, oil prices stabilised in 2010 and have remained stable at historically high levels in 2011 and 2012, giving oil & gas companies confidence to increase their capital expenditure budgets. Russia's oil production and drilling volumes have continued to grow in 2012; in 2012 average oil and condensate output grew to 10.3 million bpd, an increase of approximately 1%, and drilling volumes expanded to 21 million metres, an increase of 9.6% as compared to the full-year 2011, according to REnergyCo.

Russia's oil production is mostly comprised of output from mature fields, which in 2012 produced over 80% of total oil output in Russia. Since 2008 the output from these fields has been declining; the overall growth in Russian production was achieved by the contribution from greenfield sites coming on stream in Eastern Siberia, Timan-Pechora, the Caspian, and Sakhalin.

Operations review

During 2012 our business continued to benefit from favourable market conditions resulting primarily from fairly stable commodity prices and a resulting increase in demand for our services. Our 2012 results were impacted by consolidation from the beginning of the year,

the operational results of ex-Schlumberger drilling, sidetracking, and workover assets, which we acquired on 28 April 2011, and the results of *SATURN*, the jack-up drilling rig acquired on 8 February 2011 from Transocean, impacting the year-on-year comparisons. In addition, on 24 July 2012 we announced the acquisition of two onshore drilling rigs in northern Iraq, and later in the year added two more drilling rigs.

Onshore business

Our 2012 onshore operating results include:

- drilling output of 6.051 million metres, 26.6% above the output achieved in the corresponding period of 2011 (4.777 million metres);
- horizontal metres drilled during 2012 were down slightly by 1.9% compared to the corresponding period of 2011 and amounted to 862,000 metres;
- exploration drilling volumes increased by 25.9% during 2012 compared to the corresponding period of 2011;
- sidetracking activity remained at strong levels with 225 well sidetracks performed during 2012;
- the share of our largest customer, LUKOIL, amounted to 57% of our total metres drilled during 2012, as compared to 55% during the corresponding period of 2011; however, LUKOIL drilling volumes increased by 30.4% over the same period;
- the share of Rosneft, our second-largest customer, was 24% of our total metres drilled during 2012 as compared to 19% during the corresponding period of 2011;
- our market share increased to approximately 29% based on metres drilled onshore in Russia during 2012, up from 25% in the corresponding period of 2011;
- in 2012 we acquired four onshore drilling rigs in Iraq, which are currently under contract or being tendered to international customers.



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Our Russian onshore drilling volumes increased by 26.6% compared to the volumes achieved in 2011. Growth in metres drilled in our legacy operations outpaced the overall Russian market growth and amounted to 16% in 2012 versus the corresponding period of 2011. The results of onshore drilling operations from the ex-Schlumberger drilling assets ('SGC') further contributed to the overall growth of metres drilled. For the year ended 31 December 2012 drilling volumes by SGC accounted for 19% of total metres drilled. As a result of such outstanding performance our onshore Russian market share based on metres drilled increased to approximately 29%, or four percentage points above our market share in 2011.

EDC's horizontal drilling volumes in 2012 were slightly down from the corresponding period of 2011, and amounted to 862,000 metres, which corresponds to 14% of our total metres drilled. In horizontal drilling the component of high-value third-party services, such as directional drilling and telemetry services, is usually much more significant compared to conventional vertical or deviated well drilling.

Our cooperation with our main customer, LUKOIL, continues to be strong as we operate under long-term Framework Agreements that govern minimum volume commitments and indicative pricing ranges. The most recent Framework Agreement expired at the end of 2012 and we have concluded a new Framework Agreement for the three years to the end of 2015 that includes greater flexibility regarding fleet deployment and contract structures. Pursuant to the new agreement, depending on the complexity of the drilling, our services are provided either on a general contractor 'turn-key' basis or on a day-rate basis. Completion services which are a part of the well construction service that we provide, pursuant to the new Framework Agreement, are contracted separately, given the increased complexity of such services. In 2012 LUKOIL

increased its drilling volumes by 30.4% over the corresponding period of 2011. Despite such a significant increase in LUKOIL's drilling activity, its share in our total drilling volumes increased only by two percentage points compared to 2011. Most of the growth comes from intensified drilling activity in Western Siberia.

It is our strategic priority to diversify our customer base in Russia while building long-term relationships with our clients. As such, the share of Rosneft increased to 24% of our total drilling volumes during 2012 from 19% in 2011 as the metres drilled surged by 60.2% period-over-period. Most of the growth is attributable to the consolidation of SGC operations from the beginning of 2012. Rosneft is SGC's largest client and accounted for 64% of its drilling volumes for the period. In addition, our legacy drilling operations, represented by OOO Burovaya Kompaniya Evraziya ('BKE'), were awarded more contracts to drill in the Vankor field in Eastern Siberia. Management believes that EDC has a strong proven track record with Rosneft and is eager to build the cooperation beyond the existing frontiers.

In 2010 we started to provide drilling services to TNK-BP. In 2012 its share of our total drilling volumes accounted for 2%, compared to approximately 3% in 2011, as the volumes decreased by 46,000 metres period-over-period. The decrease is the result of lower activity in Western Siberia offset by increased activity in the Orenburg area, where drilling is much slower and more complex than for the drilling of an average well in Western Siberia. The share of TNK-BP in our total revenue reflects this complexity and despite the decrease in metres drilled period-over-period, revenues remained at a meaningful level. In addition, early in 2012 we concluded a three-year agreement with TNK-BP for drilling services in the Orenburg area. We are determined to meet or exceed all key performance indicators specified in the agreement.

One of the notable events of 2012 was the award of a drilling contract on the Novopostovskoe field in the Yamalo-Nenetsk Region, one of Gazpromneft's greenfield projects, where drilling commenced in May 2012. We have also placed one rig for Gazpromneft in the Orenburg area. Overall the share of Gazpromneft in our drilling volumes decreased to 10% during 2012, compared to 15% in 2011. EDC still provides a sizable 24% of Gazpromneft's total drilling volumes in Russia, according to REnergyCo in 2012, and we are expanding collaboration in geographies of strategic importance to this customer.

Our client portfolio includes the four largest E&P companies in Russia, which, together, accounted for about 60% of the total drilling volumes in Russia in 2012, based on REnergyCo analysis. We also continue to work for smaller oil & gas companies such as Pechoranef, Samaranafta, Rusvietpetro, Rusneft and others.

The availability of rigs is one of the keys to being a successful drilling company. Our rig fleet as of 31 December 2012 totalled 257 onshore drilling and sidetracking rigs, one rig less than as of 31 December 2011. Our rigs are located in almost all the major oil & 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. Thirty-four per cent of our rigs are less than five years old and only 33% of our rigs are over 20 years old, compared to Russia's average of 59% as estimated by Douglas Westwood. Our rigs are capable of drilling a wide range of oil & 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 dominate future developments.

670

Our total land fleet of 670 rigs, including drilling, workover and sidetracking rigs is the largest in Russia



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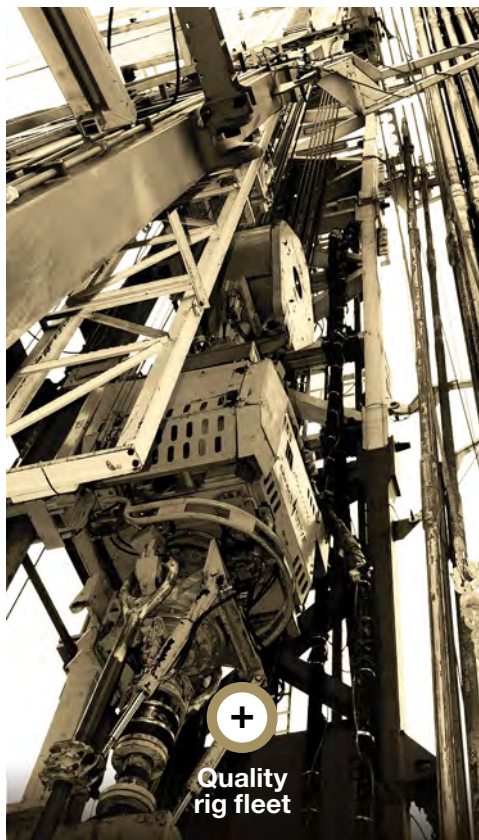
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Quality rig fleet

In Russia, as in the rest of the world, unexploited oil & gas reserves increasingly occur in more challenging environments, both geographically and geologically. The services market in Russia is evolving towards 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 oil & 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 11 rigs were contracted in 2012 for 2013/early 2014 delivery. The drilling rigs that we are ordering are produced by Russian and Chinese manufacturers at prices significantly lower than the recent peak 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 31 December 2012 totalled 413 workover rigs, as compared to 330 rigs the previous year. The increase is due to the purchase of new workover rigs which are intended to replace older workover rigs due for retirement later this year. Growth in our total workover and sidetracking jobs performed in 2012 has been quite moderate.

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. There is also an administrative office located in Houston. We operate four single-well drilling rigs capable of drilling wells of up to 5,000 metres in depth. All four rigs are contracted to international oil & gas companies including Afren, Gulf Keystone, HKN and Marathon Oil.

Offshore business

Our 2012 offshore operating results include:

- during 2012 our *ASTRA* jack-up rig was employed in Russian and Kazakh waters of the Caspian Sea;
- our *SATURN* jack-up rig continued its operations for PETRONAS Carigali (Turkmenistan) Sdn Bhd (PETRONAS) in Turkmen waters of the Caspian Sea; during 2012 four geological sidetracks were performed and two wells were drilled;
- in September 2012 EDC signed a multi-year contract extension with PETRONAS for drilling offshore Turkmenistan, effective 9 January 2013;
- we drilled and completed six wells on LUKOIL's Yuri Korchagin field platform in the Caspian Sea including five extended-reach horizontal development wells;
- modules of our third jack-up rig, the new-build *NEPTUNE*, were shipped to the Caspian Sea from Lamprell's shipyard in the UAE during 2012; and
- in April 2012 we contracted Lamprell to build our fourth jack-up drilling rig for our operations in the Caspian Sea.

Our offshore operations remained strong in 2012. Our crews remained active on LUKOIL's Yuri Korchagin field platform, drilling five challenging extended-reach development (ERD) wells. ERD on Yuri Korchagin is expected to continue. During 2012 the longest ERD well drilled by us offshore on this field was 7.4 km.

Our *ASTRA* jack-up was deployed on the N Block in the Kazakh sector of the Caspian Sea, drilling three exploration wells for N Operating Company, a joint venture between KazMunayGas, ConocoPhillips and Mubadala. Once it completed operations in N Block, the *ASTRA* moved to Russian waters of the Caspian Sea to work for LUKOIL where one well was drilled during 2012.

Our *SATURN* jack-up continues operations for PETRONAS in Turkmenistan, and at the end of 2012 we signed a multi-year contract extension with PETRONAS for drilling offshore Turkmenistan in the Caspian Sea. Effective from 9 January 2013, our jack-up drilling rig *SATURN* is contracted for a three-year period. The award marks a continuation of several previous multi-year contracts, as *SATURN* has been contracted to PETRONAS since 2003, working almost entirely throughout this period in Turkmenistan. In June 2012 the *SATURN* achieved a major milestone of working continuously for five years without a Lost Time Incident (LTI).

Fabrication of *NEPTUNE*, our third Caspian jack-up rig, remains on schedule for deployment in the third quarter of 2013, and during 2012 all the rig modules were shipped via the Volga-Don canal system to the shipyard in the Caspian Sea. The LeTourneau-designed Super 116E hull and related components are being pre-fabricated by Lamprell in its Sharjah facility, while the remaining component fabrication, final assembly, and commissioning are being performed at a shipyard in the Caspian Sea.

In April 2012 we ordered a fourth jack-up rig for our Caspian Sea operations from Lamprell; this rig will be another LeTourneau Super 116E, which we believe is the most versatile and efficient design in its class. This rig is planned for late 2014 delivery. Both Super 116E jack-ups we have on order are designed to operate in water depths of up to 350 feet, and will have rated drilling depths of 30,000 feet.

The demand for jack-up rigs in the Caspian Sea has reached a level where we are confident that both new high-spec rigs will be fully contracted for several years at favourable operating rates, once commissioned.



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Non-US GAAP measure

Reconciliation of Net Income to EBITDA

Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), a non-GAAP financial measure, is computed with reference to the Company's net income for year ending 31 December 2012 and the years ending 31 December 2011 and 2010 as follows (in thousands of US dollars, unaudited):

	2012	2011	2010
Net income	382,009	283,371	206,826
Income tax expense	121,840	84,045	71,680
(Gain) Loss on disposal of PP&E	(4,786)	1,362	(6,344)
Currency transaction (gain) loss	(631)	11,054	7,355
Gain on business exchange transaction	-	(32,284)	(557)
Impairment loss	-	1,296	7,096
Interest income	(12,094)	(11,485)	(7,993)
Interest expense	53,661	52,342	15,125
Depreciation	249,987	213,492	144,241
EBITDA	789,986	603,193	437,429

Our EBITDA in dollar terms increased by US \$187 million during 2012 as compared to the corresponding period of 2011. At the same time the EBITDA margin increased to 24.4% from the 21.8% achieved during 2011 due to increased drilling efficiency and sustained and effective cost control efforts by our management, among other factors.

Outlook

We achieved strong 2012 results and we expect good progress across all our business segments during the forthcoming year.

Global oil prices remained strong in 2012 with Urals blend crude averaging slightly over US \$110 per barrel for the full-year, marginally higher than the US \$109 per barrel average in 2011.

In the Russian market, most commentators forecast the growth in drilling volumes to continue further in 2013 as most E&P companies have continued to expand their capital budgets. Russian crude oil production in 2012 increased by approximately 1% compared to 2011 while drilling volumes in Russia increased by approximately 10% in 2012 versus the previous year as per REnergyCo analysis.

We continue to see more and more emphasis being placed on strategies to enhance upstream efficiency, including increases in new-well flow rates and improvements in the recovery factor on existing reserves using horizontal drilling techniques. The trend toward greater horizontal drilling and more complex wells that rapidly took off in 2011 continued throughout 2012 albeit at a slower pace. We expect the shift to more horizontal drilling to reaccelerate in 2013.

We continue to make significant capital expenditures for the purpose of taking advantage of the growing demand for drilling services in our market. In 2012 we have had and expect to have higher rig utilisation than in prior years. Pricing for drilling services in 2012 is more favourable than in 2011 as our customers started to observe some tightness in the rig supply, especially in heavier rig classes, which renewed certain clients' interest in establishing multi-year contracts to ensure rig availability for their future drilling plans.

For 2013 we expect our onshore drilling volumes to modestly exceed 2012 volumes; however this estimate assumes an increase in horizontal

drilling of up to 50% as we continue to see increased demand from our customers for more horizontal drilling and complex drilling in general. Given the strong growth in more complex drilling services, we expect our total revenues and EBITDA margin to continue to increase in 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 relationship with its customers continues to be strong. Most of our customers increased their drilling volumes during 2012 compared to the corresponding period of 2011 and we expect this trend to continue into 2013. We expect Rosneft to account for approximately a quarter of our total drilling volumes with the gains coming from both our legacy business and the drilling assets acquired from Schlumberger. The share of our major customer, LUKOIL, is projected to be at approximately 55% of total EDC drilling volumes. We expect our drilling volumes with Gazpromneft to continue to decline in Western Siberia, which should be offset by volumes gained in the Yamal area.

In 2013 the well intervention market in Russia is projected to expand as high oil prices encourage efforts to prolong and enhance existing well production. Workover and sidetracking drilling activity are expected to be strong contributors to the Company's revenue in 2013. We continue to provide workover services to Rosneft in the Vankor field in East Siberia, which we commenced in the second quarter of 2011. The workover assets acquired from Schlumberger are well utilised and primarily contracted to TNK-BP in their Samotlor field, representing a newer area of activity for EDC.



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6.051m

We drilled a record 6.051 million metres in 2012

EDC has established a significant offshore presence, beginning our first platform drilling services contract in 2009 and adding a second jack-up rig (the *SATURN*) to our fleet in early 2011. The *ASTRA* jack-up drilling rig is committed to a full 12-month programme in 2013 for drilling in the Russian and Kazakh sectors of the Caspian Sea at attractive day-rates. The *SATURN* jack-up will continue drilling for PETRONAS under a new three-year contract effective 9 January 2013 in the Turkmen waters of the Caspian Sea. We will continue to provide our services on LUKOIL's Yuri Korchagin field ice-resistant platform throughout the year, drilling complex extended-reach wells. Our third jack-up rig, the new-build *NEPTUNE*, is currently being assembled in a shipyard in the Caspian Sea, with the rig expected to begin operations in the third quarter of 2013. Construction of our fourth jack-up drilling rig, the new-build *MERCURY*, is proceeding as planned with expected completion near the end of 2014. First rig component shipments are expected to start at the end of 2013. We continue to evaluate opportunities for further expansion in this growing market.

Having made an initial foray into the international drilling market with the acquisition of two rigs in Iraq in July 2012, in late 2012 EDC added a third onshore drilling rig and purchased a new fourth rig from an international vendor in Houston. In 2013 we now have four rigs under contract in Iraq working for large independent oil companies. We continue to evaluate opportunities outside Russia and the CIS.

Factors affecting our operational results Macroeconomic factors affecting oil companies' capital expenditure programmes

Our operational results are subject to the business cycles of our customers in the oil & gas sector and, more specifically, to their planned capital expenditure programmes and their ability to execute them. Oil & 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 & 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 & 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 characterised 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 between the services we provide, our operational results 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 2012 we drilled 862,309 metres utilising horizontal drilling techniques, representing 14% of our total drilling volumes, while in 2011 our horizontal drilling operations were 879,090 metres, or about 18% of total drilling volumes. Unexploited oil & 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 currently higher. Additionally, Russia's strategic goal to maintain oil production at least at current levels is driving higher drilling volumes and complexity of drilling as oil becomes harder to extract from maturing brownfields. Looking forward we see an increase in horizontal drilling as our customers report higher flow rates from wells drilled horizontally. In many instances vertical wells are not economically feasible due to low flow rates.



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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 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, we experienced a decrease in pass-through services due to our customer LUKOIL-West Siberia starting to contract for telemetry services directly with the third-party provider from May 2012 as well as due to certain other non-recurring factors.

Productivity

Our operational results 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 modernisation, logistics flow and mix of services.

Our core productivity as measured in metres drilled per crew per day improved by 8% during 2012 as compared to 2011. Over the medium term to long term we expect our productivity to continue to improve due to the ongoing implementation and utilisation 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, optimisation of bottom-hole assembly and mud programmes/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 rates of penetration 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 metre 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. Another factor that affects our crew productivity is seasonality, described in more detail below.

Seasonality and extreme weather conditions

Our operational results 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 & 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 quarter 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 the drilling rigs, equipment, material and crews that are required for such services are mobilised 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 utilise, 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 mobilise 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 the 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 modernise our existing ones. Following the stabilisation 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 11 new drilling rigs in 2012 with delivery scheduled for 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 32 new onshore rigs as part of our rig fleet upgrade and modernisation plan. As of 31 December 2012, approximately 25% of our drilling rigs were in the heavy class.

At the end of 2012 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. The transaction with Schlumberger has substantially expanded our capacity and strengthened our presence in Russia.

+8%

Improvement of our core productivity as measured in metres drilled per crew per day during 2012, as compared to 2011



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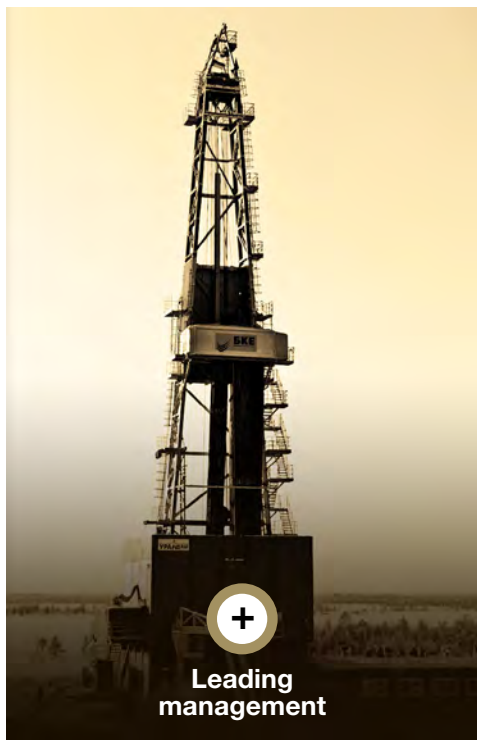
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Additionally, our operational results can be affected by the amount of capital expenditures we are required to undertake in order to modernise and renovate our drilling rig fleet periodically and to satisfy applicable equipment certification requirements. As of 31 December 2012, approximately 33% 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.

Foreign currency fluctuations

Our audited consolidated financial statements are presented in US dollars, which is the Group's presentation 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 amounts 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 31 December 2012, 39% 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.

Factors affecting comparability of prior periods

Our selected financial data, audited consolidated financial statements and related notes and the following discussion and analysis reflect the contribution of the businesses we acquire from their respective dates of consolidation, and,

as a result, include results for our consolidated subsidiaries SGC-Drilling and SKRS since May 2011 and CSVI Limited since February 2011. Full-year consolidation of these subsidiaries' results in 2012, compared to their partial consolidation in 2011, has affected the direct comparability of our results for 2012 versus 2011. Any future acquisitions that we may complete will similarly affect the comparability of our results for the relevant future periods. We do not provide comparable financial information for periods preceding the date on which we started consolidating the relevant subsidiaries. For more information, see Note 17 to the Consolidated Financial Statements, '– Liquidity and Capital Resources – Cash Flows – Investing Activities' and '– Results of Operations – Year Ended 31 December 2012 Compared to Year Ended 31 December 2011' below.

Recent developments

During the first quarter of 2013, we drew down US \$165.4 million under our five-year US \$227 million loan facility arranged by ZAO UniCredit Bank.

On 1 January 2013, our new incentive plan for top managers came into effect. It provides for a bonus computed upon a multiple of the manager's base pay and yearly cash bonus earned upon the achievement of certain EPS goals, which vests over three years. The award is paid each year in either cash or stock, at the discretion of our Board of Directors.

Revenue

We generate our revenue primarily from the sale of onshore drilling services, as well as from offshore drilling services and certain other services.

Our revenue from drilling and related services represented approximately 99.6%, 98.8%, and 99.3% of our total revenue for the years ended 31 December 2012, 2011 and 2010 respectively. Related services include our workover and sidetracking operations.

A significant portion of our revenue from drilling and related services is derived from LUKOIL, which, for the year ended 31 December 2012, accounted for approximately 63.5% of our total revenue. We provide our onshore drilling services to LUKOIL on the basis of a long-term three-year onshore drilling services framework agreement (the 'Framework Agreement'), under which we are required to provide a guaranteed scope of drilling and well construction services to LUKOIL through to the end of 2015. Pursuant to the Framework Agreement, BKE enters into annual contracts with companies in the LUKOIL Group which contain detailed information on the numbers and locations of the wells to be drilled during the relevant year, as well as the basis on which our services are provided. Depending on the complexity of the drilling, our services are provided either on a general contractor 'turn-key' basis or on a day-rate basis. Completion services which are a part of the well construction service that we provide are contracted separately, given the increased complexity of such services.

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

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



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

Cost of services, excluding depreciation and taxes

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

	Year ended 31 December					
	2012		2011		2010	
	(in US \$ '000, except percentages)					
Cost of services, excluding depreciation and taxes	2,151,336	100%	1,906,256	100%	1,204,333	100%
Services of subcontractors	936,797	43.5%	917,187	48.1%	492,243	40.9%
Wages and salaries	488,407	22.7%	425,210	22.3%	326,299	27.1%
Materials	414,288	19.2%	309,252	16.2%	221,375	18.4%
Fuel and energy	152,785	7.1%	131,776	6.9%	80,273	6.7%
Transportation of employees to drilling fields	40,003	1.9%	30,689	1.6%	23,364	1.9%
Leasing and rent	20,781	1.0%	26,336	1.4%	10,884	0.9%
Other	98,275	4.6%	65,806	3.5%	49,895	4.1%

Services of subcontractors

Under most of our onshore drilling contracts, we act as a general contractor and are contractually responsible for managing all aspects of the drilling process, including certain services we do not perform ourselves. In our onshore division, services contracted from third parties include subcontracting for technological services, transportation services, preparatory services, well facility services, petrophysical services, well services, drilling motor and drilling navigation services, cementing services, and drilling bit services. Subcontractor services was the largest component of our cost of services, excluding depreciation and taxes, for the years ended 31 December 2012, 2011 and 2010. 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 programmes 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 mobilisation 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 categorise as 'other', includes current repair expenses for fixed assets licence fees, insurance expenses, safety and environmental expenses, and maintenance expenses.

24.4%

Our EBITDA margin for 2012 was 24.4%



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Operational results

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 2012 operating results set forth below were affected by the 5.5% depreciation of the Russian ruble against the US dollar as of year-end 2012 as compared to year-end 2011.

	Year ended 31 December					
	2012		2011		2010	
	(in US \$ '000, except percentages)					
Total revenue	3,237,333	100%	2,766,749	100%	1,822,180	100%
Cost of services, excluding depreciation and taxes	(2,151,336)	(66.4%)	(1,906,256)	(68.9%)	(1,204,333)	(66.0%)
General and administrative expenses, excluding depreciation and taxes	(161,270)	(5.0%)	(144,614)	(5.2%)	(106,920)	(5.9%)
Taxes other than income taxes	(134,733)	(4.2%)	(119,181)	(4.3%)	(72,547)	(4.0%)
Depreciation	(249,987)	(7.7%)	(213,492)	(7.7%)	(144,241)	(7.9%)
Gain/(loss) on disposal of property, plant and equipment	4,786	0.1%	(1,362)	(0.1%)	6,344	0.3%
Impairment loss	-	-	(1,296)	(0.0%)	(7,096)	(0.4%)
Income from operating activities	544,793	16.8%	380,548	13.8%	293,387	16.1%
Interest expense	(53,661)	(1.6%)	(52,342)	(1.9%)	(15,125)	(0.8%)
Interest income	12,094	0.4%	11,485	0.4%	7,993	0.4%
Currency transaction gain/(loss)	631	0.0%	(11,054)	(0.4%)	(7,355)	(0.4%)
Gain/(loss) on business exchange transaction	-	-	32,284	1.2%	557	0.0%
Other income/(expenses)	(8)	(0.0%)	6,495	0.2%	(951)	(0.0%)
Income before income taxes	503,849	15.6%	367,416	13.3%	278,506	15.3%
Income tax expense	(121,840)	(3.8%)	(84,045)	(3.1%)	(71,680)	(3.9%)
Net income	382,009	11.8%	283,371	10.2%	206,826	11.4%

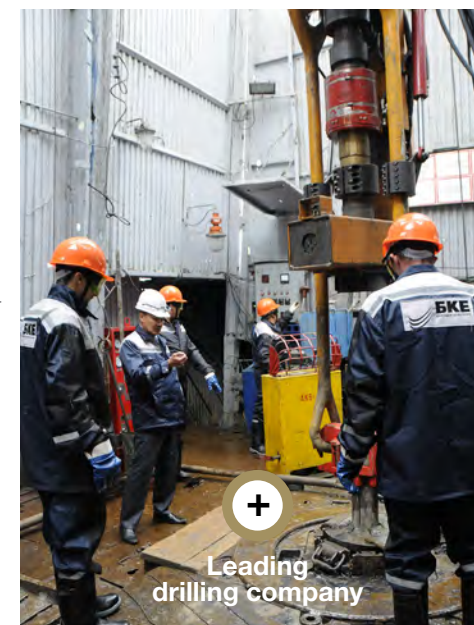
Year ended 31 December 2012 compared to year ended 31 December 2011

Revenue

Revenue increased by US \$470.6 million, or 17.0%, to US \$3,237.3 million for 2012, from US \$2,766.7 million in 2011. The increase was primarily due to an increase in services provided to our customers in most of our business lines and the full-year consolidation of the newly acquired businesses that we purchased in 2011 from Schlumberger and Transocean. In US dollar terms, revenue did not increase in line with the increase in drilling volumes primarily as a result of the 5.5% depreciation of the Russian ruble against the US dollar as of year-end 2012 as compared to year-end 2011. In addition, revenue was negatively impacted by the decrease in reimbursable pass-through telemetry services due to our customer LUKOIL-West Siberia starting to contract for such services directly with the third-party provider from May 2012.

The following table sets forth a breakdown of our revenue by type of services provided and as a percentage of total revenue for the period indicated.

	Year ended 31 December			
	2012		2011	
	(in US \$ '000, except percentages)			
Drilling and related services	3,222,830	99.6%	2,734,444	98.8%
Other sales and services	14,503	0.4%	32,305	1.2%
Total revenue	3,237,333	100%	2,766,749	100%



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Cost of services, excluding depreciation and taxes

Cost of services, excluding depreciation and taxes, increased by US \$245.1 million, or 12.9%, to US \$2,151.3 million for 2012, from US \$1,906.3 million for 2011. Cost of services, excluding depreciation and taxes, as a percentage of total revenue decreased from 68.9% for 2011 to 66.4% for 2012. The decrease as a percentage of total revenue was primarily attributable to a decrease in reimbursable pass-through services (such as, for example, telemetry and technology services) as described in more detail above, and efforts by the Group's management to control costs. The increase in absolute terms was primarily due to the overall growth of our operations.

For 2012, services of subcontractors were US \$936.8 million, or 43.5% of total cost of services, excluding depreciation and taxes, as compared to US \$917.2 million, or 48.1% of total cost of services, excluding depreciation and taxes, for 2011. The increase in absolute terms was primarily due to the full-year consolidation of newly acquired businesses, compared to their partial consolidation in 2011, and growth in workover volumes, which was almost fully offset by a decrease in reimbursable services that were largely pass-through, as described above, in the BKE onshore business, as well as a decline in technological, cementing and drilling fluids pass-through services in our offshore drilling segment.

Wages and salaries for 2012 were US \$488.4 million, or 22.7% of total cost of services, excluding depreciation and taxes, as compared to US \$425.2 million, or 22.3% of total cost of services, excluding depreciation and taxes, for 2011. The increase in absolute terms was primarily driven by the full-year consolidation of the newly acquired businesses, compared to their partial consolidation in 2011, the formation of new crews in the light of increased drilling volumes in 2012 over 2011, and a significant growth in workover volumes where wages and

salaries are a comparatively larger component of cost of services, excluding depreciation and taxes. The effect of the annual regular salary increase for our employees was largely offset by the depreciation of the Russian ruble against the US dollar. 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 pass-through services of subcontractors in total cost of services, excluding depreciation and taxes, as described above, causing the relative share of other constituents of our cost of services, excluding depreciation and taxes, to increase. We were able to achieve revenue growth in our core drilling business without proportional increase in headcount due to increased productivity.

For 2012, cost of materials was US \$414.3 million, or 19.2% of total cost of services, excluding depreciation and taxes, as compared to US \$309.3 million, or 16.2% of total cost of services, excluding depreciation and taxes, for 2011. The increase in both absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was primarily caused by the first-time full-year consolidation of SGC-Drilling in 2012 (where a significant portion of cost of materials was attributable to the casing pipe for Rosneft in Nefteyugansk, the cost of which was a pass-through) and growth in the usage of materials in West Siberia (also significantly affected by the casing pipe in Nefteyugansk).

Fuel and energy costs for 2012 were US \$152.8 million, or 7.1% of total cost of services, excluding depreciation and taxes, compared to US \$131.8 million, or 6.9% of total cost of services, excluding depreciation and taxes, for 2011. The increase in absolute terms was primarily driven by the full-year consolidation of newly acquired businesses and growth in volumes of our legacy drilling and workover operations, while the increase as a percentage of total cost of services, excluding depreciation and taxes, was immaterial.

Expenses relating to the transportation of employees to field locations for 2012 were US \$40.0 million, or 1.9% of total cost of services, excluding depreciation and taxes, compared to US \$30.7 million, or 1.6% of total cost of services, excluding depreciation and taxes, for 2011. The increase both in absolute terms and as a percentage of the total cost of services, excluding depreciation and taxes, was primarily caused by the indexation of air ticket prices and geographic diversification of our operations due to new customer relationships.

Leasing and rent costs for 2012 were US \$20.8 million, or 1.0% of total cost of services, excluding depreciation and taxes, compared to US \$26.3 million, or 1.4% of total cost of services, excluding depreciation and taxes, for 2011. The decrease in both absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was due to the gradual discontinuance of the leases in respect of drilling equipment, partially offset by the full-year consolidation of the newly acquired businesses and the rent of equipment to start a workover project for Rosneft in a new location on the Vankor field.

Other expenses amounted to US \$98.3 million, or 4.6%, of our total cost of services, excluding depreciation and taxes, for 2012, as compared to US \$65.8 million, or 3.5% of our total cost of services, excluding depreciation and taxes, for 2011. The increase both in absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, was primarily driven by the increase in insurance expenses due to the expansion of our rig fleet and higher well insurance costs related to the deeper wells we drilled. In addition, the integration of the newly acquired businesses also contributed to the increase.

24%

The share of our second-largest customer Rosneft in 2012 accounted for 24% of total EDC drilling volumes



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Offshore expertise

General and administrative expenses, excluding depreciation and taxes

General and administrative expenses, excluding depreciation and taxes, increased by US \$16.7 million, or 11.5%, to US \$161.3 million for 2012, as compared to US \$144.6 million for 2011. As a percentage of total revenue, General and administrative expenses, excluding depreciation and taxes, decreased to 5.0% for 2012 from 5.2% for 2011. The increase in absolute terms was primarily attributable to the full-year consolidation of the newly acquired businesses, while the decrease as a percentage of total revenue was not material.

Taxes other than income taxes

Taxes other than income taxes include various local taxes, such as social, property, road, and other small regional taxes. Taxes other than income taxes increased by US \$15.6 million, or 13.0%, to US \$134.7 million for 2012, as compared to US \$119.2 million for 2011. The increase in absolute terms was primarily driven by the full-year consolidation of the newly acquired businesses and the formation of new workover crews, while the decrease as a percentage of total revenue from 4.3% in 2011 to 4.2% in 2012 was not material.

Depreciation

Depreciation increased by US \$36.5 million, or 17.1%, to US \$250.0 million for 2012 as compared to US \$213.5 million for 2011. As a percentage of total revenue, depreciation was 7.7% in both 2012 and 2011. The increase in absolute terms was primarily the result of our ongoing modernisation programme, significant capital expenditures in property, plant and equipment, and the depreciation of equipment and machinery acquired with the purchase of new businesses from Schlumberger and Transocean, as described in more detail above.

Gains/(loss) on disposal of property, plant and equipment

Gains on the disposal of property, plant and equipment amounted to US \$4.8 million for 2012, as compared to a US \$1.4 million loss on the disposal of property, plant and equipment for 2011. This difference was primarily due to the timing of opportunistic sales of unneeded or obsolete equipment.

Impairment loss

In 2012 we did not recognise any impairment loss, compared to a loss of US \$1.3 million in 2011 resulting from the write-down of intangible assets of one of our smaller subsidiaries.

Income from operating activities

Income from operating activities increased by US \$164.2 million, or 43.2%, to US \$544.8 million for 2012, as compared to US \$380.5 million for 2011. The increase in absolute terms was primarily due to the increase in drilling and, to a lesser extent, workover volumes, and sustained cost control efforts, as well as the full-year consolidation of the newly acquired businesses. As a percentage of total revenue, income from operating activities increased from 13.8% for 2011 to 16.8% in 2012. This was primarily due to the overall positive impact of our cost control efforts.

Interest expense

Interest expenses increased by US \$1.3 million, or 2.5%, to US \$53.7 million for 2012, compared to US \$52.3 million for 2011. The increase in interest expense was primarily attributable to the full-year impact of additional borrowings raised during 2011 to support the growth of both our onshore and offshore businesses including the acquisitions of new businesses from Schlumberger and Transocean and the modernisation of our drilling fleet. This was partially offset by the scheduled repayment of our other outstanding loans. In particular, during 2011 we obtained a dollar-denominated credit facility from Raiffeisenbank in the amount of

US \$220 million bearing interest at 5.65% per annum, and issued ruble bonds in the amount of RUB5,000 million bearing interest at 8.4% per annum.

Interest income

Interest income increased by US \$0.6 million, or 5.3%, to US \$12.1 million for 2012 from US \$11.5 million in 2011. The increase was primarily due to larger average cash balances in 2012 as compared to 2011.

Currency transaction gain/(loss)

Currency transaction gain amounted to US \$0.6 million for 2012, as compared to a loss of US \$11.1 million in 2011. The difference was primarily due to less fluctuation in the Russian ruble/US dollar exchange rate in 2012 as compared to 2011.

Gain on business exchange transaction

We realised a gain on business exchange transaction of US \$32.3 million in 2011 in connection with the sale of our telemetry, cementing and drilling fluid assets to Schlumberger as part of the asset swap transaction. We did not have a gain on business exchange transaction during 2012.

Other income/(expenses)

Other income was US \$6.5 million in 2011. These amounts represent unusual income or expenses not resulting from our ordinary course of business activities. In 2011 we recognised income from the collection of a performance guarantee from one of our suppliers. We had a non-material amount of other expenses during 2012.

Income before income taxes

Income before income taxes increased by US \$136.4 million, or 37.1%, to US \$503.8 million for 2012, compared to US \$367.4 million for 2011. The increase in income before income taxes was attributable to the factors described in more detail above.



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Income tax expense

Income tax expenses increased by US \$37.8 million, or 45.0%, to US \$121.8 million for 2012, compared to US \$84.0 million for 2011. The increase was due primarily to a higher tax base. Our effective tax rate increased to 24.2% in 2012 from 22.9% in 2011. During 2011 we recognised a non-taxable net gain in the amount of US \$32.8 million from selling our telemetry, cementing and drilling fluid assets to Schlumberger in April 2011. During 2012 no similar items were recognised and thus our effective tax rate returned to the levels at which it was prior to 2011.

Net income

As a result of the foregoing factors, net income increased by US \$98.6 million, or 34.8%, to US \$382.0 million for 2012, compared to US \$283.4 million for 2011.

Year ended 31 December 2011 compared to 31 December 2010 Revenue

Our total revenue increased by US \$944.6 million, or 51.8%, to US \$2,766.7 million for 2011 from US \$1,822.2 million for 2010 due to an increase in revenue from both drilling and related services and other sales and services. The increase in revenue from drilling and related services was primarily due to the acquisition of new businesses in the first half of 2011 with a resulting increase in pass-through third-party services. Increase in revenue from other sales and services was mainly attributable to rental fees received for the new jack-up rig *SATURN* after its acquisition from Transocean in February 2011 to the end of May 2011, during which period we were in the process of reassigning the long-term contract with PETRONAS from an affiliate of Transocean to the Company. We had no similar income in 2010.

The following table sets out a breakdown of our revenue by type of services provided and as a percentage of total revenue for the period.

	Year ended 31 December			
	2011		2010	
	(in US \$ '000, except percentages)			
Drilling and related services	2,734,444	98.8%	1,808,905	99.3%
Other sales and services	32,305	1.2%	13,275	0.7%
Total revenue	2,766,749	100%	1,822,180	100%

Cost of services, excluding depreciation and taxes

Cost of services, excluding depreciation and taxes, increased by US \$701.9 million, or 58.3%, to US \$1,906.3 million for 2011 from US \$1,204.3 million for 2010. Cost of services, excluding depreciation and taxes, as a percentage of total revenue increased from 66.1% in 2010 to 68.9% for the fiscal year 2011. This increase was due primarily to significant changes in the mix of services. Drilling deeper wells and a higher level of horizontal drilling, which requires expensive telemetry and directional services provided by third parties, resulted in an increase in pass-through services and products sold to our customers with little or no related mark-up. Because we have very little or no margin on the pass-through third-party services we sell to our customers, this resulted in an increase of cost of services, excluding depreciation and taxes, as a percentage of total revenue. In addition, we experienced cost inflation in 2011, particularly related to social taxes, fuel, energy and transportation, as described in more detail below.

Services of subcontractors for 2011 were US \$917.2 million, or 48.1% of total cost of services, excluding depreciation and taxes, as compared to US \$492.2 million, or 40.9% of total cost of services, excluding depreciation and taxes, for 2010. The key drivers of the increase both in absolute terms and as a percentage of total cost of services, excluding depreciation and taxes, were an increase in pass-through services which are sold to customers with little or no related mark-up

(such as telemetry for horizontal wells, casing and construction of pads), as described in more detail above, and the asset swap with Schlumberger which resulted in the disposal of internal services assets and a corresponding increase in the use of subcontractors.

Wages and salaries for 2011 were US \$425.2 million, or 22.3% of total cost of services, excluding depreciation and taxes, as compared to US \$326.3 million, or 27.1% of total cost of services, excluding depreciation and taxes, for 2010. The increase in absolute terms was primarily caused by the full-year consolidation of newly acquired businesses and by the general wage indexation. The decrease in the percentage of total cost of services, excluding depreciation and taxes, was mostly caused by an increase of services of subcontractors as a percentage of total cost of services, excluding depreciation and taxes, resulting in a decrease in the relative share of other constituents of our cost of services, excluding depreciation and taxes.

Expenditures for materials for 2011 were US \$309.3 million, or 16.2% of total cost of services, excluding depreciation and taxes, as compared to US \$221.4 million, or 18.4% of total cost of services, excluding depreciation and taxes, for 2010. The increase in absolute terms was primarily due to the growth in drilling volumes and an increase in expenditures for materials attributable to casing pipe in some of our new projects, the cost of which is a pass-through.

\$790m

EBITDA increased by 31% in 2012 to US \$790 million



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\$2.59

Diluted EPS increased by 34% in 2012 to US \$2.59 per share

Fuel and energy costs for 2011 were US \$131.8 million, or 6.9% of total cost of services, excluding depreciation and taxes, as compared to US \$80.3 million, or 6.7% of total cost of services, excluding depreciation and taxes, for 2010. The increase as a percentage of total cost of services, excluding depreciation and taxes, was not material while the increase in absolute terms was primarily due to the inflation of prices for energy and fuel in 2011 and the growth of our business in general.

Expenses relating to the transportation of employees to drilling fields for 2011 were US \$30.7 million, or 1.6% of total cost of services, excluding depreciation and taxes, as compared to US \$23.4 million, or 1.9% of total cost of services, excluding depreciation and taxes, for 2010. The decrease as a percentage of total cost of services, excluding depreciation and taxes, was due to increased use of third-party services, while the increase in absolute terms was not material.

Leasing and rent costs for 2011 were US \$26.3 million, or 1.4% of total cost of services, excluding depreciation and taxes, as compared to US \$10.9 million, or 0.9% of total cost of services, excluding depreciation and taxes, for 2010. The change in percentage of total cost of services, excluding depreciation and taxes, was not material. The increase in absolute terms was primarily due to an increase in the amount of drilling equipment we hold under lease as well as the integration of leased equipment of SGC-Drilling acquired from Schlumberger in April 2011.

Other expenses amounted to US \$65.8 million, or 3.5% of our total cost of services, excluding depreciation and taxes, for 2011, as compared to US \$49.9 million, or 4.1% of our total cost of services, excluding depreciation and taxes, for 2010. The increase in absolute terms was primarily caused by an increase in insurance costs. The decrease as a percentage of total

cost of services, excluding depreciation and taxes, was mostly caused by an increase of services of subcontractors as a percentage of total cost of services, excluding depreciation and taxes, resulting in a decrease in the relative share of other constituents of our cost of services, excluding depreciation and taxes.

General and administrative expenses, excluding depreciation and taxes

General and administrative expenses, excluding depreciation and taxes, increased by US \$37.7 million, or 35.3%, to US \$144.6 million for 2011, as compared to US \$106.9 million for 2010. The increase was mostly attributable to the growth of our business, both organically and through acquisitions of new businesses from Schlumberger and Transocean. As a percentage of total revenue, General and administrative expenses, excluding depreciation and taxes, decreased to 5.3% in 2011 from 5.9% in 2010 due to the semi-fixed nature of such expenses.

Taxes other than income taxes

Taxes other than income taxes increased by US \$46.7 million, or 64.4%, to US \$119.2 million for 2011 as compared to US \$72.5 million for 2010. This increase was mostly attributable to the change in Russian tax law and continuous adjustments in the formula for social contributions. As a percentage of revenue, taxes other than income taxes increased to 4.3% of revenue in 2011 as compared to 4.0% in 2010.

Depreciation

Depreciation increased by US \$69.3 million, or 48.0%, to US \$213.5 million for 2011 as compared to US \$144.2 million for 2010. As a percentage of revenue, depreciation decreased to 7.7% for 2011 from 7.9% for 2010. The increase in absolute terms was caused primarily by our ongoing modernisation programme and significant capital expenditures in property, plant and equipment, as well as by the depreciation of the equipment and machinery acquired as part of the purchase

of the new businesses. In addition, during 2011 we revised our original estimates of the useful life of our drilling pipe from two to four years to two to three years which increased depreciation for 2011 by US \$16.1 million.

(Loss)/gain on disposal of property, plant and equipment

Loss on the disposal of property, plant and equipment amounted to US \$1.4 million for 2011 as compared to a gain of US \$6.3 million for 2010. This change is explained by ordinary course disposals of property, plant and equipment and by the fact that no significant assets were sold in 2011 compared to 2010 when gain was achieved through the sale of our transportation assets in the Perm branch of BKE.

Impairment loss

Impairment loss decreased by US \$5.8 million, or 81.7%, to US \$1.3 million for 2011 from US \$7.1 million in 2010. The decrease was primarily due to the impairment of goodwill related to the purchase of a small workover company brought on by a negative change in its business prospects.

Income from operating activities

Income from operating activities increased by US \$87.1 million, or 29.7%, to US \$380.5 million for 2011, as compared to US \$293.4 million for 2010. The increase was primarily due to an increase in metres drilled and the consolidation of the newly acquired businesses. As a percentage of total revenue, income from operating activities decreased to 13.8% in 2011 from 16.1% in 2010. This decrease was primarily due to an increase in services of subcontractors (particularly reimbursable services in horizontal drilling sold to customers with little or no mark-up and which have a negative impact on our margins) and inflation of social taxes and prices for energy, fuel and transportation, as described in more detail above.



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Interest expense

Interest expense increased by US \$37.2 million, or 246.4%, to US \$52.3 million for 2011 as compared to US \$15.1 million for 2010.

This increase was caused by interest incurred on the debt raised in the end of 2010 and the first half of 2011 (US \$254 million from Alfa-Bank in December 2010, US \$220 million from Raiffeisenbank in April 2011, and a US \$176 million ruble bond issue in June 2011). This debt was raised for the purposes of developing our onshore and offshore operations through acquisitions of new businesses from Schlumberger and Transocean and for the modernisation of our drilling fleet.

Interest income

Interest income increased by US \$3.5 million, or 43.8%, to US \$11.5 million for 2011 from US \$8.0 million in 2010. The increase was primarily due to larger average cash balances in 2011 as compared to 2010.

Currency transaction gain/(loss)

Currency transaction loss increased by US \$3.7 million, or 50.0%, to US \$11.1 million for 2011 from US \$7.4 million in 2010. The increase was primarily due to greater fluctuation of the Russian ruble/US dollar exchange rate in 2011 as compared to 2010.

Gain on business exchange transaction

Gain on business exchange transaction for 2011 was US \$32.3 million, compared to US \$0.6 million in 2010. The increase was due to a non-taxable gain realised on the sale of our in-house telemetry, drilling fluids and cementing business to Schlumberger in April 2011. No such material transactions occurred in 2010.

Other income/(expenses)

Other income amounted to US \$6.5 million for 2011 as compared to other expenses of US \$1.0 million in 2010. The difference was primarily due to collection on a performance guarantee bond from one of our suppliers in 2011. No such material events occurred in 2010.

Income before income taxes

Income before income taxes increased by US \$88.9 million, or 31.9%, to US \$367.4 million for 2011, as compared to US \$278.5 million for 2010. The increase was attributable to the net gain realised from selling telemetry, cementing and drilling fluid assets to Schlumberger in April 2011 and to the other factors described in more detail above.

Income tax expense

Income tax expense increased by US \$12.3 million, or 17.2%, to US \$84.0 million for 2011, as compared to US \$71.7 million for 2010. Our effective tax rate decreased to 22.9% in 2011 from 25.7% in 2010 primarily due to the fact that in 2010 a 5% foreign withholding tax was imposed on intercompany dividends declared and paid in the amount of RUB5,000 million. Additionally, in 2011 no tax was due on the US \$32.8 million gain realised on the sale of certain assets to Schlumberger.

Net income

As a result of the foregoing factors, net income increased by US \$76.6 million, or 37.0%, to US \$283.4 million for the fiscal year 2011, as compared to US \$206.8 million for 2010.

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, as well as by utilising a portion of the proceeds from the offering.

Cash flows

The table below shows our net cash flows from operating, investing and financing activities for the years ended 31 December 2012, 2011 and 2010.

	Year ended 31 December		
	2012	2011	2010
Net cash provided by operating activities	592,455	425,729	322,553
Net cash used in investing activities	(617,922)	(848,865)	(325,190)
Net cash provided by (used in) financing activities	(197,140)	347,340	206,188

Operating activities

Net cash provided by operating activities amounted to US \$592.5 million for 2012, as compared to US \$425.7 million for 2011. This increase in cash flows provided by operating activities was principally due to higher drilling and workover volumes, the full-year consolidation of newly acquired businesses, and sustained cost control efforts by our management.

Net cash provided by operating activities amounted to US \$425.7 million for 2011, as compared to US \$322.6 million for 2010. This increase in cash flows provided by operating activities was principally due to higher drilling volumes in 2011 compared to 2010 as well as cash flow generated by the newly acquired businesses.

Investing activities

Net cash used in investing activities amounted to US \$617.9 million for 2012, as compared to US \$848.9 million for 2011. Investing activities during 2012 were mainly represented by our capital expenditures that amounted to US \$619.9 million (including US \$150 million offshore capital expenditures) as compared to US \$400.0 million (including US \$97 million offshore capital expenditures) during the corresponding period of 2011. The increase of US \$219.9 million primarily represented a payment to Lamprell in the amount of US \$45.4 million for the construction of our second new-build jack-up rig, *MERCURY*, with delivery scheduled for late 2014, as well as acquisition of four drilling rigs in Iraq for US \$46.6 million, and our continuing focus on upgrading our onshore drilling fleet in Russia. During 2011 our investing activities were focused on the acquisitions of onshore and offshore assets from Schlumberger and Transocean, respectively.

\$620m

Capital expenditures in 2012 were US \$620 million



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Net cash used in investing activities amounted to US \$848.9 million for 2011, as compared to US \$325.2 million for 2010. The increase was attributable primarily to the acquisition of the jack-up rig *SATURN* from Transocean and the asset swap with Schlumberger. In addition, we continued to capitalise on the growth opportunities in our markets by significantly increasing our investments in new property, plant and equipment. In 2011 our capital expenditures were US \$400.0 million, as compared to US \$283.8 million in 2010 (which includes US \$50 million offshore capital expenditures), including US \$84 million spent in 2011 on construction of a new jack-up drilling rig as compared to US \$42 million for 2010. Another key factor contributing to this growth was the increase in our technical upgrade programme and payments for the new rigs ordered in late 2010 and during 2011. Starting from 2010, our capital expenditures include payments to Lamprell for the construction of two new-build jack-up rigs of US \$235 million per rig. The payments are staged and paid upon certain construction milestones.

Financing activities

Net cash used in financing activities amounted to US \$197.1 million for 2012, compared to net cash of US \$347.3 million provided by financing activities for 2011. During both periods, dividends were paid and certain debt was redeemed in accordance with its terms. During 2011, we raised RUB5,000 million (approximately

US \$167 million) through a ruble bond offering and obtained new credit line facilities, while in 2012 one new credit facility in the amount of US \$25.7 million was obtained from Sberbank for our workover division to refinance intercompany debt.

Net cash provided by financing activities amounted to US \$347.3 million for 2011, as compared to net cash of US \$206.2 million provided by financing activities for 2010. During both periods, dividends were paid and certain debt was redeemed in accordance with its terms. The increase in net cash provided by financing activities during 2011 was attributable to debt raised from Raiffeisenbank and ruble bonds issued during the year used for developing our onshore and offshore businesses through acquisitions and modernisation of our drilling fleet.

	Year ended 31 December		
	2012	2011	2010
	(in US \$ '000)		
Cash held in banks – Russian rubles	154,992	188,410	76,451
Short-term deposits – Russian rubles	128,295	194,771	154,730
Cash held in banks – mostly US dollars	19,118	81,770	357,911
Short-term deposits – US dollars	2,805	39,320	40,033
Other	123	5,510	341
Total cash and cash equivalents	305,333	509,781	629,466

Liquidity

As of 31 December 2012, 2011 and 2010, we had cash and cash equivalents of US \$305.3 million, US \$509.8 million and US \$629.5 million, respectively.

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 quarter of each year to mobilise our rigs, crews and equipment to drilling sites. See the section 'Seasonality and extreme weather conditions' on page 21.

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 modernise the technical characteristics of our existing drilling rigs and equipment.

For each of the years ended 31 December 2012, 2011 and 2010 advances given for property, plant and equipment amounted to the following:

	Year ended 31 December		
	2012	2011	2010
	(in US \$ '000)		
Advances given for property, plant and equipment	275,641	133,367	67,557

The amounts represent cash advances for property, plant and equipment purchased but of which we have not yet taken delivery. The increase in advances given for property, plant, and equipment in 2012 as compared to 2011 was mainly attributable to a US \$84.0 million payment made to Lamprell for the construction of our first new-build jack-up rig, *NEPTUNE*, with delivery scheduled for the third quarter of 2013, and a US \$45.4 million payment made to Lamprell for the construction of our second new-build jack-up rig, *MERCURY*, with delivery scheduled for late 2014. The increase in advances given for property, plant and equipment in 2011 as compared to 2010 was attributable to a US \$84 million advance paid for the construction of the new jack-up rig, *NEPTUNE*, to Lamprell and advances paid for the construction of new onshore drilling rigs.

\$395m

Our net debt position was US \$395 million as of 31 December 2012



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

	Year ended 31 December		
	2012	2011	2010
	(in US \$ '000)		
Construction in progress	51,568	92,142	40,146

The decrease in construction in progress as of 31 December 2012 compared to 31 December 2011 was the result of normal variances in the new drilling rig delivery schedule. The increase in construction in progress as of 31 December 2011 compared to 31 December 2010 was due to the arrival of new drilling rigs that had not yet been put into service.

Additionally, as of 31 December 2012, we had on deposit restricted cash in the amount of US \$45.4 million included in non-current assets to secure progress payments to Lamprell for the construction of the two new-build jack-up drilling rigs. We had an additional US \$4.0 million of restricted cash included in current assets as of 31 December 2012 used to collateralise the issuance of a guarantee for a customer.

Capital resources

For the years ended 31 December 2012, 2011 and 2010, our short-term and long-term debt amounted to the following:

	At 31 December		
	2012	2011	2010
	(in US \$ '000)		
Short-term debt and current portion of long-term debt	257,860	175,217	117,550
Long-term debt	442,013	578,117	286,367

As of 31 December 2012, our loans and borrowings were comprised of the following:

	Final maturity date	Currency	Interest rate	Outstanding debt (in US \$ '000)	Security
Long-term debt					
Debt of the Company					
Loans from stockholders	2014	US \$	5.8%	50,000	None
Debt of our subsidiaries					
<i>Bank loans</i>					
OAO Sberbank of Russia	2014	RUB	7.7%	43,899	None
OAO Sberbank of Russia	2013	RUB	LIBOR + 4.1%	20,214	Property, plant and equipment
OAO Sberbank of Russia	2015	RUB	10.15%	26,339	None
Raiffeisenbank	2016	US \$	5.65%	220,000	Shares in GSVI Limited
Alfa-Bank	2013	RUB	8.4%	122,478	None
Russian ruble bonds	2018	RUB	8.4%	164,622	None
Rushong-Hua	2015	RUB	6.3%	52,321	None
Total long-term debt				699,873	
Total non-current long-term debt				442,013	

As of 31 December 2012, we had two unused lines with ZAO UniCredit Bank. The first was a revolving short-term line of credit denominated in Russian rubles which at the applicable ruble-US \$ exchange rate of the Central Bank of Russia on 31 December 2012 equalled US \$96.1 million. Loans under this line of credit are provided for a duration of 90 days and are available for drawdown until November 2014. The second one is a revolving overdraft line denominated in Russian rubles which at the applicable ruble-US \$ exchange rate of the Central Bank of Russia on 31 December 2012 equalled US \$17.3 million and is available until September 2015. We can use both lines solely for issuing or extending unsecured commercial letters of credit for the purpose of acquiring new drilling rigs (used as security for these lines).

As of 31 December 2012, we also had a revolving multi-currency overdraft line with OAO Sberbank of Russia denominated in Russian rubles which at the applicable ruble-ruble-US \$ exchange rate of the Central Bank of Russia on 31 December 2012 equalled US \$98.8 million and is available until June 2017. We can use the overdraft line solely for issuing or extending unsecured commercial letters of credit for the purpose of acquiring new drilling rigs. As of 31 December 2012, the line was undrawn.

As of 31 December 2012, we entered into a five-year US \$227 million loan facility arranged by ZAO UniCredit Bank with an interest rate of three-month LIBOR + 3.65% per annum.

0.5

Our net debt to EBITDA ratio was 0.5 at the end of 2012



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The final maturity date of the facility is 27 December 2017. The loan facility also provides for an irrevocable renewable bank guarantee of US \$45.4 million. The loan facility is secured by our drilling assets. As of 31 December 2012, the line was undrawn. In the first quarter of 2013, we drew down US \$165.4 million under this facility.

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 flow from our operations, other financing arrangements, and our available working capital.

The following table summarises the principal maturities of our long-term debt, including its current portion, as of 31 December 2012. 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.

	Total	Payments due by period					2018 and thereafter	
		2013	2014	2015	2016	2017		
			(US \$ '000)					
Contractual obligations								
Long-term debt	699,873	257,860	148,615	94,930	33,846	–	164,622	

Our long-term debt and overdraft lines are secured by certain property, plant and equipment with a carrying amount of US \$264.9 million as of 31 December 2012. As of 31 December 2012, our secured debt represented approximately 34% of our total long- and short-term debt.

As of 31 December 2012, 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, operational results, liquidity, capital expenditures or capital resources.

Overview of other matters

Dividend policy and year-end 2012 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 operational results 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 31 December 2012 a dividend was declared by the Board of Directors on 12 December 2012 in the amount of 70 cents per share, or US \$103 million, which was included in 'Accounts payable and accrued liabilities' and paid on 17 January 2013. For 2011 a dividend of 47 cents per share, or US \$69 million, was declared in December 2011 and paid early in 2012. For 2010 a dividend of 31 cents per share, or US \$45 million, was declared in December 2010 and paid early in 2011.

Treasury shares

In March 2008, the Company introduced an incentive plan for certain members of management for a five-year period beginning 1 January 2008. In accordance with its Incentive Compensation Plan (the Plan), 522,060 GDRs were awarded early in 2011 to participants in the Plan for their performance in 2010.

No GDRs were awarded to our officers under the Plan for the fiscal year 2011 as the Company's stock price did not increase past the required amount.

In August 2011, we announced that we might buy back up to US \$60 million of our GDRs due to exogenous market conditions. The repurchase programme lasted for 180 days and expired on 26 February 2012.

0.9

Our total debt to EBITDA ratio was 0.9 at the end of 2012



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During the time of the share buy-back programme 105,781 GDRs were purchased. During the reporting period 27,924 shares were transferred to Directors in lieu of cash for their service in 2011. As of 31 December 2012 there are 77,857 shares in treasury.

In accordance with the Company's Incentive Compensation Plan participants of the Plan were awarded 875,260 GDRs for their performance in 2012.

Earnings per share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding during the reporting periods. Diluted earnings per share reflects shares that may be issued contingent upon stock price performance under the terms of the Plan.

The calculation of earnings per share for the periods indicated was as follows:

	2012	2011	2010
Net income available for common stockholders	382,009	283,371	206,826
Weighted average number of outstanding shares	146,782,754	146,768,307	143,270,265
Basic earnings per share of common stock (US \$)	2.60	1.93	1.44
Contingent shares of the Plan	875,260	–	522,060
Weighted average number of outstanding shares, after dilution	147,658,014	146,768,307	143,792,325
Diluted earnings per share of common stock (US \$)	2.59	1.93	1.44

Earnings per share calculated on a diluted basis of 147,658,014 shares amounted to US \$2.59 in 2012, compared to US \$1.93 in 2011. The improvement in earnings per share was attributable mainly to the increase in net income of 35% in 2012 compared to 2011.

Basic earnings per share were US \$2.60 in 2012 compared to US \$1.93 in 2011.

Related party transactions

Shareholder loans

In the period from November 2006 through March 2007 the Company entered into loan agreements with its shareholders to partially fund the investment programme of our onshore drilling services division and the purchase of our offshore drilling services business.

The aggregate principal amount of such loans was US \$50 million as of 31 December 2012 and 31 December 2011 and US \$70 million as of 31 December 2010. These loans are denominated in US dollars and bear interest at 5.8% per annum (starting 2011, prior to that the interest rate was set at 8.6%), with the maturity date on or before 31 December 2014.

US \$2.9 million of interest was recognised and paid on these loans during both 2012 and 2011. US \$6 million of interest was recognised and paid on the year ended 31 December 2010. Management believes the terms of these loans are no more onerous than those that would have been negotiated in an arm's-length negotiation.

Legal services

The Company's General Counsel, Douglas Stinemetz, is a partner with The Stinemetz Law Firm (the Firm). During the years ended 31 December 2012, 2011 and 2010 the Firm billed EDC for costs and expenses of US \$2.0 million, US \$2.4 million and US \$2.2 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.

Loan to associate company

During 2012 the Group decreased its share in OOO Kliver from 51% to 25% but increased its investment in OOO Kliver by US \$5.6 million. During 2012 the Group issued short-term loans of US \$20.6 million to an associate company, OOO Kliver. The loans are denominated in Russian rubles, bear interest at 10% and mature on 1 July 2013. The outstanding balance was US \$3.6 million as of 31 December 2012. Interest income of US \$0.2 million was recognised during 2012.

Guarantees

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

70 cents

Dividend per share declared by EDC for 2012



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Qualitative and quantitative 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 programmes 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 as such the Company has significant concentrations of credit risk with the LUKOIL Group.

Included in our sales and accounts receivable are the following transactions and balances with LUKOIL Group companies:

	At 31 December		
	2012	2011	2010
Revenue for the years ended 31 December 2012, 2011 and 2010	2,054,724	1,692,200	1,280,826
Accounts receivable as of 31 December 2012, 2011 and 2010	260,781	194,005	124,182

	Scheduled maturity						Fair value	
	2013	2014	2015	2016	2017	2018 and thereafter	Total	31 December 2012
	(in millions of US \$, except percentages)							
Total long-term debt	257.9	148.6	94.9	33.9	–	164.6	699.9	699.9
Fixed rate	237.7	148.6	94.9	33.9	–	164.6	679.7	679.7
Average interest rate	7.2%	7.1%	7.5%	7.9%	8.4%	8.4%	–	–
Variable rate*	20.2	–	–	–	–	–	20.2	20.2
Average interest	5.7%	–	–	–	–	–	–	–

* Based on LIBOR at the end of 2012, which rate may fluctuate in later periods.

The LUKOIL Group made up approximately 63.5%, 61.2% and 70.3% of our sales for the years ended 31 December 2012, 2011 and 2010, 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 accounts 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 2012, 2011 or 2010. Our allowance for doubtful accounts stood at US \$12.6 million at 31 December 2012, 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 at the lower left presents scheduled long-term debt maturities in US dollars and related weighted-average interest rates for each of the 12-month periods ending 31 December relating to debt obligations as of 31 December 2012.

\$700m

Our total debt was US \$700 million as of 31 December 2012



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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 31 December 2012, 2011 and 2010 we had US \$429.9 million, US \$479.9 million, and US \$327.5 million of a total of US \$699.9 million, US \$753.3 million, and US \$403.9 million respectively of our long- and short-term debt denominated in the Russian ruble. In addition, the operational results 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 recognised revenue and expenses associated with such transactions. Furthermore, while the majority of our revenue is 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 operational results. In addition, in each of 2012, 2011 and 2010 certain of our intercompany debt was denominated in a currency other than the functional currency of the debtor company (in all cases the debtor companies are and were 100% owned members of our consolidated Group).

Critical accounting policies

The preparation of consolidated financial statements in conformity with US GAAP requires estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and the disclosure of contingent assets and liabilities. Actual amounts may differ from these estimates. The following critical accounting policies require significant judgments, assumptions and estimates and should be read in conjunction with our consolidated financial statements.

Revenue recognition

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

In 2012 we changed our revenue recognition policy from the units-of-delivery method to the percentage-of-completion method. This change was caused by the intention to shift from US GAAP to IFRS. In connection with this change, certain prior period amounts have been adjusted to conform to the current period presentation. All such adjustments are disclosed in Note 2 to the Consolidated Financial Statements.

The units-of-delivery method recognises as revenue the contract price of units of a basic production product delivered during a period and as the cost of earned revenue the costs allocated to the delivered units; costs allocated to undelivered units were reported in the balance sheet as inventory or work in progress.

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

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

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

All sales are shown net of applicable value-added tax.

The description of our other critical accounting policies is provided in the audited consolidated financial statements for the year ended 31 December 2012.

Transition from US GAAP to IFRS

We currently anticipate that we will continue to report our financial results under US GAAP up to and including the year 2014, but intend to report our interim and full-year 2015 financial results and all periods thereafter under IFRS. We do not expect the adoption of IFRS to have a material impact on our operational results, financial position or cash flows.

57%

Our major customer LUKOIL accounted for 57% of total EDC drilling volumes in 2012



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Corporate responsibility

At EDC we believe that ethical, sustainable and socially responsible operations are fundamental to our business and to our long-term growth. It is the way we work.

Acting responsibly

- We observe and promote ethical business practices and advocate respect and tolerance by and for all people.
- Our business decisions are made to ensure long-term growth for the benefit of our employees, customers and investors.
- We care about where we work and together with our employees, local people and government bodies, we develop constructive solutions to shared problems and promote suitable projects and initiatives that are of long-term benefit to our local communities.
- We are committed to high standards in occupational health and safety and to protecting the environment.

Commitment to our people

With approximately 23,000 employees we are focused on providing them with a safe and high-quality working environment backed up by a first-class compensation and benefits package.

In addition, we have a 'Collective Bargaining Agreement' that governs social and labour relations for more than 80% of our workforce.

One of the key components of employees' social protection is the supplementary pension plan provided by LUKOIL-Garant, a non-state pension fund to which we contribute on behalf of our employees.

For a company like ours, with a significant number of employees spread over the vast territories of Russia and the CIS, it is important to keep open channels of communication. We continuously seek ways to engage with our employees regarding matters occurring across the business. Our news directory contains news from our subsidiaries and is available to each employee to keep them informed of ongoing developments. We have also initiated an annual employee survey to identify the degree of satisfaction of our employees and to define areas for improvement. We are pleased with the most recent results of this survey as the vast majority of our employees indicated they are generally satisfied and would recommend EDC as an employer. The results were published internally and we continue to improve communication channels with our employees.

We place special emphasis on developing young specialists. An annual contest held by EDC identifies young, creative employees and supports their development while encouraging innovative projects. The best projects of prior years are now implemented within EDC's operations. In May 2012 the final young specialists contest was hosted by our Western Siberia branch in Kogalym. The winners from each branch of the Company presented their projects at the final competition covering various aspects of EDC operations and business activities, including environmental responsibility. The first prize was awarded to a project on increasing coring efficiency in operations. Winners and all contestants received monetary prizes, certificates and souvenirs.

On an annual basis the Ministry of Energy of the Russian Federation and the NS 'Integratsiya' Society organise a contest for the best youth projects covering Russia's oil and energy sector issues. Winners of the 2011 EDC competition took part in the 20th national contest in May 2012, and four projects out of four submitted were awarded prizes.

We have established Youth Boards to help improve our young employees' social life and communicate their concerns to the management of the Company. We have also introduced a counsellor-counselee system where our young specialists are mentored by senior employees to help them achieve their potential.

Every year our Western Siberia branch organises a contest for the Best Drilling Crew of the year. The competition covers both theoretical and practical testing and lasts for one day. The top operation management of the branch determines the winners and awards them with monetary prizes, certificates and souvenirs.

Commitment to HSE

Our 200-strong HSE Group promotes our Health, Safety and Environmental Protection policies and procedures to all our employees and works to ensure that we comply with all government laws and regulations. We are a member of the International Association of Drilling Contractors (IADC) to which we regularly report our HSE statistics. Historically, since 2005, our lost time incident rate (LTIR) has been lower than the worldwide industry indicator reported by the IADC. We are happy to report that this trend continued in 2012, when our LTIR was 0.22 compared to 0.26 for the industry as reported by the IADC.

In September 2008, BKE, our Russian onshore operating subsidiary, received compliance certificates for ISO 14001:2004 (Environmental Protection Management System) and OHSAS 18001:2007 (Health and Safety Management System). In 2012, a surveillance audit was carried out by Bureau Veritas, an independent certification body, and BKE was recertified as compliant with the requirements of the above-mentioned standards. In June 2007, BKE Shelf, our offshore operating subsidiary, was audited and recognised as complying with the quality standard ISO 9001:2000 (Russian Register Certification System) under the IQNET programme. Early in 2010 BKE Shelf was audited and recognised as complying with the revised quality standard ISO 9001:2008.

The minimisation of any negative effects of our operations on the environment is critical to us. Our offshore operations in the Caspian Sea are in strict compliance with the zero discharge principle. This principle means that no waste is discharged into the sea; rather it is collected in closed containers and transported onshore for disposal. The zero discharge principle is applied for all of our exploration and production drilling.



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Commitment to the community

We are involved in several projects in various communities where we operate, aimed at improving the wellbeing of the local population. Our support includes financial assistance for the disabled, low-income families, disabled and elderly war veterans, and disadvantaged, disabled and orphaned children.

The charities we supported in 2012 included the Government of Russia Charity Fund, to which we provided financial assistance for publishing unique books for blind children. We financed a trip for the kids from Tuzhinskaya boarding school pre-school orphanage to Moscow within the project 'Show the homeland to the kids'. We took part in the charity event 'Holidays out of home', organised by the Here and Now orphan charity fund, for children from five orphanages.

EDC supports the development of youth sport in the regions of our operations, and we strive to enrich the cultural life of local communities. As an example, we sponsor local national holidays for the Khanty-Mansiysk and Yamalo-Nenets Autonomous Regions' population. We have a long-standing cooperation with many educational institutions to provide internships for students at our facilities. In 2012 we provided over 400 places for university and college students. Educational institutions involved include: Kostroma State Technical University, Ufa State Aviation and Technical University, Orenburg State University (Buguruslansk branch), Tyumen State University, Ufa State Oil and Technical University, Tyumen State Oil & Gas University, Saratov State University of N.G. Chernyshevsky, Zhirnovsk Oil College, Samara

State Technical University, Perm State Technical University, SPO Ishimbaisk Oil College, Perm Oil College, Perm State University, Tchaikovsky Industrial and Humanitarian College, Osa Agricultural College, Russian State University of Gubkin, Volgograd Academy of Government Service, the Modern Humanitarian Academy of Volgograd, Irkutsk State Technical University, North-Caucasus State Technical University and Utah State Technical University.

Commitment to our investors and customers

We do all this while never losing sight of the fact that, fundamentally, we are here to run a successful business that makes a profit and invests for continued long-term growth.

We are focused on improving liaison with our shareholders and analysts in an open and efficient way. We put our efforts into ensuring that our stakeholders are well informed on our strategy, outlook, financial and operational performance in a timely manner.

During the year we provide four financial and operations updates including annual and interim results. We report our drilling volumes on our website (www.eurasiadrilling.com) to keep our investors and analysts informed of the direction of our business on a monthly basis. We understand and recognise the importance of our investors' opinions and feedback, which we collect during numerous investor meetings. As such, in 2012 we held over 200 one-on-one and Group meetings and attended 11 investor conferences, including two global energy conferences. We conducted two investor non-deal roadshows covering Russia, USA, UK and Europe through the course of the year, involving our Chief Executive Officer, Chief Operating Officer and Chief Financial Officer.

In November 2012 we hosted our first Capital Markets Days, in London and New York City, involving presentations by top management team.

The Investor Relations section on our website provides additional information, including investor presentations, Annual reports, a calendar of events and other useful information.



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Board of Directors



1. The Earl of Clanwilliam

Chairman of the Board of Directors of EDC

The Earl of Clanwilliam has been the Chairman of the Board of Directors of the Company since October 2007. Until recently, he has also been a member of the board of directors of OJSC Polyus Gold (since March 2006); he now sits on the board of directors of the parent company Polyus Gold International Limited. The Earl of Clanwilliam founded and is currently a director of Meade Hall & Associates (formerly Gardant Communications). Since 1997, The Earl of Clanwilliam has served as a member of the board of directors of the Benevolent Society of St Patrick, and since 2005, has served on the Advisory Council of the Ukrainian British City Club, and from 2000 to 2004 was non-executive chairman of Cleveland Bridge UK Ltd. The Earl of Clanwilliam is a graduate of Eton College.



2. Dr Alexander Djaparidze

Chief Executive Officer of EDC

Dr Djaparidze has been the Chief Executive Officer of the Company since August 2007 and was one of the Company's founders in 2002. He has also been the Chairman of BKE since 2005. From June 1995 to February 2007, Dr Djaparidze served as President of PetroAlliance. Prior to joining PetroAlliance, he held various executive positions at CGE, and served as Managing Director of MD SEIS. Dr Djaparidze holds a degree in mining engineering and geophysics from the Gubkin Russian State University of Oil & Gas. Dr Djaparidze also holds a doctorate degree in technical science from the Gubkin Moscow Institute of Oil & Gas and is a member of the Eurasia Geophysical Society. Dr Djaparidze was awarded the Russian Federation Government prize for special achievements in science and technology in 2006. He is a member of the Eurasia Geophysical Federation (EGS).



3. Richard Anderson

Chief Financial Officer of EDC

Mr Anderson has been the Chief Financial Officer of the Company since July 2008 and has been a member of the Board of Directors since October 2011. Mr Anderson has 32 years of experience in the oil & gas industry in various finance and management roles. Mr Anderson was the President and Chief Executive Officer of Prime Natural Resources, Inc. from May 2002 to March 2007. Mr Anderson also served as a director of Transocean from September 2007 to June 2011 and as a director of Boots & Coots, Inc. from April 1998 to September 2010. He also currently serves as a director of Vanguard Natural Resources Ltd. Mr Anderson is a certified public accountant and holds a bachelor of science degree, magna cum laude, in business from the University of Colorado and a masters degree in taxation from the University of Denver.



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Board of Directors *continued*



4. Maurice Dijols

Mr Dijols has been a member of the Board of Directors since October 2011. Mr Dijols was the President of Schlumberger Russia from 2003 to 2011. Mr Dijols joined Schlumberger in the Middle East in May 1977 and has held a variety of executive positions during his 30-year career with Schlumberger. Mr Dijols is a Member of the Society of Petroleum Engineers, Member of the Presiding Committee of the European Business Congress and Member of the Conseil du Commerce Extérieur de la France. Mr Dijols holds a degree from the Ecole d'Ingénieurs de Marseille and the Ecole Supérieure d'Electricité.



5. Martin Hansen

Mr Hansen has been a member of the Board of Directors since 2005. He served as the Chief Financial Officer of the Company from May 2004 to November 2007. He was formerly a member of the board of directors of BKE from 2005 to 2007. From 1999 to 2002, Mr Hansen was Chief Financial Officer of PetroAlliance. Mr Hansen holds a bachelor of business administration degree from the University of Iowa.



6. René Huck

Mr Huck has been a member of the Board of Directors since October 2007. He has also been a Director of BWO, a Norwegian FPSO Company, since 2006. In October 2005 Mr Huck retired from Schlumberger where he had held a variety of senior positions over 15 years, most recently as Vice-President QHSE and Industry Affairs. He also served on the Board of Directors of PetroAlliance from 2004 to 2007. From 1988 to 1990, he served as CEO of the drilling contractor Techfor Cosifor. Prior to that, Mr Huck worked for 16 years as drilling and operations manager and then President of TOTAL Egypt at TOTAL S.A. Mr Huck holds a degree in mechanical engineering from the Ecole Centrale in Nantes, France and a degree in petroleum engineering from the French Petroleum Institute, Rue Malmaison in Paris.



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Board of Directors *continued*



7. Richard Matzke

Mr Matzke has been a member of the Board of Directors since September 2010. From 2002 to 2010, and from 2011, he served as a member of the Board of Directors of LUKOIL and Chairman of its Strategy and Investment Committee. Mr Matzke served as Vice Chairman of the Board of Directors of Chevron until his retirement in 2002 after 41 years of service with the Company.

Mr Matzke holds a degree in geology from Iowa State University in 1959, received a masters degree in geology from Pennsylvania State University in 1961, and an MBA from St Mary's College in California in 1977. In 1996, he was awarded an honorary doctorate from the Georgian Technical University in Tbilisi. He received a medal for 'Development of the Russian Oil and Gas Industry' in 2006 and received a national prize as 'Director of the Year, 2006' from the Russian Association of Independent Directors.



8. Alexander Shokhin

Mr Shokhin has been a member of the Board of Directors since October 2007. He has served on the Board of Directors of LUKOIL from 2005 and TNK-BP from 2009. Mr Shokhin has been the President of the State University-Higher School of Economics since 1995. He has been President of the Russian Union of Industrialists and Entrepreneurs since 2005. Mr Shokhin was Chairman of the Supervisory Council of Renaissance Capital Investment Group from 2002 until 2005. From 1994 until 2002, he was a Deputy of the State Duma, where his last position was Head of the Duma Committee on Credit Institutions and Capital Markets. Mr Shokhin holds a degree in economics from Moscow State University. He is a Doctor of Economic Science and Professor and Member of the Russian Academy of Natural Sciences. He was awarded the Order of Honour (1997) and the State Order 'For Merits before the Fatherland' of 4th degree (2008).



9. Anatoliy Kozyrev

Mr Kozyrev has been a member of the Board of Directors since September 2012. He served as a member of the Board of Directors of BKE and BKE Shelf from 2008 to 2012. From 1998 to 2007, Mr Kozyrev served as Vice President and Director of the Chief Administration for Corporate Budget and Economy Planning and Investments of LUKOIL. From 1993 to 1998, he served as Deputy Minister of Fuel and Energy of the Russian Federation, and sat on the Board of Directors of LUKOIL. Mr Kozyrev holds a degree in engineering and economics from the Moscow Institute of engineering and economy and a degree in international economic relations from the USSR Federal Academy of Foreign Trade.



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Corporate governance report

The Company is committed to observing high standards of corporate governance. This report describes how the Company has applied the Principles of Good Governance as set out in the UK Corporate Governance Code, issued by the UK Financial Reporting Council in June 2010 (the 'Code'), except where indicated otherwise within this report. An updated version of the UK Corporate Governance Code was published in September 2012. Although the 2012 Code will first apply to companies with financial years commencing on or after 1 October 2012, the Company will give consideration to reporting early under the 2012 Code in its Annual report next year.

While the Company as a legal entity incorporated in the Cayman Islands is not subject to UK corporate governance requirements per se, the Company nevertheless intends to comply with established practices under the Code, wherever reasonably possible.

The Board

Members of the Company's Board of Directors are collectively responsible to the Company's shareholders for the direction and oversight of the Company to ensure its long-term success. The Board met regularly throughout the year to approve the Company's strategic objectives, to lead the Company within a framework of effective controls, which enable risk to be assessed and managed, and to ensure that sufficient resources are available to meet the objectives set.

Board composition

As of the date of this report, the Board of Directors of the Company comprised nine directors:

Chairman

The Earl of Clanwilliam

Executive Directors

Dr Alexander Djaparidze (Chief Executive Officer) and Mr Richard Anderson (Chief Financial Officer).

Non-Executive Directors

Mr Dijols, Mr Huck, Mr Hansen, Mr Kozyrev, Mr Matzke and Mr Shokhin.

Mr Kalyuzhny resigned from his role as a Non-Executive Director of the Company with effect from the 2012 Annual General Meeting held on 28 September 2012. Mr Anatoliy Kozyrev was elected as a Director with effect from the close of the same meeting on 28 September 2012.

The Board considers five of these seven Non-Executive Directors (The Earl of Clanwilliam, Mr Huck, Mr Hansen, Mr Kozyrev and Mr Matzke) to be independent for purposes of the Code. Two Non-Executive Directors, Mr Shokhin and Mr Dijols, are not strictly independent for the purposes of the Code, since Mr Shokhin is also a member of the board of directors of two customers of the Company, LUKOIL and TNK-BP, and Mr Dijols was Chairman of the Russian Schlumberger companies and also a Senior Advisor to the Schlumberger CEO Paal Kibsgaard. Nevertheless, the Board does not consider that these facts undermine their independence. In fact, the Board considers that, as a result of their services on these other boards, Mr Shokhin and Mr Dijols bring particular expertise to the Company's Board of Directors since they have greater industry-specific knowledge.

The Board considers and will continue to consider its composition from time to time. The Remuneration and Nomination Committee of the Board on 1 March 2009 adopted a policy as to how best to consider and nominate members of the Board. The Board may choose to deviate from the strict

requirements of the Code in relation to Board composition on a case-by-case basis if it is considered in the best interests of the Company, consistent with industry practice generally or required by applicable Cayman Islands law.

Brief biographies of the Executive and Non-Executive Directors are set out on pages 38 to 40. The biographies illustrate that the Directors have a range of business and financial experience that is important and relevant to the management of the Company. The role of Chairman of the Board and Chief Executive Officer are clearly defined and separate. Except as otherwise noted, each member of the Board of Directors was appointed to the Board on 15 October 2007.

Staggered Board

In accordance with the Articles of Association, the Company's Board of Directors is divided into three classes. Each Director holds his office for a term of three years, such terms being staggered in accordance with resolutions adopted at the Company's Annual General Meeting held 9 September 2009.

Our Board of Directors is divided into three classes as described below:

Classes	No. of Directors	Term to expire at the Annual General Meeting to be held in
Class I	3	2015
Class II	3	2013
Class III	3	2014

At each Annual General Meeting of the shareholders of the Company, one class of Directors will be elected for a full term of three years to succeed that class of Directors whose terms shall be expiring. The three-year-cycle relating to the appointment and tenure of each class of Directors referred to above is

a continuous rolling cycle, commencing for the second time in the year following the third year of the cycle. Shareholders may only appoint or remove directors at such time in the cycle as they are due for re-election.

The following persons were elected to the Board of Directors in accordance with the class designated against their names:

Name of Director	Age	Position	Class designation
Martin E. Hansen	72	Director	Class I
Maurice Dijols	61	Director	Class I
Anatoliy Kozyrev	70	Director	Class I
Richard Matzke	76	Director	Class II
René Huck	65	Director	Class II
Richard Anderson	59	Director and Chief Financial Officer	Class II
The Earl of Clanwilliam	52	Chairman of the Board of Directors	Class III
Alexander Yu. Djaparidze	57	Director and Chief Executive Officer	Class III
Alexander Shokhin	61	Director	Class III

Richard Matzke and René Huck were appointed to the Board on 16 September 2010. The Earl of Clanwilliam, Alexander Yu. Djaparidze and Alexander Shokhin were appointed to the Board on 25 October 2011. Richard Anderson was appointed to the Board on 25 October 2011. Martin E. Hansen, Maurice Dijols and Anatoliy Kozyrev were appointed to the Board on 28 September 2012.



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Board business

During 2012 the key activities of the Board included:

Strategy	<ul style="list-style-type: none"> • review and discussion of the proposed five-year plan for 2013-2018; • review and discussion of various potential acquisitions and financings;
Governance and risk	<ul style="list-style-type: none"> • approval of the Company's full-year and interim results; • approval of the 2012 dividend; • reviews of the material financial and non-financial risks facing the Group's businesses; • receiving regular safety updates;
Performance monitoring	<ul style="list-style-type: none"> • receiving regular reports to the Board from the Chief Executive and the Company's management; • approval of the Group plan and budget for the 2012 financial year. • undertaking capital expenditure reviews, and reviews of potential acquisitions, as well as receiving reports on the Company's GDRs' market performance; • receiving, on a rolling basis, management presentations; • receiving feedback on meetings held with institutional investors;
Corporate responsibility	<ul style="list-style-type: none"> • receiving regular management reports on health, safety and environment issues; • receiving an update on the Group's anti-bribery policy and procedures; • conducting an annual self-evaluation of the Board's work;
People	<ul style="list-style-type: none"> • nomination of Mr Kozyrev as a Non-Executive Director; • consideration of senior succession planning and people development; • review and approval of the new compensation plan for senior management and 2013 Long-Term Incentive Compensation Plan.

Board meeting attendance

During 2012 the Company's Board of Directors held three meetings, on 14 February 2012, 22 May 2012 and 28 September 2012. All the Board members attended two meetings (on 14 February 2012 and 22 May 2012) in person. Mr Huck and Mr Kalyuzhny were absent from the meeting on 28 September 2012.

Periodically, Board meetings take place overseas; during the year under review, one of the meetings was held in Moscow. The Board visited the local office of BKE, one of the Company's subsidiaries in Russia, providing the Non-Executive Directors in particular with the opportunity to extend their knowledge of the Group and to meet local management and other employees.

Senior executives are invited, when appropriate, to attend Board meetings and to make presentations on the results and strategies of the Company and their business units. Papers and information for Board and committee meetings are generally provided to Directors for Board and committee meetings in advance to enable adequate preparation for thorough discussion at these meetings. This allows any Director who is unable to attend a meeting to provide comments to the Chairman, the Chairman of the relevant committee or the Company Secretary, who will then relay these comments to the relevant meeting.

Some decisions are taken between Board meetings by written resolution or consent in accordance with the Company's Articles of Association.

When Directors are not able to attend in person, video and teleconferencing facilities allow them to participate fully.

Board appointment process

To ensure a rigorous and transparent procedure, any new candidate for nomination as a Director is considered by the Board as a whole, on the recommendation of the Remuneration and Nomination Committee. The nomination process involves considering the existing balance of skills and experience, and a continual process of assessing the needs of the Company. Non-Executive Directors are required to devote sufficient time to the Company's affairs. Successful candidates are subject to election at the Annual General Meeting.

Role and authority of the Board

The Company is controlled through its Board. The Board's main roles are to manage the Company with the objective of maximising shareholder value, setting the general business strategy of the Company and overseeing decision-making and risk management processes within the Company. The Board is governed by its Charter, which is posted on the Company's website.

The Board reserves to itself certain key matters to approve or monitor, such as the Company's business plans, annual budget, significant capital expenditures, as well as the Company's operating and financial performance. The Directors are provided with regular information on the Company's performance and activities and meet on a regular basis. Meetings include a formal schedule of matters specifically reserved for the Board's decision. Additional special meetings of the Board may be called as necessary.



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Information and professional development

As required by the Code, all Directors have access to the advice and services of the Company Secretary, and any Director wishing to do so in furtherance of his duties may take independent professional advice at the Company's expense. In the year ended 31 December 2012, only members of the Nomination and Remuneration Committee sought independent professional advice, i.e. employed the services of a professional firm, in the valuation of compensation for the purposes of the Nomination and Remuneration Committee's evaluation of the Company's compensation structure. In order to discharge their duties, Directors are provided with access to papers prior to Board meetings and Directors are free to seek any further information they consider necessary. In addition, between Board meetings, Directors have access to the Company's officers and employees in order to progress the Company's business.

In order to facilitate the Directors' fulfilment of their responsibilities regarding continuing education and to enhance each Director's knowledge of the Company, the Company's business operations and the latest developments in corporate governance, the management provides Directors with the following:

- access to, or notice of, continuing educational programmes that are designed to keep Directors abreast of the latest developments in corporate governance matters and critical issues relating to the operation of public company boards;
- material that contains information pertaining to (i) the Company's industry and (ii) comparisons of the Company with its major competitors; and
- reports and presentations from various advisors of the Company on its business.

Chairman and Chief Executive

There is a clear division of responsibilities between the Chairman and the Chief Executive Officer. The Board is chaired by The Earl of Clanwilliam. The Chairman is responsible for leadership of the Board, ensuring its effectiveness in all aspects of its role, setting its agenda and implementing the Board's resolutions, as well as for coordination of operational activities with the Chief Executive Officer with an objective of delivering value to the shareholders.

Dr Alexander Djaparidze is the Company's Chief Executive Officer. The CEO is responsible for formulating strategy and for ensuring its delivery once agreed upon by the Board. The Chief Executive Officer is appointed by the Board to manage the Company and to supervise and hold accountable all EDC operations personnel. The Chief Executive Officer has authority on all matters of management and is accountable for all duties and responsibilities delegated by the Board for the performance of the Company. The Chief Executive Officer is primarily responsible for new business development, communicating with shareholders and analysts and all other areas of day-to-day management of operations of the Company. In doing so, he works with the executive management team, which comprises Vice Presidents and certain other senior executives.

Company Secretary

The Company Secretary is Mr Douglas Stinemetz, who is also a General Counsel of the Company and a partner with The Stinemetz Law Firm. Mr Stinemetz supports the Chairman in the delivery of the corporate governance agenda, in particular in the planning of agendas for the Board and Committee meetings, and in ensuring that information is made available to Board members on a timely basis. He advises the Directors on Board procedures and corporate governance matters. During 2012,

Mr Stinemetz responded to various consultations on the evolving global governance and reporting agenda on behalf of the Group. He also engaged with shareholders to ensure they fully understood the Company's governance and remuneration arrangements.

Board evaluation

The Board of Directors undertakes an annual evaluation to assess the performance of the Board as a whole, its Committees and individual Directors, with the aim of improving the effectiveness of the Board and its members and the performance of the Company.

In 2012, the performance of the Board and its committees was evaluated using a questionnaire-based self-assessment process. The assessment was discussed with the full Board at its meeting. The assessment focused on consideration and discussion of the Board's contribution to the Company; the nature and level of its interaction with the Company's management; the quality, quantity and scope of information which flows to the Board from management, and the way in which it flows; the content of Board meetings and presentations to Board meetings; the practical arrangements for the work of the Board; the work and operation of the Board's committees; and the areas in which the Board or management believes that the Board could improve. Overall, Board members concluded that the Board and its committees were operating in an effective and constructive manner.

Insurance

In accordance with the Code, the Company maintains Directors' and officers' insurance in respect of the Directors' duties as directors, which is renewed on an annual basis.

Board committees

The principal committees of the Board are the Audit and Finance, Remuneration and Nomination, Corporate Governance and Safety Committees. We believe that our Audit and Finance Committee serves the same function as the audit committee recommended by the Code and that our Remuneration and Nomination Committee serves the same function as the remuneration committee and the nominations committee recommended by the Code. We are not currently able to comply with the requirements of the Code in relation to the composition of the audit committee and the remuneration committee.

Our Audit and Finance Committee comprises of five members: Mr Martin Hansen, the Chairman and our former Chief Financial Officer, The Earl of Clanwilliam, Mr Anatoly Kozyrev, Mr Richard Anderson, our Chief Financial Officer and Mr Alexander Shokhin, who, although a Non-Executive Director, is not strictly independent for the purposes of the Code.

Our Remuneration and Nomination Committee is comprised of four members: Mr Dijols, the Chairman, who, although a Non-Executive Director, is not strictly independent for the purposes of the Code, Dr Djaparidze, our Chief Executive Officer, and The Earl of Clanwilliam and Mr Huck, who are Non-Executive Directors and are independent for the purposes of the Code.

Our Corporate Governance Committee comprises of three members: The Earl of Clanwilliam, the Chairman, Mr Matzke and Mr Kozyrev, who are Non-Executive Directors and are independent for purposes of the Code.

Our Safety Committee comprises three Board members, Mr Huck, The Earl of Clanwilliam and Mr Dijols, and two members from management, Mr Sampiev and Mr Vasilev.



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We will seek to modify the composition of our committees over time as further appointments are made to our Board of Directors.

Each of the committees has terms of reference under which authority is delegated by the Board.

The terms of reference for each committee can be found at: www.eurasiadrilling.com/corporategovernance.html

The Board delegates specific responsibilities to committees as described below.

Audit and Finance Committee

The Company's Audit and Finance Committee consists of five members: Mr Hansen, Mr Anderson, The Earl of Clanwilliam, Mr Kozyrev and Mr Shokhin. The Committee is chaired by Mr Hansen. The Audit and Finance Committee convenes as often as necessary. The Committee is authorised to carry out the following functions relating to the control of the Company's financial and business operations:

- coordinate with the Company's independent auditors and prepare recommendations for its Board of Directors in connection with the election and removal of the independent auditors and on the fee and scope of services to be provided by the independent auditors;
- assess the independent auditors' reports;
- review the Company's standards and internal controls procedures and make appropriate reports and recommendations to the Company's Board of Directors;
- assess the Company's financial reports;
- review and approve budgets and business plans, as well as the process for developing budgets and business plans;
- review and approve intercompany financings; and
- review and approve any financing transactions with a value in excess of US \$50 million.

Remuneration and Nomination Committee

The Company's Remuneration and Nomination Committee consists of four members: Mr Dijols, The Earl of Clanwilliam, Dr Djaparidze and Mr Huck. The Committee is chaired by Mr Dijols. The Committee is responsible for establishing and implementing a policy for the compensation of Directors, consultants and members of senior management, which may take the form of cash, stock options granted pursuant to stock option plans and other benefits. More detailed information about the Remuneration and Nomination Committee is given in the Remuneration report on pages 49 to 51.

Corporate Governance Committee

Our Corporate Governance Committee consists of three members: The Earl of Clanwilliam, Mr Kozyrev and Mr Matzke. The Committee is chaired by The Earl of Clanwilliam. The Corporate Governance Committee is responsible for assisting and advising the Board of Directors with respect to matters relating to the general operation of the Board of Directors, corporate governance and the performance of the Board of Directors and individual Directors. To ensure compliance with the Company's obligations under the Listing Rules (including the obligations under the Disclosure and Transparency Rules) of the United Kingdom Listing authority (UKLA), to preserve the Company's reputation for integrity and ethical conduct and to avoid improper conduct by anyone associated with the Company, the Company introduced a Corporate Disclosure Policy, a Share Dealing Policy, Anti-Bribery Compliance Policy, as well as the Enforcement Policy and Procedures. The Company has also established a Disclosure Committee. More detailed information about the above corporate policies is given in the Directors' report on pages 47 to 48.

Safety Committee

Our Safety Committee is comprised of three Board members, Mr Huck, The Earl of Clanwilliam and Mr Dijols, and two members from management, Mr Sampiev and Mr Vasilev. The Committee is chaired by Mr Huck.

The Safety Committee is responsible for evaluating the effectiveness of the Company's policies and systems for identifying and managing health, safety and environmental risks within its operations, as well as for ensuring compliance with health, safety and environmental regulatory requirements. It receives on behalf of the Board, reports from management concerning any fatalities and/or serious accidents within the Company and any resulting action. The Committee also reviews any strategies and action plans developed by management in response to issues raised and, where appropriate, makes recommendations to the Board concerning the same.

Based on Safety Committee recommendations, the Company has taken several new initiatives to promote health and safety internally: it had (1) developed and implemented a new QHSE system (2) hired an experienced specialist in drilling health and safety management to head the Company's HSE Department in Moscow and (3) introduced a new reporting system for accidents.

Relationship with shareholders

The Company is a strong proponent of transparency, best practice disclosure, consistent communication and equal and timely dissemination of information to shareholders.

The Company continues to increase its communication with shareholders, investors and brokers. Presentations are made to analysts, the press and institutional investors at the time of the announcement of the full-year and half-year results. The Company, principally through the Chief Executive Officer, Chief Financial Officer and Vice President Marketing and Investor Relations, maintains a regular dialogue with institutional shareholders and financial analysts, particularly following the interim and preliminary results announcements.

The Company has a website www.eurasiadrilling.com on which it publishes its press releases, Stock Exchange announcements, announcements of conference calls with shareholders and other information concerning the Company's business, and upon which it also publishes its annual and interim results. The Annual General Meeting is the principal forum for dialogue with private shareholders. Shareholders may obtain copies of annual and interim reports upon request. A business presentation is made by the Chief Executive Officer and there is an opportunity for shareholders to put questions to the Directors.



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Internal controls

The Board has overall responsibility for the Company's system of internal controls and for reviewing its effectiveness, while the implementation of internal control systems is the responsibility of the Company's management. However, such a system can only manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss. The Board maintains full control over strategic, financial, operational and compliance issues. Within the overall objectives set by the Board, the management of the Company is delegated to the Chief Executive Officer, who is assisted by the Company's management. The responsibilities of the Company's management include:

- the development and recommendation of strategic plans for consideration and approval by the Board that reflect the longer-term objectives and priorities established by the Board;
- implementation of the strategies and policies of the Company as determined by the Board;
- monitoring of the operating and financial results against the plans and budgets;
- prioritising the allocation of technical and human resources;
- developing and implementing risk management systems; and
- managing and monitoring health, safety and environmental matters.

In addition, the Company's policies contain a statement on business conduct, which emphasises the legal, ethical and moral standards that have to be employed in all of the Company's business dealings. The Company expects the highest standards from all employees and key suppliers.

Statement of compliance with the Code

The Directors believe the Company has complied with the provisions set out in the Code, except as set out above in this report. The Directors are of the opinion that these areas of non-compliance do not prejudice shareholders' interests and are justifiable given the specific circumstances of the Company.

Going concern

The Directors are satisfied that the Group has adequate resources to continue to operate for the foreseeable future and have adopted the going concern basis in preparing the financial statements.

Greater than 10% shareholdings

As of 31 December 2012, the following are shareholders who, to the Company's knowledge, own, directly or indirectly, over ten per cent (10%) of the Company's issued and outstanding shares:

Alexander Putilov	22.70% ¹
Alexander Djaparidze	14.48% ²

¹ Mr Alexander Putilov is the beneficial owner of the shares held by Burned Sun Limited, through his ownership of Burned Sun Limited.

² Dr Djaparidze is Chief Executive Officer as well as a member of the Board of Directors of the Company. His shareholding includes shares owned by The Patrimony 2012 Trust, by Mr Djaparidze directly and by Margin Finance Company Limited.

Results of 2012 Annual General Meeting of shareholders

On 28 September 2012, the Company held its annual shareholders' meeting in Cannes, France. The primary business brought before the meeting consisted of two proposals. The first proposal sought re-election and appointment of Class I Directors. The second proposal sought shareholder approval of the appointment of KPMG as the Company's independent auditor.

The first proposal (election of Class I Directors: Mr Hansen, Mr Dijols and Mr Kozyrev) was approved by about 86%, 87% and 97% of the shares voting, respectively, while the second proposal was passed by about 99% of the shares voting. Approximately 87.5% of the total issued and outstanding shares of the Company voted at the meeting either in person or by proxy.

Auditors' fees for 2012

The Company's independent auditing firm is ZAO KPMG, a company incorporated under the laws of the Russian Federation and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. During 2012 the Company paid ZAO KPMG US \$1,385,924 (net of VAT) for auditing services. The firm provided no material non-audit services to EDC during 2012.



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Statement of Directors' responsibilities in respect of the Annual Report and the financial statements

The Directors are responsible for preparing the Annual report and the Company financial statements in accordance with applicable law and regulations. Our corporate affairs are governed by our amended and restated memorandum of association (the 'Memorandum of Association'), the amended and restated articles of association (the 'Articles of Association') and by the Companies Law (2010 Revision) (the 'Companies Law') and the common law of the Cayman Islands. As noted in the Corporate Governance report, because the Company is incorporated in the Cayman Islands, it is not subject to UK corporate governance requirements. However, because the Company intends to comply with established best practice, wherever possible and where it is in the Company's interests, the Company has applied the Principles of Good Governance as set out in the Corporate Code, except where indicated within this report. The Company's audited consolidated financial statements and the accompanying notes have been prepared in accordance with US GAAP.

In preparing the Company's financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with US GAAP; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with US GAAP. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other applicable or controlling jurisdictions. To the best of the Directors' knowledge:

- (a) the financial statements prepared in accordance with US GAAP give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and its consolidated undertakings; and
- (b) the Annual report includes a fair review of the development and performance of the Company's business and the position of the Company and its consolidated undertakings as a whole, together with a description of the principal risks and uncertainties it faces.



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Directors' report

This report is submitted for the year ended 31 December 2012.

Activities, profits and dividends

The principal activities of the Company continue to be onshore and offshore drilling services in Russia and in the Caspian Sea, as well as onshore integrated well construction and workover services. The Company's profit for the year amounted to US \$382 million (2011: US \$283 million).

For the year ended 31 December 2012 the Board of Directors declared an ordinary dividend on 12 December 2012 in the amount of 70 cents per share or US \$103 million which was included in 'Accounts payable and accrued liabilities' and paid on 18 January 2013. In 2011 a dividend of 47 cents per share or US \$69 million was declared and paid early in 2012.

Further descriptions of the Company's development and performance during the year, position at the year-end and likely future prospects are reviewed in the Chairman's Statement, the Chief Executive's Statement, in the Management's discussion and analysis of financial condition and operational results on pages 15 to 35, the Corporate governance report on pages 41 to 45, and the Remuneration report on pages 49 to 51, which are incorporated into this Directors' report as if set forth herein.

Share capital and major shareholders

The Company's share capital and major shareholders are set forth in the Notes to consolidated financial statements on pages 58-75 the Corporate governance report on pages 41-45 and the Remuneration report on pages 49-51.

Retirement and re-election of Directors

In accordance with the Articles of Association, the Company's Board of Directors is divided into three classes. Each Director holds his office for a term of three years, such terms being staggered in accordance with resolutions adopted at the Company's Annual General Meeting held on 9 September 2009. Pursuant to the Articles of Association, one-third of the Directors of the Company are required to retire by rotation at each Annual General Meeting (AGM). The retiring Directors are eligible to stand for re-election.

At the 2012 Annual General Meeting, Mr Hansen, Mr Dijols and Mr Kozyrev were elected as Class I Directors on 28 September 2012.

Company policies

The Directors have adopted several policies applicable to the Directors, officers and employees of the Company as summarised below.

Corporate Disclosure Policy summary

The Company has adopted a Corporate Disclosure Policy, a copy of which is available on the Company's website. The Corporate Disclosure Policy regulates the disclosure of information about the Company to the public. The purpose of the Policy is to raise awareness among the Board of Directors, senior management and employees of the Company. This Corporate Disclosure Policy does not derogate from the Company's existing policies and practices regarding confidential information.

A disclosure committee (the 'Disclosure Committee') has been established with responsibility for overseeing the Company's disclosure practices and consists of the Chief Executive Officer, Chief Financial Officer and General Counsel of EDC. Confidential information about or related to the Company must not be disclosed to third parties except in accordance with the Corporate Disclosure Policy. The Corporate Disclosure Policy provides examples of what may constitute confidential information, which depending upon the circumstances may include, but are not limited to the following: (i) changes in corporate structure; (ii) changes in capital structure; (iii) changes in financial results; (iv) changes in business operations; (v) acquisitions and dispositions; and (vi) changes in credit arrangements.

Share Dealing Policy summary

The Company has adopted a Share Dealing Policy, a copy of which is available on the Company's website. The Share Dealing Policy forbids dealing in the Company's shares based on material non-public information, i.e. insider trading and similar offences. The purpose of the Share Dealing Policy is to ensure compliance with the law, to preserve the Company's reputation for integrity and ethical conduct and to avoid improper conduct by anyone associated with the Company. The Share Dealing Policy makes the Company's Directors, officers and employees aware that they are all personally responsible for ensuring the Company's strict compliance with this Policy and that any breach of it will be treated as a disciplinary offence with the severest consequences. The Policy establishes certain procedures and requires all persons to consult with the General Counsel of the Company before taking any action that may be covered by the Policy.



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Policy and practice on payment of suppliers

As a result of the nature of the Company's business, its contractual relationships with suppliers of goods and services and with subcontractors vary according to circumstances. It is the Company's policy to enter into an appropriate form of contractual agreement on payment terms and to pay according to those terms. The Company does not follow any particular code or practice for the payment of creditors. In practice, the Company makes every effort to pay accordingly when it can be confirmed that the supplier has provided the goods or services in accordance with the relevant terms of the contract.

Anti-bribery Compliance Policy summary

It is the policy of EDC to comply with applicable laws against bribery, including the UK Bribery Act 2010 which came into force on 1 July 2011, the Foreign Corrupt Practices Act and other relevant legislation, and prohibit the taking of bribes. The Anti-bribery Compliance Policy is intended to serve as a preventive and teaching tool, to assist in recognising and avoiding potential conflicts with and violations of anti-bribery laws. The Anti-bribery Compliance Policy applies to all levels of the Company's business across all the jurisdictions in which the Company does business. The Company requires all the Company's directors, officers, managers, employees, agents, sales representatives, contractors, joint venture

partners and all other parties carrying out services and acting on behalf of and with the authority of the Company to comply with the Anti-bribery Compliance Policy, including: (i) not to offer, promise, pay and/or request and accept bribes or anything designed to create an undue advantage or improper influence, and (ii) to report any incidents of bribery as required by the Anti-bribery Compliance Policy and by law to the Company's compliance officer and/or outside legal counsel.

Enforcement Policy and Procedures

The Enforcement Policy and Procedures ('EPP') of the Company set out EDC's policy and procedures for processing allegations of corruption in relation to activities of the Company, including procurement of contracts, and dealings with the administrative authorities of the territories in which EDC operates.

Significant agreements

The Directors are not aware of any significant agreements to which the Company and/or any of its subsidiaries or associates is a party that take effect, alter or terminate upon a change of control of the Company following a takeover bid, save that a subsidiary that ceased to be a subsidiary of the Company would cease to benefit from the Company's financing arrangements.

Annual General Meeting

The Directors have scheduled an Annual General Meeting of the Members of the Company for 23 September 2013 in St Tropez, France. Details of the resolutions to be proposed at the Annual General Meeting are given in the Notice of Annual General Meeting, which is published separately and sent to shareholders. The Directors consider that all of the resolutions set out in the Notice of Annual General Meeting are in the best interests of the Company and its shareholders as a whole and recommend that shareholders vote in favour of each of them.

Auditors

During the year KPMG Limited remained as the Company's independent auditors. KPMG Limited have expressed their willingness to continue in office. Accordingly, a resolution to reappoint KPMG Limited as the Company's independent auditor will be proposed the forthcoming Annual General Meeting.



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Remuneration report

This Remuneration report for the year ending 31 December 2012 sets out how the principles of the UK Corporate Governance Code (the 'Code') relating to Directors' and senior management remuneration are applied. The Board believes that the Company was generally compliant with the provisions of the Code relating to management remuneration throughout the period, except where indicated within this report.

Remuneration of the Board of Directors

Board member remuneration for the Company consists of a stipend plus reimbursement for each Director's actual expenses incurred in attending the Company's Board meetings. The stipend paid to each Board member for 2012 was as follows:

Name	Amount
The Earl of Clanwilliam	\$187,500
Maurice Dijols	\$168,750
René Huck	\$112,500
Alexander Djaparidze	\$112,500
Alexander Shokhin	\$112,500
Martin Hansen	\$112,500
Richard Anderson	\$112,500
Richard Matzke	\$112,500
Victor Kalyuzhny	\$84,750
Anatoly Kozyrev*	N/A

* Anatoly Kozyrev joined EDC's Board of Directors in September 2012. The cash stipend for his service in 2012 was paid in 2013.

At its December 2008 meeting the Board adopted a policy by which Board members could elect to receive the value of their yearly stipend in either cash or shares of the Company's stock, valued at the previous year-end closing price. Certain of the Directors chose the share option for 2012. Non-Executive Directors do not receive any performance-related bonuses, pensions, share options or other forms of benefit. The Board may grant

extra remuneration to any Director who performs special services at the request of the Company. No such extra remuneration was granted in 2012.

Remuneration Committee

The Board has delegated to the Remuneration and Nomination Committee, through its terms of reference, consideration of executive remuneration issues generally, including the use of share incentive plans. The Remuneration and Nomination Committee comprises four members:

- Maurice Dijols, who, although a Non-Executive Director, is not strictly independent for purposes of the Code;
- The Earl of Clanwilliam, Chairman of the Board and a Non-Executive Director whom the Company deems independent;
- René Huck, a Non-Executive Director whom the Company deems independent; and
- Alexander Djaparidze, a Director who is also the Company's Chief Executive Officer. Dr Djaparidze does not vote on his own compensation.

The terms of reference permit the Remuneration Committee to obtain its own external advice on any matter at the Company's expense. The Committee terms of reference are publicly available on the Company's website.

Remuneration policy for Executive Directors and senior management

The objective of the Company's remuneration policy is to ensure that Executive Directors and members of the senior management of the Company are provided with appropriate incentives to encourage enhanced performance and are, in a fair and responsible manner, rewarded for their individual contributions to the success of the Company. Dr Djaparidze, the Company's Chief Executive Officer, and Mr Anderson are the only Executive Directors. The Committee aims to provide a competitive remuneration package to attract, retain and

motivate senior management with the experience needed to shape and execute the Company's strategy and deliver shareholder value. The Committee takes account of external market data supplied by independent professional advisors and is sensitive to the wider scene, including pay and employment conditions elsewhere in the Company, especially when determining annual salary increases.

The Committee's policy is for a significant proportion of executive reward to be variable and dependent upon the Company's performance. Variable reward components provide an opportunity for higher levels of remuneration where this remuneration is supported by exceptional performance, whether at an individual level or in relation to the Company's short-term and longer-term business priorities. Variable rewards will continue to be provided through a balanced mix of performance-related elements. The annual bonus scheme supports operational objectives over the financial year, whilst the Company's schedule of awards under its 2007 Incentive Compensation Plan will reward superior performance over a longer period.

In 2012, the remuneration of senior management consisted of:

- Basic salary – which forms the major element of remuneration and is based on comparable positions in leading businesses of similar size and complexity.
- Annual discretionary bonus – which is based on achievement of Company profit targets, as well as other financial and non-financial measures and personal targets. The maximum bonus payout is fifty per cent (50%) of salary.
- 2007 Incentive Compensation Plan – under which the senior management may receive awards in an aggregate value of up to fifteen times (15x) each such person's annual salary and bonus, depending upon the increase in the price of the Company's GDRs over five years, payable in shares of the Company.

Further details of each element of the senior management's remuneration package, together with details of interests in shares, are set out below in this report.

Information on compensation of the Company's top five officers

The following table sets forth compensation for the Company's five most highly compensated officers employed on a full-time basis during 2012. In addition to the amounts set forth below, the Company reimburses its officers for their actual out-of-pocket expenses incurred while conducting the Company's business. This table does not include benefits under the Company's Incentive Compensation Plans, if any.

Name	Title	Total compensation paid in 2012 US \$
Murat Sampiev	Chief Operating Officer	997,000
Alexander Djaparidze	Chief Executive Officer	900,000
Edward Redd	Senior Vice President – Offshore Operations	774,986
Richard Anderson	Chief Financial Officer	600,000
Taleh Aleskerov	Senior Vice President, Finance	434,000



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Remuneration report *continued*

Management remuneration

(a) Basic salary and benefits

The Company structures remuneration packages which are appropriate to the particular function and level of responsibility of each individual member of senior management and which are designed to attract, retain and motivate such persons. It takes into account the remuneration structures and levels at other companies, in particular in the Russian oilfield services sector. Eligible members of senior management are also provided with insurance and other health benefits in accordance with market standards.

Senior management compensation for the period 1 January 2012 through 31 December 2012 in aggregate was approximately US \$5,325,986.

(b) Annual discretionary bonus scheme

The Company operates an annual discretionary bonus scheme under which eligible members of management are able to earn a discretionary bonus up to a maximum of fifty per cent (50%) of salary, dependent upon performance conditions being met. The bonus is payable in cash. Senior management discretionary bonuses for the period 1 January 2012 through 31 December 2012 in aggregate was approximately US \$1,833,000.

(c) Share incentive plan

It is the Remuneration and Nomination Committee's policy that senior management should participate in the Company's Incentive Compensation Plan as this scheme aligns their interests with those of our shareholders by linking the reward available to participants with increases in the overall price of the Company's GDRs. Details of the share incentive awards are set out below.

2007 Incentive Compensation Plan

In July 2007, the Board of Directors considered and approved the 2007 Incentive Compensation Plan (the 'Plan'). The Plan was adopted by the Board of Directors to reward certain corporate officers, Directors and key employees of the Company and certain independent consultants by enabling them to acquire ordinary shares of the Company and/or other awards, as the Remuneration and Nomination Committee of the Board of Directors deems appropriate. The Plan was designed to attract and retain key employees of the Company and its subsidiaries, to attract and retain qualified Directors of the Company, to attract and retain consultants and other independent contractors and to stimulate the active interest of such persons in the development and financial success of the Company and its subsidiaries. The Plan allowed the Company to issue ordinary shares in the Company up to five per cent (5%) of the total ordinary shares issued and outstanding on such terms and conditions as are, in the best judgment of the Board of Directors, necessary, appropriate, advisable or convenient in connection with the foregoing.

In March 2008, the Remuneration and Nomination Committee approved a schedule of awards under the Plan, similar to a phantom stock plan. Under this schedule of awards, eligible members of senior management are granted an opportunity during the period beginning 1 January 2008 and ending 31 December 2012 (the 'Performance Period') to earn incentive compensation awards (individually an 'Award' and collectively – 'Awards') in an aggregate value of up to fifteen times (15x) each such participant's annual compensation, meaning each participant's annual salary and bonus, calculated for each calendar year beginning 1 January and ending 31 December ('Award Year') within the Performance Period based on the participant's current salary and bonus at the Starting Date for such Award Year ('Annual Compensation').

Starting Date means the date one year prior to the last trading day on the London Stock Exchange (LSE) prior to the end of the applicable Award Year (the 'Target Date'). Each Award Year, the Award is an amount equal to the participant's respective annual compensation times fifteen (x15) multiplied by the applicable Annual Available Award Percentage for the Award Year and then multiplied by the applicable Annual Award Percentage Reached for the Award Year. Annual Available Award Percentage means a percentage set forth in the table below, indicating how much Annual Compensation is available for an Award each Award Year if a Target Price Increase (i.e. percentages listed below for target increases in the Company's GDR price each Award Year) is realised. Annual Award Percentage Reached means the percentages set forth below, indicating what percentage of the available Annual Compensation shall be granted as an Award each Award Year if an applicable Target Price Increase is realised.

Pursuant to the Incentive Plan, the terms and conditions of each Award are to be set forth in an award agreement between the participant and the Company, incorporating the terms of the Incentive Plan and its Exhibits. Awards may be earned by the participants each Award Year upon the Company's GDR price reaching certain Target Price Increases. No such Award is to be made if such Target Price Increases are not achieved. The Target Price Increase achieved in any Award Year will be calculated based on the percentage increase of (i) the average sale price per GDR, quoted by the LSE, for the twenty (20) trading days preceding the Target Date over (ii) the Starting Price.

Column A of the table below sets out five (5) possible Target Price Increases for each Award Year of the Performance Period. Column B states the Annual Award Percentage Reached upon achievement of the applicable Target Price

Increase for such Award Year.

Column A	Column B
	Annual award percentage
Target Price Increase reached	
Below 5% increase in the Starting Price	0%
From 5% up to 10% increase in the Starting Price	25%
From 10% up to 15% increase in the Starting Price	50%
From 15% up to 20% increase in the Starting Price	75%
20% or more increase in the Starting Price	100%

The Award will be made in un-equal instalments each Award year during the Performance Period in accordance with the table below, in which (i) Column C represents the applicable Award Year and (ii) Column D represents the Annual Available Award Percentage of Annual Compensation available to calculate the Award in such Award Year.

Column C	Column D
Award Year percentage	Annual available award
2008	12%
2009	15%
2010	18%
2011	25%
2012	30%
Total:	100%

Each participant's right to such Award vests on the earliest of (i) the calendar day which is immediately after the applicable Target Date, provided that the participant on that date is still employed or otherwise in good standing with the Company and/or its affiliates. The Company will pay the participant such Award within thirty (30) days of the date it vests (the 'Payment Date').



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Remuneration report *continued*

If a participant's employment with the Company or its affiliates is terminated on or prior to a Target Date or such participant is deemed not in good standing as may be determined by the Company from time to time in its sole discretion on or prior to a Target Date, such participant will forfeit any Award and shall have no right to receive any Award arising on such Target Date.

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

Interests of Directors and senior management in the Company

As of 31 December 2012, the Directors and certain senior management of the Company, to the Company's best knowledge, had the following interests in shares of the Company:

Directors and senior management	Shares (including GDRs)	Percentage of shares
Alexander Djaparidze ¹	21,250,559	14.48%
Alexander Bogachev	179,004	0.12%
Martin Hansen	174,039	0.12%
Taleh Aleskerov	135,684	0.09%
W. Richard Anderson	101,927	0.07%
Eddy Redd	31,400	0.02%
Doug Stinemetz ²	24,571	0.02%
The Earl of Clanwilliam	7,350	0.01%
Richard Matzke	7,787	0.01%

1. Alexander Djaparidze is a Director, as well as Chief Executive Officer. Alexander Djaparidze was the beneficial owner of an aggregate of 21,250,559 shares. Alexander Djaparidze owned directly 2,716,307 shares. A familial trust of Alexander Djaparidze was a beneficial owner of 18,489,172 shares, which included 1,570,000 shares through its ownership of Margin Finance Company Limited.

2. S. Douglas Stinemetz, our General Counsel and Secretary, was a beneficial owner of 24,571 shares through his ownership of Eagle Eye Holdings, Inc.

As of 31 December 2012, no other Directors, to the Company's best knowledge, had interests in shares in the Company. As of 31 December 2012, there were no options or other commitments to issue additional shares in the Company apart from any disclosed above.

2013 Long-Term Incentive Compensation Plan

In 2012, the Remuneration and Nomination Committee conducted a thorough review of executive compensation and incentives in the Company, consulting widely with its key senior officers and Directors. Following the completion of this consultation process, the Board approved the new 2013 Long-Term Incentive Compensation Plan ('2013 Plan') to be effective 1 January 2013.

The 2013 Plan was adopted by the Board to provide incentives and reward certain eligible officers of the Company whose present and potential contributions are important to the success of the Company, by offering them an opportunity to participate in the Company's future performance through the grant of Cash Awards and/or Share Awards as the Committee deems appropriate.

Pursuant to the 2013 Plan, each Award Year (a calendar year commencing 1 January and ending 31 December each year within the validity of the Plan), the Company's named executive officers (the 'Participants') are eligible to receive Cash Awards and/or Share Awards if the Company achieves a target increase in its earnings per share (EPS). The target EPS is set annually by the Board of Directors of the Company based on recommendations from the Company's management.

Awards are payable to the Participants based on a percentage of their respective annual salary and bonus, calculated for each Award Year based on the Participants' current salary and bonus at the beginning of such Award Year (the 'Annual Compensation') and such officer's position (as set forth in the chart below).

The chart below states four (4) target EPS Increases for each Award Year and the Annual Award Percentage upon achievement of the applicable Target EPS Increase for such Award Year. The Award is then based on the range of EPS performance actually achieved between the target levels. At Grade A level, the Award opportunities under the Plan range from 100% to 250% of Annual Compensation. At Grade B level, Award opportunities range from 85% to 225% of Annual Compensation and from 75% to 200% for Grade C.

If EPS Target is	0%<T<5%	5%<T<10%	10%<T<15%	>15%
Grade A	100%	150%	200%	250%
Grade B	85%	125%	175%	225%
Grade C	75%	115%	150%	200%

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

Payment of Awards may be made in the form of cash or ordinary shares, or a combination thereof, and may include such restrictions as the Committee shall determine, in the case of ordinary shares, restrictions on transfer and forfeiture provisions.

If Cash Awards are granted, the Company shall pay the Participant such Award within thirty (30) days of the date it vests (the 'Payment Date'). At the election of the Company, each Participant may receive the Award in Shares/GDRs rather than cash. In the case of such an election, the Participant shall receive the Award in GDRs from the Company valued at the average closing price per GDR, quoted by the LSE, for the twenty (20) trading days preceding the Payment Date. The Company shall issue or otherwise cause such GDRs to be transferred to the Participant within thirty (30) days of the Payment Date.



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Independent auditors' report

To the Board of Directors

Eurasia Drilling Company Limited

We have audited the accompanying consolidated financial statements of Eurasia Drilling Company Limited and its subsidiaries, which comprise the consolidated balance sheets as of 31 December 2012, 2011 and 2010, and the consolidated statements of comprehensive income, stockholders' equity and cash flows for 2012, 2011 and 2010, and the related notes to the consolidated financial statements.

Management's responsibility for the consolidated financial statements

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

Auditors' responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Eurasia Drilling Company Limited and its subsidiaries as of 31 December 2012, 2011 and 2010, and the operational results and their cash flows for 2012, 2011 and 2010 in accordance with US generally accepted accounting principles.

Usov A.I.

Director, Power Of Attorney dated 1 October 2010 No. 52/10
ZAO KPMG

29 March 2013
Moscow, Russian Federation

Audited entity: Eurasia Drilling Company Limited

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

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

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

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

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

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



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Consolidated balance sheets

as of 31 December 2012, 2011 and 2010
(all amounts in US \$ '000, unless otherwise noted)

	Note	2012	2011 (adjusted)	2010 (adjusted)
Assets				
Current assets				
Cash and cash equivalents	3	305,333	509,781	629,466
Accounts receivable, net	4	528,813	378,523	252,749
Inventories		213,058	190,727	127,918
Taxes receivable	12	27,201	33,146	34,960
Deferred income tax assets	12	11,175	3,710	11,472
Other current assets	8	13,792	42,719	20,241
Total current assets		1,099,372	1,158,606	1,076,806
Property, plant and equipment	5	1,768,119	1,286,125	765,184
Long-term accounts receivable	6	256	2,181	6,838
Deferred income tax assets	12	2,156	2,833	1,422
Goodwill	7, 17	107,998	105,399	32,727
Other non-current assets	8	57,154	48,672	70,830
Total assets		3,035,055	2,603,816	1,953,807

Liabilities and stockholders' equity

Current liabilities

Accounts payable and accrued liabilities		465,256	407,410	258,706
Advances received		2,288	3,766	20,295
Current portion of long-term debt	10	257,860	175,217	117,550
Taxes payable	12	90,276	69,030	54,257
Deferred income tax liabilities	12	6,499	5,340	478
Total current liabilities		822,179	660,763	451,286
Long-term debt	11	442,013	578,117	286,367
Accrued pension liability	13	15,598	11,216	6,889
Deferred income tax liabilities	12	92,639	49,376	24,744
Total liabilities		1,372,429	1,299,472	769,286

	Note	2012	2011 (adjusted)	2010 (adjusted)
Stockholders' equity				
Common stock	16	1,469	1,469	1,469
Treasury stock, at cost		(1,652)	(2,244)	(13,148)
Additional paid-in capital		684,398	680,198	691,535
Retained earnings		1,072,369	793,111	578,716
Accumulated other comprehensive loss		(93,958)	(168,190)	(74,051)
Total stockholders' equity		1,662,626	1,304,344	1,184,521
Total liabilities and stockholders' equity		3,035,055	2,603,816	1,953,807

W. Richard Anderson

CFO of Eurasia Drilling Company Limited
29 March 2013



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Consolidated statements of comprehensive income

for the years ended 31 December 2012, 2011 and 2010
(all amounts in US \$ '000, unless otherwise noted)

	Note	2012	2011 (adjusted)	2010 (adjusted)
Revenues				
Drilling and related services		3,222,830	2,734,444	1,808,905
Other sales and services		14,503	32,305	13,275
Total revenues		3,237,333	2,766,749	1,822,180
Cost of services, excluding depreciation and taxes	15	(2,151,336)	(1,906,256)	(1,204,333)
General and administrative expenses, excluding depreciation and taxes		(161,270)	(144,614)	(106,920)
Taxes other than income taxes		(134,733)	(119,181)	(72,547)
Depreciation		(249,987)	(213,492)	(144,241)
Gain (loss) on disposal of property, plant and equipment		4,786	(1,362)	6,344
Impairment loss	17	-	(1,296)	(7,096)
Income from operating activities		544,793	380,548	293,387
Interest expense		(53,661)	(52,342)	(15,125)
Interest income		12,094	11,485	7,993
Currency transaction gain (loss)		631	(11,054)	(7,355)
Gain on business exchange transaction	17	-	32,284	557
Other (expenses) income		(8)	6,495	(951)
Income before income taxes		503,849	367,416	278,506
Income tax expense	12	(121,840)	(84,045)	(71,680)
Net income		382,009	283,371	206,826

	Note	2012	2011 (adjusted)	2010 (adjusted)
Basic earnings per share of common stock (US dollars)		2,288	3,766	20,295
Diluted earnings per share of common stock (US dollars)	16	2.60	1.93	1.44
Diluted earnings per share of common stock (US dollars)	16	2.59	1.93	1.44
Other comprehensive income:				
Foreign currency translation gain (loss)		76,010	(92,089)	(7,498)
Pension benefits:				
Prior service cost		(931)	(561)	(1,535)
Actuarial (loss) gain		(847)	(1,489)	464
Other comprehensive income (loss)		74,232	(94,139)	(8,569)
Comprehensive income		456,241	189,232	198,257

W. Richard Anderson

CFO of Eurasia Drilling Company Limited
29 March 2013



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Consolidated statements of stockholders' equity

for the years ended 31 December 2012, 2011 and 2010
(all amounts in US \$ '000, unless otherwise noted)

	Common stock	Treasury stock, at cost	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income/(loss), net of tax	Total stockholders' equity
Balances as of 31 December 2009 (adjusted)	1,469	(58,332)	528,163	596,594	(65,482)	1,002,412
Net income (adjusted)	-	-	-	206,826	-	206,826
Other comprehensive loss (adjusted)	-	-	-	-	(8,569)	(8,569)
Comprehensive income (adjusted)	-	-	-	-	-	198,257
Sale of common stock	-	54,956	162,548	-	-	217,504
Purchase of treasury stock	-	(13,148)	-	-	-	(13,148)
Incentive compensation plan	-	-	4,200	-	-	4,200
Exercise of incentive compensation plan	-	3,376	(3,376)	-	-	-
Dividends declared	-	-	-	(224,704)	-	(224,704)
Balances as of 31 December 2010 (adjusted)	1,469	(13,148)	691,535	578,716	(74,051)	1,184,521
Net income (adjusted)	-	-	-	283,371	-	283,371
Other comprehensive loss (adjusted)	-	-	-	-	(94,139)	(94,139)
Comprehensive income (adjusted)	-	-	-	-	-	189,232
Purchase of treasury stock	-	(5,114)	-	-	-	(5,114)
Disposal of treasury stock	-	481	-	-	-	481
Incentive compensation plan	-	-	4,200	-	-	4,200
Exercise of incentive compensation plan	-	15,537	(15,537)	-	-	-
Dividends declared	-	-	-	(68,976)	-	(68,976)
Balances as of 31 December 2011 (adjusted)	1,469	(2,244)	680,198	793,111	(168,190)	1,304,344
Net income	-	-	-	382,009	-	382,009
Other comprehensive income	-	-	-	-	74,232	74,232
Comprehensive income	-	-	-	-	-	456,241
Disposal of treasury stock	-	592	-	-	-	592
Incentive compensation plan	-	-	4,200	-	-	4,200
Dividends declared	-	-	-	(102,751)	-	(102,751)
Balances as of 31 December 2012	1,469	(1,652)	684,398	1,072,369	(93,958)	1,662,626



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Consolidated statements of cash flows

for the years ended 31 December 2012, 2011 and 2010
(all amounts in US \$ '000, unless otherwise noted)

	Note	2012	2011 (adjusted)	2010 (adjusted)
Cash flows from operating activities				
Net income		382,009	283,371	206,826
Adjustments for non-cash items:				
Depreciation		249,987	213,492	144,241
Accrued interest expense		–	2,586	2,893
Deferred income tax		34,307	27,747	8,635
(Gain) loss on disposal of property, plant and equipment		(4,786)	1,362	(6,344)
(Gain) loss on disposal of subsidiary		–	(32,284)	557
Impairment loss	17	–	1,296	7,096
Decrease in allowance for doubtful accounts receivable		(2,833)	(1,806)	(947)
Foreign currency exchange rate difference (unrealised)		1,546	8,097	3,862
Incentive plan		4,200	4,200	4,200
All other items – net		3,186	368	(651)
Changes in operating assets and liabilities:				
Accounts receivable		(126,878)	(113,378)	(51,104)
Inventories		(10,527)	(51,191)	(18,941)
Taxes receivable and payable		29,300	26,671	1,846
Other current assets and liabilities		32,588	(31,157)	(4,792)
Accounts payable and accrued liabilities		2,000	103,319	42,015
Advances received		(1,644)	(16,964)	(16,839)
Net cash provided by operating activities		592,455	425,729	322,553
Cash flows from investing activities				
Purchases of property, plant and equipment		(616,499)	(417,873)	(224,970)
Change in restricted cash	8	(3,400)	17,919	(58,807)
Proceeds from sale of property, plant and equipment		11,121	14,034	8,190
Disposal of subsidiary, net of cash disposed	17	–	95,374	767
Loans issued		(20,637)	–	(7,238)
Loan principal collections		17,136	1,021	–
Acquisition of subsidiaries, net of cash acquired	17	–	(559,340)	(43,132)
Investment in associate		(5,643)	–	–
Net cash used in investing activities		(617,922)	(848,865)	(325,190)

	Note	2012	2011 (adjusted)	2010 (adjusted)
Cash flows from financing activities				
Proceeds from issuance of short-term debt		–	90,000	–
Principal repayments of short-term debt		–	(90,000)	–
Proceeds from issuance of long-term debt		25,729	465,649	255,193
Principal repayments of long-term debt		(153,893)	(67,808)	(40,037)
Repayment of capital lease obligations		–	–	(538)
Dividends paid		(68,976)	(45,387)	(212,786)
Proceeds from sale of treasury stock		–	–	217,504
Purchase of treasury stock		–	(5,114)	(13,148)
Net cash (used in) provided by financing activities		(197,140)	347,340	206,188
Effect of exchange rate changes on cash		18,159	(43,889)	(7,809)
Net (decrease) increase in cash and cash equivalents		(204,448)	(119,685)	195,742
Cash and cash equivalents at beginning of period		509,781	629,466	433,724
Cash and cash equivalents at end of period	3	305,333	509,781	629,466
Supplemental disclosures of cash flow information				
Interest paid		50,706	46,286	11,910
Income tax paid		92,294	55,394	57,145



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Notes to the consolidated financial statements

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Note 1. Organisation and environment

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

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

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

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

As of 31 December 2012, 2011 and 2010 OOO Burovaya Kompaniya Eurasia had onshore operating branches in Kogalym, Perm, Usinsk and Zhirnovsk (Volgograd Region) in the Russian Federation.

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

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

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

In June 2010, the Group acquired a 100% interest in OOO Meridian which performs workover services in the Komi region (refer to Note 17).

In February 2011 the Group acquired a 100% interest in Caspian Sea Ventures International Limited (CSVI). The acquired company is the owner of a jack-up drilling rig operating in the Turkmen waters of the Caspian Sea (refer to Note 17).

In April 2011 the Group acquired a 100% interest in OOO Sibirskaya Geophysicheskaya Company (OOO SGC) and 100% in ZAO Samatlorsky KRS (ZAO SKRS). The acquired companies perform drilling and workover services in West Siberia (refer to Note 17).

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

The majority of the Group's revenues are currently derived from services provided to OAO LUKOIL and its affiliated entities (the 'LUKOIL Group') and as such, the Group is economically dependent upon its contractual agreements with the LUKOIL Group (refer to Note 21).

Business and economic environment

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

Basis of preparation

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

Note 2. Summary of significant accounting policies

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

Principles of consolidation

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

Use of estimates

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



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Note 2. Summary of significant accounting policies *continued*

Acquisitions

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

Functional and reporting currency

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

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

- all assets and liabilities were translated from the functional to the reporting currency at the exchange rate effective at the reporting date;
- equity items were translated from the functional to the reporting currency at the historical exchange rate;
- items in the statement of comprehensive income and cash flows were translated from the functional currency to the reporting currency at rates which approximate rates at the date of transaction.

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

The closing exchange rate as of 31 December 2012, 2011 and 2010 was 30.3727, 32.1961 and 30.4769 Russian rubles to one US dollar, respectively.

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

Cash and cash equivalents

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

Cash with restrictions on immediate use

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

Accounts receivable

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

Inventories

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

Property, plant and equipment

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

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

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

Goodwill

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



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Note 2. Summary of significant accounting policies *continued*

Impairment of long-lived assets

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

Leased assets

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

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

Income taxes

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

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

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

Interest-bearing borrowings

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

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

Pension benefits

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

Environmental expenditures

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

Revenue recognition

Drilling and related services

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

In 2012 the Group changed its revenue recognition policy from the units-of-delivery method to the percentage-of-completion method. This change was caused by the intention of the Group to convert from US GAAP to IFRS at some future date. Both methods are acceptable under US GAAP but the percentage-of-completion method is preferable as it provides more transparency and more regular recognition of income. The adjustments required to reflect this change in accounting policy are shown in the Comparative amounts sub-section of Note 2 on page 62.

The units-of-delivery method recognises as revenue the contract price of units of a basic production product delivered during a period, and as the cost of earned revenue the costs allocated to the delivered units; costs allocated to undelivered units were reported in the balance sheet as inventory or work in progress.



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Note 2. Summary of significant accounting policies *continued*

Revenue recognition *continued*

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

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

Other sales and services

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

All sales are shown net of value-added tax.

Treasury stock

Purchases by Group companies of the Company's outstanding stock are recorded at cost and classified as treasury stock within stockholders' equity. Authorised and issued stock includes treasury stock. Outstanding stock does not include treasury stock.

Earnings per share

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

Share-based payments

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

Commitments and contingencies

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

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

Changes in accounting policy

In September 2011, the FASB issued Accounting Standards Update ('ASU') No. 2011-08, '*Testing Goodwill for Impairment*,' which allows an entity to use a qualitative approach to test goodwill for impairment. This ASU permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount and hence whether it is necessary to perform the two-step goodwill impairment test as required by the provisions of Topic 350 of the Codification. ASU No. 2011-08 is effective for annual and interim goodwill impairment tests performed for the fiscal years beginning after 15 December 2011. The Group adopted the requirements of ASU No. 2011-08 starting from the first quarter of 2012. This adoption did not have a material impact on the Group's operational results, financial position or cash flows and did not require additional disclosures.

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 has the option to present the components of net income and comprehensive income in either one or two statements. The ASU eliminates the option in US GAAP to present other comprehensive income in the statement of changes in equity. ASU No. 2011-05 is effective for public entities for fiscal years, and interim periods within those years, beginning after 15 December 2011 (except those reclassification adjustments deferred by ASU No. 2011-12) and should be applied retrospectively. The Group adopted the requirements of ASU No. 2011-05 starting from the first quarter of 2012. This adoption changed the presentation of net and comprehensive income and stockholders' equity, but did not have any impact on the Group's operational results, financial position or cash flows.

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



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Note 2. Summary of significant accounting policies *continued*

Changes in accounting policy *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 the Codification. This ASU provides additional guidance in considering whether a restructuring constitutes a troubled debt restructuring and helps creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties. ASU No. 2011-02 is effective starting from the first interim or annual period beginning on or after 15 June 2011. The Group adopted the requirements of ASU No. 2011-02 starting from the third quarter of 2011. This adoption did not have a material impact on the Group's operational results, financial position or cash flows and did not require additional disclosures.

Recent accounting pronouncements

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

In January 2013, the FASB issued ASU No. 2013-01 '*Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*', which clarifies that ordinary trade receivables and payables are not in the scope of ASU No. 2011-11. The Group is evaluating the effect of the adoption of ASU No. 2011-11 but does not expect any material impact on its operational results, financial position or cash flows.

Comparative amounts

In 2012 the Group changed its revenue recognition policy from the units-of-delivery method to the percentage-of-completion method. This change was caused by the intention of the Group to convert from US GAAP to IFRS at some future date (see above in the Revenue recognition section of Note 2 on page 60).

The following prior period amounts have been adjusted to conform to the current period presentation.

Consolidated balance sheet

The following are the consolidated balance sheet captions as of 31 December 2011 as previously reported and adjusted:

	2011 as previously reported	Adjustment	2011 as adjusted
Accounts receivable, net	348,082	30,441	378,523
Inventories	214,434	(23,707)	190,727
Deferred income tax assets (current)	5,057	(1,347)	3,710
Retained earnings	787,250	5,861	793,111
Accumulated other comprehensive loss	(167,717)	(473)	(168,190)

The following are the consolidated balance sheet captions as of 31 December 2010 as previously reported and adjusted:

	2010 as previously reported	Adjustment	2010 as adjusted
Accounts receivable, net	235,360	17,389	252,749
Inventories	145,633	(17,715)	127,918
Deferred income tax assets (current)	11,407	65	11,472
Retained earnings	578,989	(273)	578,716
Accumulated other comprehensive loss	(74,063)	12	(74,051)

The retained earnings as of 31 December 2009 were adjusted from US \$596,340 thousand to US \$596,594 thousand.



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Note 2. Summary of significant accounting policies *continued*

Consolidated statement of comprehensive income

The following are captions of the statement of comprehensive income for the year ended 31 December 2011 as previously reported and adjusted:

	2010 as previously reported	Adjustment	2010 as adjusted
Revenue from drilling and related services	2,720,112	14,332	2,734,444
Cost of services	(1,898,246)	(8,010)	(1,906,256)
Taxes other than income taxes	(118,850)	(331)	(119,181)
Depreciation	(215,168)	1,676	(213,492)
Income tax expense	(82,512)	(1,533)	(84,045)
Net income	277,237	6,134	283,371
Basic (and diluted) earnings per share of common stock (US dollars)	1.89	0.04	1.93
Foreign currency translation loss	(91,604)	(485)	(92,089)
Comprehensive income	183,583	5,649	189,232

The following are captions of the statement of comprehensive income for the year ended 31 December 2010 as previously reported and adjusted:

	2010 as previously reported	Adjustment	2010 as adjusted
Revenue from drilling and related services	1,798,881	10,024	1,808,905
Cost of services	(1,195,891)	(8,442)	(1,204,333)
Depreciation	(142,000)	(2,241)	(144,241)
Income tax expense	(71,812)	132	(71,680)
Net income	207,353	(527)	206,826
Basic earnings per share of common stock (US dollars)	1.45	(0.01)	1.44
Foreign currency translation loss	(7,510)	12	(7,498)
Comprehensive income	198,772	(515)	198,257

Consolidated statement of cash flows

The following are captions of the statement of cash flows for the year ended 31 December 2011 as previously reported and adjusted:

	2010 as previously reported	Adjustment	2010 as adjusted
Net income	277,237	6,134	283,371
Depreciation	215,168	(1,676)	213,492
Deferred income tax	26,214	1,533	27,747
Accounts receivable, net	(98,111)	(15,268)	(113,379)
Inventories	(60,468)	9,277	(51,191)

The following are captions of the statement of cash flows for the year ended 31 December 2010 as previously reported and adjusted:

	2010 as previously reported	Adjustment	2010 as adjusted
Net income	207,353	(527)	206,826
Depreciation	142,000	2,241	144,241
Deferred income tax	8,767	(132)	8,635
Accounts receivable, net	(41,080)	(10,024)	(51,104)
Inventories	(27,383)	8,442	(18,941)

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

Note 3. Cash and cash equivalents

Cash and cash equivalents include the following:

	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
Short-term deposit – Russian rubles	128,295	194,771	154,730
Cash held in banks – Russian rubles	154,992	188,410	76,451
Cash held in banks – US dollars	19,118	81,770	357,911
Short-term deposit – US dollars	2,805	39,320	40,033
Other	123	5,510	341
Total cash and cash equivalents	305,333	509,781	629,466



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Note 4. Accounts receivable, net

Accounts receivable include the following:

	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
Trade accounts receivable	522,930	385,062	261,288
Advances given	18,460	8,062	8,737
	541,390	393,124	270,025
Allowance for doubtful accounts	(12,577)	(14,601)	(17,276)
Total accounts receivable, net	528,813	378,523	252,749

Note 5. Property, plant and equipment

Property, plant and equipment include the following:

	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
Machinery and equipment	2,121,620	1,524,661	964,134
Buildings	39,674	28,654	38,112
Vehicles	42,185	23,231	34,712
	2,203,479	1,576,546	1,036,958
Less: accumulated depreciation	(762,569)	(515,930)	(379,477)
Construction in progress	51,568	92,142	40,146
Advances given for property, plant and equipment	275,641	133,367	67,557
Total property, plant and equipment	1,768,119	1,286,125	765,184

Note 6. Long-term accounts receivable

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

	Stated interest rates	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
Long-term accounts receivable denominated in US dollars	6%	–	–	791
Long-term accounts receivable denominated in Russian rubles	0.00%-8.25%	256	2,181	6,047
Total long-term accounts receivable		256	2,181	6,838

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

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

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

Note 7. Goodwill

The movement in goodwill was as following:

Goodwill as of 31 December 2010	32,727
Goodwill acquired	110,458
Goodwill disposed	(30,628)
Cumulative translation adjustment	(7,158)
Goodwill as of 31 December 2011	105,399
Cumulative translation adjustment	2,599
Goodwill as of 31 December 2012	107,998

Note 8. Other current and non-current assets

The Group had restricted cash of US \$45.4 million, US \$42.0 million and US \$61.7 million included in other non-current assets as of 31 December 2012, 31 December 2011 and 31 December 2010, respectively. This amount collateralises the Company's issuance of commercial letters of credit.

The Group had additional restricted cash of US \$4.0 million, US \$1.4 million and US \$6.1 million included in other current assets as of 31 December 2012, 31 December 2011 and 31 December 2010, respectively. These amounts of US \$4.0 million and US \$1.4 million as of 31 December 2012 and 2011, respectively, collateralise the Company's issuance of a guarantee for a customer. The amount of US \$6.1 million as of 31 December 2010 consists of a bid bond in the amount of US \$1.0 million and a guarantee issued for a subcontractor in the amount of US \$5.1 million (refer to Note 19).

The Group had bank deposits with original maturities that exceeded three months in amount of US \$34.6 million included in other current assets as of 31 December 2011.



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Note 9. Obligations under capital leases

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

Included in machinery and equipment and vehicles is nil, nil and US \$2.4 million of assets under capital lease as of 31 December 2012, 2011 and 2010, respectively.

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

	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
At cost	–	–	3,761
Less: accumulated depreciation	–	–	(1,349)
Net property, plant and equipment	–	–	2,412

Note 10. Current portion of long-term debt

Current portion of long-term debt includes the following:

	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
Current portion of long-term debt (Note 11)	257,860	175,217	117,274
Short-term capital lease obligations	–	–	276
Total current portion of long-term debt	257,860	175,217	117,550

Note 11. Long-term debt

Long-term debt includes the following:

Lender	Final maturity date	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
<i>Debt of the Company</i>				
Loans from stockholders	2014	50,000	50,000	70,000
<i>Debt of the Company's subsidiaries</i>				
Raiffeisenbank	2016	220,000	220,000	–
8.4% Russian ruble bonds, maturing 2018	2018	164,622	155,298	–
Alfa Bank	2013	122,478	231,084	254,291
OOO Rushong-Hua	2015	52,321	–	–
OAO Sberbank of Russia	2014	43,899	62,119	–
OAO Sberbank of Russia	2015	26,339	–	–
OAO Sberbank of Russia	2013	20,214	31,441	50,275
Individual	2012	–	3,392	6,392
ZAO UniCredit Bank	2012	–	–	11,866
<i>Loans from LUKOIL Group companies</i>				
OOO LUKOIL-West Siberia	2011	–	–	7,078
OOO LUKOIL-Perm	2041	–	–	1,000
OAO Tebukneft	2010	–	–	282
OAO Uhtaneft	2015	–	–	78
Total long-term debt		699,873	753,334	401,262
Current portion of long-term debt (Note 10)		(257,860)	(175,217)	(117,274)
Long-term lease obligation		–	–	2,379
Total non-current long-term debt		442,013	578,117	286,367

Stockholders

Long-term loans from stockholders as of 31 December 2012 represent loans denominated in US dollars which bear interest at 5.8% and mature on or before 31 December 2014.



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Note 11. Long-term debt *continued* Debt of the Company's subsidiaries

Raiffeisenbank

Long-term debt with Raiffeisenbank with an outstanding balance of US \$220.0 million as of 31 December 2012 is denominated in US dollars and bears interest at 5.65% per annum. This debt is secured by the shares of a newly acquired company CSVI (refer to Note 17).

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.

Alfa-Bank

Long-term debt with Alfa-Bank with an outstanding balance of US \$122.5 million as of 31 December 2012 is denominated in Russian rubles and bears interest at 8.4% per annum.

OOO Rushong-Hua

Long-term debt with OOO Rushong-Hua with an outstanding balance of US \$52.3 million as of 31 December 2012 is denominated in Russian rubles at an effective interest rate of 6.3% per annum.

OAO Sberbank of Russia

Long-term debt with OAO Sberbank of Russia with an outstanding balance of US \$43.9 million as of 31 December 2012 is denominated in Russian rubles and bears interest at 7.7% per annum.

Long-term debts with OAO Sberbank of Russia with an outstanding balance of US \$20.2 million as of 31 December 2012 is denominated in Russian rubles and bears interest at LIBOR plus 4.1% per annum.

Long-term debt with OAO Sberbank of Russia with an outstanding balance of US \$26.3 million as of 31 December 2012 is denominated in Russian rubles and bears interest at 10.15% per annum.

Individual

Long-term debt from an individual represents a loan denominated in US \$ which bore interest at a stated rate of 0% and matured on 1 May 2012. This relates to the acquisition of the new workover company OOO Meridian (refer to Note 17). This loan was recorded at fair value based on the effective interest rate estimated by the management at the acquisition date, which was 13% per annum.

This debt was secured by the shares of OOO Meridian.

ZAO UniCredit Bank

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

LUKOIL Group companies

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

As of 31 December 2012 and 2011 the Group had two unused lines of credit with ZAO UniCredit Bank. The first one is a revolving line of credit denominated in Russian rubles which at the currency exchange rate as of 31 December 2012 equalled to US \$96.1 million. This line of credit is short-term in nature with a duration of 90 days and availability period until November 2014. The second line of credit is a revolving overdraft line denominated in Russian rubles which at the currency exchange rate as of 31 December 2012 equals to US \$17.3 million and is available until September 2015. Both lines are solely intended for issuing or extending unsecured commercial letters of credit for the purpose of acquiring new drilling rigs (used as security for these lines). At year-end both lines of credit were undrawn.

As of 31 December 2012, the Group also had a revolving multi-currency overdraft line with OAO Sberbank of Russia denominated in Russian rubles which at the currency exchange rate as of 31 December 2012 equalled to US \$98.8 million and is available until June 2017. It is solely intended for issuing or extending unsecured commercial letters of credit for the purpose of acquiring new drilling rigs. As of 31 December 2012, the line was undrawn.

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

These unused lines of credit, along with debts from OAO Sberbank of Russia, are secured by property, plant and equipment with a carrying amount of US \$264.9 million as of 31 December 2012 (2011: US \$50.4 million; 2010: US \$53.2 million).

Maturities of long-term debts outstanding at 31 December 2012 are as follows:

2013	2014	2015	2016	2017	2018 and thereafter	Total
257,860	148,615	94,930	33,846	–	164,622	699,873



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Note 12. Taxes

Income taxes

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

Operations in the Russian Federation are subject to a federal income tax rate of 20.0% and a regional income tax rate that varies from 13.5% to 18.0% at the discretion of the individual regional administration.

The Group's operations outside the Russian Federation are subject to the following rates of income tax:

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

The majority of the Group's earnings in 2012, 2011 and 2010 were taxed in the Russian Federation.

As of 31 December 2012, 2011 and 2010, and during 2012, 2011 and 2010 the Group did not have any unrecognised tax benefits and, thus, no interest and penalties related to unrecognised tax benefits were accrued. The Group's policy is to record interest and penalties related to unrecognised tax benefits as components of income tax expense. In addition, the Group does not expect that the amount of unrecognised tax benefits will change significantly within the next 12 months.

The Company and its subsidiaries file standalone income tax returns in each country in which they operate. Income tax returns are open for inspection by the tax authorities in Russia for tax years 2010-2012, in Turkmenistan for 2010-2012, in Kazakhstan for 2009-2012 and Cyprus for 2011-2012.

	Year ended 31 December 2012	Year ended 31 December 2011 (adjusted)	Year ended 31 December 2010 (adjusted)
Current income tax expense	87,533	56,298	63,045
Deferred income tax expense	34,307	27,747	8,635
Total income tax expense	121,840	84,045	71,680

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

	Year ended 31 December 2012	Year ended 31 December 2011 (adjusted)	Year ended 31 December 2010 (adjusted)
Deferred income tax assets – current	11,175	3,710	11,472
Deferred income tax assets – non-current	2,156	2,833	1,422
Deferred income tax liabilities – current	(6,499)	(5,340)	(478)
Deferred income tax liabilities – non-current	(92,639)	(49,376)	(24,744)
Net deferred income tax liability	(85,807)	(48,173)	(12,328)

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

	Year ended 31 December 2012	Year ended 31 December 2011 (adjusted)	Year ended 31 December 2010 (adjusted)
Inventories	15,884	8,720	7,581
Accrued pension liability	3,128	2,236	1,378
Property, plant and equipment	2,156	2,056	1,422
Accounts payable and accrued liabilities	2,064	1,810	5,852
Long-term accounts receivable	97	33	173
Long-term debt	–	–	290
Other current assets	–	203	570
Deferred income tax assets	23,329	15,058	17,266
Property, plant and equipment	(95,865)	(50,995)	(26,450)
Accounts receivable	(9,859)	(7,705)	(2,143)
Investments	(3,412)	(4,325)	–
Inventories	–	(206)	(12)
Long-term debt	–	–	(135)
Other current liabilities	–	–	(854)
Deferred income tax liabilities	(109,136)	(63,231)	(29,594)
Net deferred income tax liabilities	(85,807)	(48,173)	(12,328)

Based upon the level of historical taxable income and expectations for future taxable income over future periods in which the deferred income tax assets are deductible, management believes it is more likely than not the Group will realise the benefits of these deductible temporary differences as of 31 December 2012, 2011 and 2010.



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Note 12. Taxes *continued*

The Company has not recognised deferred income taxes on US \$1,182 million of undistributed earnings of its Russian subsidiaries, since such earnings are considered to be reinvested indefinitely. If the earnings were distributed in the form of dividends, the Company would be subject to foreign withholding taxes. The amount of unrecognised deferred income tax liability is US \$57 million.

Bases on the Company's intercompany dividend policy the Company recognised deferred income tax on 20% of the undistributed earnings of its Russian subsidiaries from its onshore segment earned during the reporting period, and on 30% of the undistributed earnings of its Russian subsidiaries from its offshore segment earned during the reporting period. The remaining balances of retained earnings of these companies are considered to be reinvested indefinitely. Management of the Company has the intention and the ability not to distribute these retained earnings.

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

	Year ended 31 December 2012	Year ended 31 December 2011 (adjusted)	Year ended 31 December 2010 (adjusted)
Income before income tax	503,849	367,416	278,506
Notional income tax at Russian statutory rate 20%	100,770	73,483	55,701
Increase in income tax due to:			
Non-deductible items, net	6,176	8,958	7,461
Regional rate differences	(2,179)	(967)	(1,255)
Withholding tax	4,258	4,325	8,103
Foreign rate differences	12,815	(1,754)	1,670
Total income tax expense	121,840	84,045	71,680

Taxes receivable include the following:

	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
Prepaid income tax	18,274	13,930	14,169
Prepaid value-added tax	8,024	13,436	16,096
Value-added tax recoverable	707	4,147	3,565
Other taxes	196	1,633	1,130
Total taxes receivable	27,201	33,146	34,960

Taxes payable include the following:

	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
Value-added tax	53,112	45,442	33,138
Social taxes and contributions	15,720	5,843	7,859
Personal income tax	10,516	2,844	6,559
Property tax	5,012	6,988	3,139
Income tax payable	1,649	3,181	1,942
Other taxes	4,267	4,732	1,620
Total taxes payable	90,276	69,030	54,257

Note 13. Pension benefits

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

Jubilee benefits were calculated for the first time as at 31 December 2010 of US \$1.3 million and recognised immediately through earnings in 2010.

Additionally the Company provides financial support, of a defined benefit nature, to its old-age and disabled pensioners who did not acquire any pension under the occupational pension programme. The liabilities in respect of future pensioners were calculated for the first time as at 31 December 2011 of US \$1.8 million and recognised immediately through earnings in 2011. Additionally in 2012 the liabilities in respect of payments in case of death of a pensioner were calculated for the first time as at 31 December 2012 of US \$0.5 million and recognised immediately through earnings in 2012.

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

Employees also have the right to receive upon retirement the benefits accumulated under the previous pension plan when OOO Burovaya Kompaniya Eurasia was a subsidiary of the LUKOIL Group. This plan was replaced in December 2003. These benefits have been fixed and included in the benefit obligation as of 31 December 2012, 2011 and 2010. The amount was determined primarily based on a formula including past pensionable service and relative salaries as of 31 December 2003.



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Note 13. Pension benefits *continued*

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

The Company uses 31 December as the measurement date for its post-employment and post-retirement benefits programme. An independent actuary has assessed the benefit obligations as of 31 December 2012, 2011 and 2010.

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

The following table provides information about the benefit obligations and plan assets as of 31 December 2012, 2011 and 2010. The benefit obligations below represent the projected benefit obligation of the pension plan.

	2012	2011	2010
Benefit obligations			
Benefit obligations as of 1 January	15,171	14,883	11,558
Plan amendments	1,449	941	1,794
Service cost	1,324	1,107	797
Interest cost	1,277	954	1,037
Effect of exchange rate changes	997	(898)	(134)
Actuarial loss (gain)	969	1,667	(785)
Curtailment	–	(3,759)	–
Benefits paid	(1,878)	(1,554)	(652)
Benefits in case of death of a pensioner	495	–	–
Financial support to future pensioners	–	1,830	–
Jubilee benefits	–	–	1,268
Benefit obligations as of 31 December	19,804	15,171	14,883

	2012	2011	2010
Plan assets			
Fair value of plan assets as of 1 January	3,954	7,994	7,770
Employer contributions	1,580	1,290	515
Return on plan assets	312	65	347
Other changes in fair value of individual pension accounts	–	–	(230)
Effect of exchange rate changes	238	(81)	(60)
Divestitures	–	(3,759)	–
Benefits paid	(1,878)	(1,554)	(652)
Interest income on individual pension accounts	–	–	304
Fair value of plan assets as of 31 December	4,206	3,955	7,994
Funded status	(15,598)	(11,216)	(6,889)

Amounts recognised in the consolidated balance sheet as of 31 December

Accrued pension liability	(15,598)	(11,216)	(6,889)
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Weighted average assumptions used to determine benefit obligations as of 31 December 2012, 2011 and 2010:

	2012	2011	2010
Discount rate	7.10%	7.80%	7.80%
Rate of compensation increase	7.10%	7.30%	7.70%

Weighted average assumptions used to determine net periodic benefit costs for the year ended 31 December 2012, 2011 and 2010:

	2012	2011	2010
Discount rate	7.80%	7.80%	8.70%
Expected return on plan assets	8.63%	8.95%	10.07%
Rate of compensation increase	7.30%	7.70%	8.10%

Included in accumulated other comprehensive loss as of 31 December 2012, 2011 and 2010, are the following pre-tax amounts that have not yet been recognised in net periodic benefit cost:

	2012	2011	2010
Unamortised prior service cost	(1,988)	(777)	(80)
Unrecognised actuarial (loss) gain	(1,366)	(325)	1,622
Total benefit	(3,354)	(1,102)	1,542



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Note 13. Pension benefits *continued*

Amounts recognised in other comprehensive loss before tax during the years ended 31 December 2012, 2011 and 2010:

	2012	2011	2010
Additional prior service cost from plan amendment	1,483	859	1,788
Reclassified prior service (cost) benefit amortisation	(319)	(158)	131
Additional loss (gain) arising during the period	1,058	1,822	(593)
Reclassified gain amortisation	–	39	13
Net amount recognised in other comprehensive loss for the period	2,222	2,562	1,339

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

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

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

Type of assets	As of 31 December 2012	As of 31 December 2011	As of 31 December 2010
Bank deposits	73%	44%	41%
Shares in investment funds	11%	13%	13%
Eurobonds	8%	4%	0%
Russian corporate bonds	4%	28%	37%
Equity securities of Russian issuers	0%	6%	5%
Shares of OAO LUKOIL	0%	2%	1%
Russian municipal bonds	–	–	2%
Other assets	4%	3%	1%
	100%	100%	100%

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

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

Components of net periodic benefit cost were as follows:

	Year ended 31 December 2012	Year ended 31 December 2011	Year ended 31 December 2010
Service cost	1,324	1,107	797
Interest cost	1,277	954	1,037
Less expected return on plan assets	(335)	(394)	(719)
Amortisation of prior service cost (benefit)	312	173	(132)
Recognised actuarial gain	–	(42)	(13)
Benefits in case of death of a pensioner	495	–	–
Financial support to future pensioners	–	1,830	–
Jubilee benefits	–	–	1,268
Total net periodic benefit cost	3,073	3,628	2,238

Total employer contributions for 2013 are expected to be approximately US \$1.6 million.

Accumulated benefit obligations were US \$15.2 million, US \$12.1 million and US \$12.6 million as of 31 December 2012, 2011 and 31 December 2010, respectively.

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

	2013	2014	2015	2016	2017	5-year period 2013-2017	5-year period 2018-2022
Pension benefits	385	477	613	836	733	3,044	2,781
Lump sum payments upon retirement, death and disability	1,909	1,376	1,623	1,760	1,933	8,601	9,995
Total expected benefits to be paid	2,294	1,853	2,236	2,596	2,666	11,645	12,776



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Note 14. Fair value of financial instruments

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

During the years ended 31 December 2012, 2011 and 2010, the Group did not have significant transactions or events that would result in non-financial assets and liabilities needing to be measured at fair value on a non-recurring basis.

Note 15. Cost of services, excluding depreciation and taxes

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

	Year ended 31 December 2012	Year ended 31 December 2011 (adjusted)	Year ended 31 December 2010 (adjusted)
Services of subcontractors	936,797	917,187	492,243
Wages and salaries	488,407	425,210	326,299
Materials	414,288	309,252	221,375
Fuel and energy	152,785	131,776	80,273
Transportation of employees to drilling fields	40,003	30,689	23,364
Leasing and rent	20,781	26,336	10,884
Other	98,275	65,806	49,895
Total cost of services	2,151,336	1,906,256	1,204,333

Note 16. Stockholders' equity

Common and treasury stock

	Year ended 31 December 2012	Year ended 31 December 2011	Year ended 31 December 2010
Number of shares			
Authorised and issued common stock, par value 0.01 US dollar each	146,865,243	146,865,243	146,865,243
Treasury stock	(77,857)	(105,781)	(455,797)
Issued and outstanding common stock, par value 0.01 US dollar each	146,787,386	146,759,462	146,409,446

During 2010 certain Directors of the Group elected to receive GDRs in lieu of cash. 19,854 shares of common stock held as treasury stock were issued to these Directors as a compensation fee.

During 2010 the Group awarded 718,868 shares of common stock held as treasury stock to certain top managers as a part of its incentive plan (refer to Note 22).

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

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

The movement of treasury stock during 2011 and 2012 was as follows:

Number of shares held in treasury as of 31 December 2010	455,797
Number of shares purchased	188,200
Exercise of Incentive Compensation Plan	(522,060)
Directors' fees	(16,156)
Number of shares held in treasury as of 31 December 2011	105,781
Directors fees	(27,924)
Number of shares held in treasury as of 31 December 2012	77,857

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 RUB36.4 billion, RUB25.4 billion and RUB26.7 billion, respectively as of 31 December 2012, 2011 and 2010, pursuant to the statutory financial statements, which at the US dollar exchange rates as of 31 December 2012, 2011 and 2010 amount to US \$1,199 million, US \$789 million and US \$950 million, respectively.

At the Board of Directors' meeting on 12 December 2012, dividends were declared for 2012, in the amount of US \$0.70 per share of common stock. Dividends payable by the Company of US \$103 million were included in 'Accounts payable and accrued liabilities' in the consolidated balance sheet as of 31 December 2012.

At the Board of Directors' meeting on 12 December 2011, dividends were declared for 2011, in the amount of US \$0.47 per share of common stock. Dividends payable by the Company of US \$69 million were included in 'Accounts payable and accrued liabilities' in the consolidated balance sheet as of 31 December 2011. During the reporting period this dividend was fully paid.



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Note 16. Stockholders' equity *continued*

At the Board of Directors' meeting on 14 December 2010, dividends were declared for 2010, in the amount of US \$0.31 per share of common stock. Dividends payable by the Company of US \$45 million were included in 'Accounts payable and accrued liabilities' in the consolidated balance sheet as of 31 December 2011.

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

Earnings per share

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

	Year ended 31 December 2012	Year ended 31 December 2011 (adjusted)	Year ended 31 December 2010 (adjusted)
Net income available for common stockholders	382,009	283,371	206,826
Weighted average number of outstanding shares	146,782,754	146,768,307	143,270,265
Basic earnings per share of common stock (US dollars)	2.60	1.93	1.44
Contingent shares of stock incentive programme (refer to Note 22)	875,260	–	522,060
Weighted average number of outstanding shares, after dilution	147,658,014	146,768,307	143,792,325
Diluted earnings per share of common stock (US dollars)	2.59	1.93	1.44

Note 17. Business combinations

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

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

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

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

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

On 28 April 2011 the Group acquired a 100% interest in OOO Sibirskaya Geophisicheskaya Company (OOO SGC) and 100% in ZAO Samatlorsky KRS (ZAO SKRS) from Schlumberger Limited Group. The aggregate purchase price of the acquired entities was approximately US \$345.5 million, which included US \$242.9 million cash and US \$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 of the onshore drilling market and to diversify its client base.

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

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

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

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

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



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Note 17. Business combinations *continued*

In June 2010, the Group acquired a 100% interest in OOO Meridian for US \$12.2 million which was paid in three instalments ending 1 May 2012. The fair value of the consideration comprised US \$11.0 million as of the date of acquisition, of which US \$6.4 million was paid before 31 December 2011. The remaining amount of US \$3.4 million was recorded as a loan to individual (refer to Note 11).

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

The Group allocated US \$9.0 million to goodwill, US \$0.7 million to property, plant and equipment, US \$2.5 million to current assets, and US \$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 the amount of US \$7.1 million was recognised at 31 December 2010 due to the revision of future development plans. The amount of the loss was determined based on a present value valuation technique.

On 9 August 2010 the Group acquired a 100% interest in OOO Megionskoye Tamponazhnoye Upravleniye (OOO MTU) from OOO Slavneft-Megionneftegaz for RUB275 million (or US \$9.0 million at the US dollar exchange rate as of 31 December 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 Group's spectrum of well construction services, improve the technical efficiency of the Group and to obtain a new customer in West Siberia.

The Group allocated US \$7.7 million to property, plant and equipment, US \$5.2 million to other assets, and US \$3.4 million to liabilities and recognised a US \$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 18. Commitments and contingencies

Commitments

Insurance

The insurance industry in the Russian Federation and certain other areas where the Group has operations is in course of development. Management believes that the Group has adequate property damage coverage for its main production assets. In respect of third-party liability for property and environmental damage arising from accidents on Group property or relating to Group operations, the Group has insurance coverage that is generally higher than insurance limits set by the local legal requirements. Management believes that the Group has adequate insurance coverage of those 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, operational results, or liquidity.

Environmental obligations

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

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

Taxation

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

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

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



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Note 19. 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 the years ended 31 December 2012, 2011 and 2010 the firm billed the Company for costs and expenses of US \$2.0 million, US \$2.4 million and US \$2.2 million, respectively. Mr Stinemetz is not otherwise paid for his services as the Company's General Counsel.

Long-term loans from stockholders were US \$50 million as of 31 December 2012 and 31 December 2011 and US \$70 million as of 31 December 2010 (refer to Note 11). Interest expense of US \$2.9 million was recognised and paid on these loans during the years ended 31 December 2012 and 2011 and US \$6 million during the year ended 31 December 2010.

During 2012 the Group decreased its share in OOO Kliver from 51% to 25% but increased its investment in OOO Kliver by US \$5.6 million. During 2012 the Group issued a short-term loan of US \$20.6 million to an associate company OOO Kliver. The loans are denominated in Russian rubles, bear interest at 10% and mature on 1 July 2013. The outstanding balance was US \$3.6 million as of 31 December 2012. Interest income of US \$0.2 million was recognised during 2012.

In October 2010 the Company originated a bank guarantee with a value of US \$5.1 million (refer to Note 8) in favour of a subcontractor in consideration for an option to acquire an interest in an exploration project from a company controlled by related parties. The bank guarantee and the option expired in October 2011 without being exercised and at no cost to the Company.

Note 20. Segment information

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

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

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

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

For the year ended 31 December 2012

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

For the year ended 31 December 2011

	Onshore drilling services (CIS)	Offshore drilling services (Caspian Sea)	Consolidated
Total revenues (adjusted)	2,581,730	185,019	2,766,749
Net income (adjusted)	233,810	49,561	283,371
Total assets (adjusted)	2,102,159	501,657	2,603,816
Goodwill	43,272	62,127	105,399

For the year ended 31 December 2010

	Onshore drilling services (CIS)	Offshore drilling services (Caspian Sea)	Consolidated
Total revenues (adjusted)	1,709,456	112,724	1,822,180
Net income (adjusted)	181,307	25,519	206,826
Total assets (adjusted)	1,801,484	152,323	1,953,807
Goodwill	32,727	–	32,727



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Note 21. 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.

	2012	2011	2010
Revenues for the year ended 31 December (adjusted)	2,054,724	1,692,200	1,280,826
Accounts receivable as of 31 December (adjusted)	260,781	194,005	124,182

Note 22. Incentive Compensation Plan

In March 2008, the Company introduced an incentive plan for certain members of management (Participants) for a five-year period beginning 1 January 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 12% for 2008, 15% for 2009, 18% for 2010, 25% for 2011 and 30% for 2012.

The Starting Price for the 2008 year was US \$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 five-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 US \$21 million by an independent consulting firm. The Company has accrued the total amount as of 31 December 2012.

The participants may only receive GDRs, each representing one ordinary share of the Company. Therefore, the Plan is equity-classified. The Group recognised US \$4.2 million of compensation expense during the year ended 31 December 2012. As of 31 December 2012, US \$21 million was recognised on the Company's balance sheet as an increase in additional paid-in capital.

On 1 February 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 1 February 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 31 December 2011 no incentive plan award was due for 2011.

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

Note 23. Subsequent events

The Company has evaluated subsequent events from the balance sheet date through to 29 March 2013, the date at which the financial statements were available to be issued, and determined there are no other items to disclose.



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Directors

The Earl of Clanwilliam

Chairman of the Board of Directors,
Eurasia Drilling Company Ltd
Principal, Policy Partnership Ltd

Alexander Yu. Djaparidze

Chief Executive Officer,
Eurasia Drilling Company Ltd

W. Richard Anderson

Chief Financial Officer,
Eurasia Drilling Company Ltd

Maurice Dijols

Chairman of the Russian Schlumberger
companies and Senior Advisor to
Schlumberger CEO.

Martin E. Hansen

Former Chief Financial Officer,
Eurasia Drilling Company Ltd

René Huck

Former Vice-President, Schlumberger

Anatoliy Kozyrev

Former Vice President and Director of the
Chief Administration for Corporate Budget and
Economy Planning and Investments of LUKOIL

Richard Matzke

Former Vice-Chairman of the Board of Chevron

Alexander Shokhin

President of the Russian Union of Industrialists
and Entrepreneurs

Officers

Alexander Yu. Djaparidze

Chief Executive Officer

Murat Sampiev

Chief Operating Officer

W. Richard Anderson

Chief Financial Officer

Edward Redd

Senior Vice President Offshore Operations

Atle Loge

Vice President Business Development

Tom O'Gallagher

Vice President Marketing and Investor Relations

S. Douglas Stinemetz

General Counsel and Secretary

Subsidiary officers

Alexander N. Bogachev

President, OOO Burovaya Kompaniya Eurasia

Taleh M. Aleskerov

Senior VP Finance and CFO, OOO Burovaya
Kompaniya Eurasia

Yury K. Gagaev

General Director, BKE Shelf Ltd

Yury V. Vetluzhskih

General Director, OOO 'SGC'
(subsidiary from April 2011)

Registered address

Boundary Hall
Cricket Square
PO Box 1111
Grand Cayman KY1-1102
Cayman Islands

Principal administrative offices

No. 53, Mykonos Court
Aristide Charalambous 2
1077 Nicosia
Cyprus

Financial advisors

Goldman Sachs International
CJSC 'Sberbank CIB'

Transfer agent

JP Morgan Securities Ltd

Legal Advisors

Skadden, Arps, Slate, Meagher & Flom LLP
& Affiliates

Bankers

Barclays Bank PLC
OAO Sberbank (Zapadno-Uralskiy branch)
ZAO Unicredit Bank
OAO Alfa-Bank
ZAO Raiffeisenbank
ZAO VTB Capital

Auditors

ZAO KPMG

Annual General Meeting

The Annual General Meeting of members
of Eurasia Drilling Company Limited will be
held on Monday, 23 September 2013 in
St Tropez, France.

Investor relations contacts

Evgeniya Bitsenko

Head of Investor Relations
T: +44 (0) 20 7717 9707
E: investors.relations@eurasiadrilling.com
or through our website at:
www.eurasiadrilling.com



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