

PIMCO COMMERCIAL MORTGAGE SECURITIES TRUST INC

Form N-CSR

March 10, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT
INVESTMENT COMPANIES

Investment Company Act file number: 811-7816

PIMCO Commercial Mortgage Securities Trust, Inc.

(Exact name of registrant as specified in charter)

840 Newport Center Drive, Newport Beach, CA 92660

(Address of principal executive offices)

John P. Hardaway

Treasurer

PIMCO Funds

840 Newport Center Drive

Newport Beach, CA 92660

(Name and address of agent for service)

Copies to:

Brendan Fox

Dechert LLP

1775 I Street, N.W.

Washington, D.C. 20006

Registrant's telephone number, including area code: (949) 720-4761

Date of fiscal year end: December 31

Date of reporting period: July 1, 2004 - December 31, 2004

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

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Item 1. Reports to Shareholders.

The following is a copy of the report transmitted to shareholders pursuant to Rule 30e-1 under the Act (17 CFR 270.30e-1).

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PIMCO

ANNUAL

REPORT

PIMCO COMMERCIAL MORTGAGE SECURITIES TRUST, INC.

December 31, 2004

A CLOSED-END FUND SPECIALIZING

IN INVESTMENTS IN COMMERCIAL

MORTGAGE-BACKED SECURITIES

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Pacific Investment Management Company LLC (PIMCO), an investment adviser with approximately \$445 billion of assets under management as of December 31, 2004, is responsible for the management and administration of the PIMCO Commercial Mortgage Securities Trust, Inc. (the Fund). Founded in 1971, PIMCO manages assets on behalf of mutual fund and institutional clients located around the world. Renowned for its fixed income management expertise, PIMCO manages assets for many of the largest corporations, foundations, endowments, and governmental bodies in the United States and the world.

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Chairman's Letter

For the 12-month reporting period ended December 31, 2004, the PIMCO Commercial Mortgage Securities Trust, Inc. (the Fund) returned 1.62% based on its NYSE share price and 9.07% based on its net asset value. The Lehman Brothers Aggregate Bond Index, which is the Fund's benchmark and considered a representative of the entire bond market, returned 4.34% for the same period. During the year 2004, concern about rising interest rates led to a decrease in investor demand, which contributed to the decline in the Fund's NYSE share price. Net assets in the Fund stood at \$140.2 million on December 31, 2004, the Fund's fiscal year end.

The Fund's long-term performance continued to be strong, as the Fund posted annualized returns of 11.53% based on its NYSE share price and 9.82% based on its net asset value for the ten-year period ended December 31, 2004. The Fund outperformed the Lehman Index return of 7.72% for the ten-year period.

All major fixed income sectors posted gains in fourth quarter 2004, capping a year in which bonds showed late strength. The 4.34% gain of the Lehman Brothers Aggregate Bond Index for the year came despite several major headwinds. These issues included the further expansion of U.S. fiscal deficits, a declining U.S. dollar, and market perceptions when the year began that interest rates were bound to rise from levels that were near historic lows at that time.

In addition to these headwinds, fixed income markets weathered the tightening cycle by the Federal Reserve that began in June 2004. The central bank raised the federal funds rate five times during the year for a total increase of 1.25%. The most recent move came on December 14, 2004 with an increase of 0.25%, leaving the federal funds rate at 2.25% at the end of the year. Despite this tightening cycle, bond investors were encouraged by statements from the Federal Reserve that it would continue to move at a measured pace. Investors also understood that the Federal Reserve was lifting rates from unusually low levels that had originally been set to prevent deflation.

Yields on longer maturity Treasuries decreased in 2004. The yield on the benchmark ten-year Treasury ended the year at 4.22%, which was down 0.03% for the year. However, yields on shorter maturity securities rose by more than 1% as a result of the Federal Reserve rate increases. The relatively steep two- to ten-year portion of the yield curve flattened during the year. The difference between yields on securities maturing in two years versus ten years narrowed from 2.43% at the beginning of 2004 to 1.15% by the end of the year.

On the following pages you will find details as to the Fund's portfolio and total return investment performance, including PIMCO's discussion of those main factors that affected performance during the one-year reporting period.

We appreciate the trust you have placed in us, and we will continue to focus our efforts to meet your investment needs. If you have any questions regarding your PIMCO Funds investment, please contact your account manager or call one of our shareholder associates at 1-866-746-2606. We also invite you to visit the Fund's website at www.pcmfund.com.

Sincerely,

Brent R. Harris

Chairman of the Board, PIMCO Commercial Mortgage Securities Trust, Inc.

January 31, 2005

December 31, 2004 | PIMCO Commercial Mortgage Securities Trust, Inc. Annual Report **1**

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Important Information About the Fund

We believe that bond funds have an important role to play in a well diversified investment portfolio. It is important to note, however, that in an environment where interest rates may trend upward, rising rates will negatively impact the performance of most bond funds, and fixed income securities held by a fund are likely to decrease in value. The price volatility of fixed income securities can also increase during periods of rising interest rates resulting in increased losses to a fund. Bond funds and individual bonds with a longer duration (a measure of the expected life of a security) tend to be more sensitive to changes in interest rates, usually making them more volatile than securities or funds with shorter durations. The longer-term performance of most bond funds has benefited from capital gains in part resulting from an extended period of declining interest rates. In the event interest rates increase, these capital gains should not be expected to recur.

The Fund may be subject to various risks in addition to those described above. Some of these risks may include, but are not limited to, the following: real rate risk, derivative risk, small company risk, non-U.S. security risk, high yield security risk and specific sector investment risks. The Fund may use derivative instruments for hedging purposes or as part of an investment strategy. Use of these instruments may involve certain costs and risks such as liquidity risk, interest rate risk, market risk, credit risk, management risk and the risk that the Fund could not close out a position when it would be most advantageous to do so. A Fund investing in derivatives could lose more than the principal amount invested in these instruments. Investing in non-U.S. securities may entail risk due to non-U.S. economic and political developments; this risk may be enhanced when investing in emerging markets. High-yield bonds typically have a lower credit rating than other bonds. Lower rated bonds generally involve a greater risk to principal than higher rated bonds. Smaller companies may be more volatile than larger companies and may entail more risk. Concentrating investments in individual sectors may add additional risk and volatility compared to a diversified portfolio. The credit quality of the investments in the Fund's portfolio does not apply to the stability of the Fund.

An investment in the Fund is not a deposit of a bank and is not guaranteed or insured by the Federal Deposit Insurance Corporation or any other government agency. It is possible to lose money on an investment in the Fund.

Information about how the Fund voted proxies relating to portfolio securities during the 12-month period ended June 30, 2004 is available without charge, upon request, by calling the Fund at 866-746-2606, visiting our website at <http://www.pcmfund.com>, and visiting the SEC's website at <http://www.sec.gov>. Copies of the written Proxy Policy and the factors that PIMCO may consider in determining how to vote proxies for the Fund is available by calling the Fund at 866-746-2606 and on the SEC's website at <http://www.sec.gov>.

The Fund files complete schedules of its portfolio holdings with the SEC on Form N-Q for the first and third quarters of each fiscal year, which are available on the SEC's website at <http://www.sec.gov>. A copy of the Fund's Form N-Q is available without charge, upon request, by calling the Fund at 866-746-2606 or visiting our website at <http://www.pcmfund.com>. In addition, the Fund's Form N-Q may be reviewed and copied at the SEC's Public Reference Room in Washington, DC. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. Holdings are subject to change daily.

On May 12, 2004, the Fund submitted a CEO annual certification to the New York Stock Exchange (NYSE) on which the Fund's principal executive officer certified that he was not aware, as of that date, of any violation by the Fund of the NYSE's Corporate Governance listing standards. In addition, as required by Section 302 of the Sarbanes-Oxley Act of 2002 and related SEC rules, the Fund's principal executive and principal financial officers have made quarterly certifications, included in filings with the SEC on Forms N-CSR and N-Q, relating to, among other things, the Fund's disclosure controls and procedures and internal control over financial reporting, as applicable.

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Important Information (continued)

The following disclosure provides important information regarding the Fund's Expense Example, which appears on the Fund's individual page in this annual report. Please refer to this information when reviewing the Expense Example for the Fund.

Example

As a shareholder of the Fund, you incur two types of costs: (1) transaction costs, including brokerage fees; and (2) ongoing costs, including advisory and administrative fees; and other Fund expenses. The Example is intended to help you understand your ongoing costs (in dollars) of investing in the Fund and to compare these costs with the ongoing costs of investing in other mutual funds.

The Example is based on an investment of \$1,000.00 invested at the beginning of the period indicated and held for the entire period from July 1, 2004 to December 31, 2004.

Actual Expenses

The information in the table under the heading **Actual Performance** provides information about actual account values and actual expenses. You may use the information in these columns, together with the amount you invested, to estimate the expenses that you paid over the period. Simply divide your account value by \$1,000.00 (for example, an \$8,600.00 account value divided by \$1,000.00 = 8.60), then multiply the result by the number in the appropriate column, in the row entitled **Expenses Paid During Period** to estimate the expenses you paid on your account during this period.

Hypothetical Example for Comparison Purposes

The information in the table under the heading **Hypothetical Performance (5% return before expenses)** provides information about hypothetical account values and hypothetical expenses based on the Fund's actual expense ratio and an assumed rate of return of 5% per year before expenses, which is not the Fund's actual return. The hypothetical account values and expenses may not be used to estimate the actual ending account balance or expenses you paid for the period. You may use this information to compare the ongoing costs of investing in the Fund and other funds. To do so, compare this 5% hypothetical example with the 5% hypothetical examples that appear in the shareholder reports of the other funds.

Please note that the expenses shown in the table are meant to highlight your ongoing costs only and do not reflect any transactional costs. Therefore, the information under the heading **Hypothetical Performance (5% return before expenses)** is useful in comparing ongoing costs only, and will not help you determine the relative total costs of owning different funds. In addition, if these transactional costs were included, your costs would have been higher.

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Expense ratio may vary period to period because of various factors such as increase in expenses not covered by the advisory and administrative fees [such as expenses of the trustees and their counsel or litigation expense].

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PIMCO Commercial Mortgage Securities Trust, Inc. Performance Summary

NYSE Symbol:

PCM

Primary Investments:

Commercial mortgage-backed securities

Fund Inception Date:

September 2, 1993

Objective:

The Fund's primary investment objective is to achieve high current income, with capital gains from the disposition of investments as a secondary objective.

Total Net Assets:

\$140.2 million

Portfolio Managers:

Bill Powers

Dan Ivascyn

INVESTMENT PERFORMANCE For the period ended December 31, 2004

	<u>1 Year</u>	<u>5 Years*</u>	<u>10 Years*</u>	<u>Since Inception*</u>
NYSE Market Value	1.62%	11.78%	11.53%	9.01%
Net Asset Value	9.07%	9.64%	9.82%	8.52%
Lehman Brothers Aggregate Bond Index	4.34%	7.71%	7.72%	

* Annualized. All Fund returns are net of fees and expenses.

Past performance is no guarantee of future results. Performance data current to the most recent month-end is available at www.pcmfund.com or by calling (866) 746-2606.

Please refer to page 3 herein for an explanation of the information presented in the following Expense Example.

EXPENSE EXAMPLE	Actual Performance	Hypothetical Performance (5% return before expenses)
Beginning Account Value (07/01/04)	\$ 1,000.00	\$ 1,000.00
Ending Account Value (12/31/04)	\$ 1,090.70	\$ 1,015.38
Expenses Paid During Period	\$ 5.21	\$ 5.08

Expenses are equal to the Fund's annualized expense ratio of 1.94%, multiplied the average account value over the period, multiplied by 184/366 (to reflect the one-half year period).
Calculation is based on Net Asset Value

SECTOR BREAKDOWN

Multi-Class [^]	47.4%
Multi-Family	22.0%
Asset-Backed Securities	12.7%
Hospitality	7.3%
Other Mortgage-Backed Securities	6.8%
Other	3.8%

% of Total Investments as of December 31, 2004.

[^] *A mix of all type of commercial properties*

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MONTH	NYSE Market Value	Net Asset Value	Lehman
			Brothers Aggregate Bond
			Index
08/31/1993	10,000	10,000	10,000
09/30/1993	10,000	9,993	10,027
10/31/1993	10,484	10,014	10,065
11/30/1993	9,767	10,022	9,979
12/31/1993	9,946	10,043	10,033
01/31/1994	9,672	10,131	10,169
02/28/1994	9,399	9,970	9,992
03/31/1994	9,422	9,898	9,746
04/30/1994	8,955	9,786	9,668
05/31/1994	9,328	9,853	9,667
06/30/1994	9,165	9,802	9,645
07/31/1994	9,260	9,893	9,837
08/31/1994	9,547	10,023	9,849
09/30/1994	9,666	9,916	9,704
10/31/1994	8,983	9,803	9,695
11/30/1994	8,690	9,780	9,674
12/31/1994	8,910	9,882	9,741
01/31/1995	9,285	10,068	9,934
02/28/1995	9,663	10,408	10,170
03/31/1995	9,740	10,516	10,232
04/30/1995	10,124	10,739	10,375
05/31/1995	10,408	11,143	10,777
06/30/1995	10,799	11,246	10,856
07/31/1995	10,668	11,166	10,831
08/31/1995	10,852	11,286	10,962
09/30/1995	10,400	11,407	11,069
10/31/1995	10,802	11,631	11,213
11/30/1995	10,775	11,771	11,381
12/31/1995	10,857	11,989	11,540
01/31/1996	11,378	12,122	11,617
02/29/1996	11,682	11,943	11,415
03/31/1996	11,376	11,797	11,336
04/30/1996	11,179	11,844	11,272
05/31/1996	11,038	11,856	11,249
06/30/1996	11,124	11,931	11,400
07/31/1996	11,714	12,134	11,431
08/31/1996	11,917	12,219	11,412
09/30/1996	11,771	12,379	11,611
10/31/1996	12,154	12,697	11,868
11/30/1996	12,421	12,990	12,072
12/31/1996	12,438	13,003	11,959
01/31/1997	12,771	12,968	11,996
02/28/1997	12,618	13,144	12,026

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03/31/1997	12,894	13,099	11,892
04/30/1997	13,048	13,287	12,070
05/31/1997	13,142	13,554	12,185
06/30/1997	13,799	13,695	12,329
07/31/1997	13,956	14,024	12,662
08/31/1997	14,051	13,939	12,554
09/30/1997	14,083	14,193	12,739
10/31/1997	14,051	14,297	12,924
11/30/1997	14,472	14,342	12,983
12/31/1997	14,479	14,478	13,114
01/31/1998	14,644	14,607	13,282
02/28/1998	15,010	14,694	13,272
03/31/1998	14,909	14,740	13,318
04/30/1998	14,943	14,723	13,387
05/31/1998	14,705	14,961	13,514
06/30/1998	14,876	15,265	13,629
07/31/1998	15,324	15,387	13,658
08/31/1998	15,359	15,380	13,880
09/30/1998	15,114	15,559	14,205
10/31/1998	14,939	15,475	14,130
11/30/1998	15,186	15,480	14,210
12/31/1998	15,907	15,528	14,253
01/31/1999	15,943	15,668	14,355
02/28/1999	15,688	15,559	14,104
03/31/1999	15,505	15,712	14,182
04/30/1999	15,542	15,832	14,227
05/31/1999	15,727	15,789	14,103
06/30/1999	16,439	15,653	14,058
07/31/1999	16,100	15,776	13,998
08/31/1999	15,910	15,839	13,991
09/30/1999	15,566	15,808	14,153
10/31/1999	15,681	15,752	14,205
11/30/1999	14,788	15,878	14,204
12/31/1999	15,203	15,907	14,136
01/31/2000	15,084	15,862	14,090
02/29/2000	15,204	15,954	14,260
03/31/2000	16,049	16,159	14,448
04/30/2000	16,170	16,214	14,407
05/31/2000	15,558	15,990	14,400
06/30/2000	16,093	16,482	14,699
07/31/2000	16,383	16,680	14,833
08/31/2000	16,339	16,867	15,048
09/30/2000	16,299	16,898	15,143
10/31/2000	15,535	17,035	15,243
11/30/2000	16,990	17,265	15,492
12/31/2000	17,727	17,578	15,779
01/31/2001	18,194	17,788	16,037
02/28/2001	18,470	18,055	16,177
03/31/2001	19,391	18,337	16,258
04/30/2001	19,368	18,468	16,191
05/31/2001	19,983	18,502	16,289
06/30/2001	20,237	18,663	16,350
07/31/2001	20,537	18,854	16,716
08/31/2001	20,498	19,290	16,907
09/30/2001	21,026	19,614	17,104
10/31/2001	21,692	19,882	17,462
11/30/2001	21,154	19,535	17,221
12/31/2001	22,016	19,456	17,112
01/31/2002	22,224	19,674	17,250
02/28/2002	22,215	19,771	17,417
03/31/2002	22,079	19,593	17,128
04/30/2002	22,640	19,970	17,460

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05/31/2002	23,557	20,287	17,608
06/30/2002	23,450	20,529	17,760
07/31/2002	24,266	21,104	17,975
08/31/2002	24,207	21,238	18,279
09/30/2002	24,327	21,516	18,574
10/31/2002	22,800	21,409	18,490
11/30/2002	23,238	21,204	18,485
12/31/2002	24,568	21,590	18,867
01/31/2003	25,244	21,613	18,883
02/28/2003	25,112	21,977	19,144
03/31/2003	24,562	22,017	19,129
04/30/2003	24,901	22,041	19,287
05/31/2003	26,352	22,395	19,647
06/30/2003	25,331	22,454	19,608
07/31/2003	25,052	21,720	18,948
08/31/2003	25,131	21,780	19,074
09/30/2003	25,969	22,521	19,579

INCOME/(LOSS)

BEFORE

INCOME TAXES	20,211	(27,515)	(47,726)	(236.1%)
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Income taxes	(9,778)	(21,628)	(11,850)	121.2%
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NET

INCOME/(LOSS) \$	10,433	\$	(49,143)	\$ (59,576)	(571.0%)
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Revenues

Revenues from drilling contracts increased by \$190.5 million, or 80.8%, to \$426.5 million for the six-month period ended June 30, 2012, as compared to \$236.0 million for the six-month period ended June 30, 2011. The increase is primarily attributable to the operation of the Ocean Rig Mykonos and the Ocean Rig Poseidon that commenced drilling activities during third quarter of 2011, which contributed \$155.8 million in aggregate revenues during the six-month period ended June 30, 2012. Further, the Ocean Rig Olympia and the Ocean Rig Corcovado, which commenced drilling activities during the first and second quarters of 2011, respectively, contributed an aggregate of \$126.5 million in revenues during the six-month period ended June 30, 2012, as compared to \$45.3 million in aggregate revenues during the same period in 2011, which is offset by decreased revenues amounting to an aggregate of \$46.4 million for the Leiv Eiriksson and the Eirik Raude, due to lower rates and utilization during 2012. The maximum day rates for the contracts on which our drilling units were employed during the six-month period ended June 30, 2012 ranged between approximately \$449,000 and \$648,000 per day. The maximum day rates for the contracts on which our drilling units were employed during the six-month period ended June 30, 2011 ranged between approximately \$415,000 and \$665,000 per day. Revenues for the six-month period ended June 30, 2012 also include \$24.6 million for loss of hire insurance recovery related to Ocean Rig Corcovado.

Operating expenses

Drilling rigs and drillships operating expenses increased by \$126.3 million, or 121.2%, to \$230.4 million for the six-month period ended June 30, 2012, compared to \$104.1 million for the six-month period ended June 30, 2011. The increase in operating expenses was mainly due to the commencement of drilling operations of the Ocean Rig Mykonos and the Ocean Rig Poseidon, resulting in operating expenses of \$64.4 million in total. In addition, for the six-month period ended June 30, 2012, the operating expenses relating to the Leiv Eiriksson, the Eirik Raude and the Ocean Rig Corcovado increased by \$31.7 million, mainly due to a more extensive maintenance program and upgrades performed during the six month period ended June 30, 2012. Furthermore, operating expenses related to the Ocean Rig Olympia increased by \$24.2 million during the six month period ended June 30, 2012 due to the fact that the drillship was fully operational during such period as compared to the same period in 2011, when the drillship was operating for less than a quarter.

Depreciation and amortization expense

Depreciation and amortization expense for the drilling units increased by \$46.6 million, or 71.8%, to \$111.5 million for the six-month period ended June 30, 2012, as compared to \$64.9 million for the six-month period ended June 30, 2011. The increase in depreciation and amortization was mainly attributable to the \$35.6 million of depreciation related to the depreciation of the Ocean Rig Poseidon and the Ocean Rig Mykonos, which were delivered during the third quarter of 2011. In addition, the Ocean Rig Olympia contributed \$8.9 million more depreciation in the six-month period ended June 30, 2012 as compared to the same period of 2011, due to ownership of the drillship for the entire six-month period in 2012.

Loss /(Gain) on disposals

Gain on asset sales amounted to \$0.04 million for the six-month period ended June 30, 2012, while for the relevant period in 2011, there was a loss on sale of assets amounting to \$0.09 million, related to disposal of office equipment.

General and administrative expenses

General and administrative expenses increased by \$16.7 million, or 95.8%, to \$34.1 million for the six-month period ended June 30, 2012, as compared to \$17.4 million for the six-month period ended June 30, 2011. This increase is mainly due to increased costs related to the management of six drilling units during the six-month period ended June 30, 2012, as compared to four drilling units during the corresponding six-month period ended June 30, 2011, as well as expenses related to the operation of the Company's office in Brazil that commenced operations in late 2011.

Legal Settlements

The amount of \$6.4 million in legal settlements is mainly related to a claim settlement related to import/export taxes duties in Angola that was settled during the second quarter of 2012. No such charges were incurred during the relevant period in 2011.

Interest and finance costs

Interest and finance costs increased by \$40.7 million, or 183.4%, to \$63.0 million for the six-month period ended June 30, 2012, compared to \$22.2 million for the six-month period ended June 30, 2011. The increase is mainly associated with higher level of debt during the six month period ended June 30, 2012, as compared to the corresponding period of 2011.

Interest income

Interest income decreased by \$10.1 million, or 96.9%, to \$0.3 million for the six-month period ended June 30, 2012, compared to \$10.4 million for the six-month period ended June 30, 2011. The decrease was mainly due to lower interest rates on our deposits during 2012 as compared to 2011.

Loss on interest rate swaps

The Company recorded a loss related to interest rate swaps of \$10.9 million for the six-month period ended June 30, 2012, as compared to \$18.6 million for the six-month period ended June 30, 2011. The loss for the six-month period ended June 30, 2012 was mainly due to mark to market losses of outstanding swap positions as swap rates trended downwards.

Other, net

Other, net increased by \$0.7 million, or 52.6% to a gain of \$1.9 million for the six-month period ended June 30, 2012, compared to a gain of \$1.3 million for the six-month period ended June 30, 2011. The increase is mainly due to gains arising from foreign currency exchange rate differences.

Income taxes

Income taxes increased by \$11.9 million, or 121.2%, to \$21.6 million for the six-month period ended June 30, 2012, compared to \$9.8 million for the six-month period ended June 30, 2011. Since our drilling units operate around the world, they may become subject to taxation in many different jurisdictions. The basis for such taxation depends on the relevant regulation in the countries in which we operate. Consequently, there is no expected relationship between the income tax expense or benefit for the period and the income or loss before taxes.

Liquidity

As of June 30, 2012, we had \$191.2 million and \$173.2 million of cash and cash equivalents and restricted cash, respectively, related mainly to: (i) bank deposits which are blocked or pledged as cash collateral; and (ii) required minimum cash and cash equivalents or "minimum liquidity" clauses.

Our cash and cash equivalents decreased by \$59.7 million, or 23.8%, to \$191.2 million as of June 30, 2012, compared to \$250.9 million as of December 31, 2011, and our restricted cash decreased by \$8.9 million, or 4.9%, to \$173.2 million as of June 30, 2012, compared to \$182.1 million as of December 31, 2011. The decrease in our cash and cash equivalents relates mainly to net cash from operating activities of \$115.8 million and the decrease in restricted cash, which is offset mainly by loan repayments amounting to \$95.8 million, drillships' equipment and other improvements amounting to \$61.7 million and advances for rigs under construction and other investments amounting to \$25.5 million. Working capital is defined as current assets minus current liabilities (including the current portion of long-term debt). Our working capital deficit amounted to \$7.0 million as of June 30, 2012, compared to a working capital surplus of \$68.9 million as of December 31, 2011. We believe that we will be able to satisfy our liquidity needs for the next 12 months with the cash we generate from our operations and, if required, proceeds from future debt or equity issuances.

As of June 30, 2012, we had total indebtedness of \$2.6 billion under our senior secured credit facilities and senior notes, excluding unamortized financing fees. Please refer to the discussion on Long-term Debt as detailed in Note 9 of the Company's Consolidated Financial Statements included in the Annual Report Form 20-F (File No. 001-35298) for the year ended December 31, 2011 filed with the Commission on March 14, 2012.

As of June 30, 2012, we had \$1.1 billion of remaining installment payments under our drillship newbuilding contracts relating to our three newbuilding drillships. We have not obtained financing for these three contracted drillships. We plan to finance these capital expenditures with new debt or equity financing.

Cash flow

Net cash used in operating activities was \$115.8 million for the six-month period ended June 30, 2012. In determining net cash provided by operating activities for the six-month period ended June 30, 2011, net loss was adjusted for the effects of certain non-cash items including \$122.7 million of depreciation and amortization. Moreover, for the six-month period ended June 30, 2012, net income was also adjusted for the effects of non-cash items, such as the gain in the change in fair value of derivatives of \$7.9 million and amortization of discontinued cash flow hedges of \$6.5 million. Net cash provided by operating activities was \$93.9 million for the six-month period ended June 30, 2011.

Net cash used in investing activities was \$78.3 million for the six-month period ended June 30, 2012, compared to \$850.8 million used in for the six month period ended June 30, 2011. We made shipyard payments and expenditures related to the acquisition of drillships of approximately \$25.5 million for the six-month period ended June 30, 2012, compared to \$1,187.7 million in the corresponding period of 2011. The decrease in restricted cash was \$8.9 million during the six-month period ended June 30, 2012, compared to a decrease of \$346.9 million in the corresponding period of 2011.

Net cash used in financing activities was \$97.2 million for the six-month period ended June 30, 2012, mainly consisting of repayments of credit facilities and financing costs. This compares to net cash provided by financing activities of \$853.0 million for the six-month period ended June 30, 2011, mainly consisting of \$1,713.5 million of proceeds from long term credit facilities, which was partly offset by repayments of credit facilities amounting to an aggregate of \$829.2 million.

Financing activities

Long-term debt

As of June 30, 2012, the Company was in compliance with all of the financial covenants in its credit facilities.

As of June 30, 2012, we had a total of \$2.6 billion in debt outstanding (net of financing fees) under our credit facilities with various institutions. The table below reflects the classification of certain debt repayments scheduled to be due after June 30, 2012, as payable by such date indicated below.

Twelve months ending:	Total (in thousands)
June 30, 2013	\$ 246,667
June 30, 2014	594,167
June 30, 2015	176,667
June 30, 2016	1,143,332
June 30, 2017 and thereafter	522,500
Total principal payments	2,683,333
Less: Financing fees	(40,942)
Total debt	\$ 2,642,391

Off-balance sheet arrangements

We do not have any off-balance sheet arrangements.

Contractual Obligations and Contingencies

The following table sets forth our contractual obligations and their maturity dates as of June 30, 2012:

Obligations (In thousands of Dollars)	Total	1st year	2nd year	3rd year	4th year	5th year and thereafter
Drillships under construction (1)	1,096,826	-	1,096,826	-	-	-
Retirement Plan Benefits (2)	2,139	91	86	124	160	1,678
Operating leases (3)	\$2,736	1,232	1,232	272	-	-
					\$	
Total	\$ 1,101,701	\$ 1,323	\$ 1,098,144	\$ 396	160	\$ 1,678

(1) Up to June 30, 2012, the Company had made an aggregate of \$726.7 million of construction and construction-related payments for the Company's three seventh generation drillships and, as of June 30, 2012, has remaining total construction and construction-related payments for these seventh generation drillships which are currently under construction of approximately \$1,097 million in aggregate.

(2) Ocean Rig has three defined benefit plans for its employees managed and funded through Norwegian life insurance companies at June 30, 2012. The pension plans covered 50 employees as of June 30, 2012. Pension liabilities and pension costs are calculated based on the actuarial cost method as determined by an independent third party actuary.

(3) Ocean Rig entered into two three year office lease agreements with an unrelated party, which commenced on September 1, 2011 and October 1, 2011. These leases include an option for an additional two- and three-year term, which must be exercised at least six months prior to the end of the term of the contracts which expire in September 2014 and October 2014, respectively. Ocean Rig also entered into a three-year office lease with a third party in Nicosia, Cyprus, which commenced on September 1, 2010 and expires in 2014. The lease agreements relating to office space are considered to be operational lease contracts.

Recent developments

- On August 7, 2012, we entered into an amortizing interest rate swap agreement for an initial notional amount of \$450 million maturing in July 2017. This agreement was entered into to hedge the Company's exposure to interest rate fluctuations by fixing the interest rate at 1.0425% from July 2013 until July 2017.
-

Significant accounting policies

A discussion of the Company's significant accounting policies can be found in the Company's Consolidated Financial Statements included in the Annual Report Form 20-F (File No. 001-35298) for the year ended December 31, 2011 filed with the Commission on March 14, 2012. There have been no material changes to these policies in the six-month period ended June 30, 2012.

Changes in accounting policies

There have been no material changes to our accounting policies from the year ended December 31, 2011.

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides safe harbor protections for forward-looking statements in order to encourage companies to provide prospective information about their business. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical or present facts or conditions.

We desire to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and are including this cautionary statement in connection therewith. This document and any other written or oral statements made by us or on our behalf may include forward-looking statements, which reflect our current views with respect to future events and financial performance. The words "believe," "anticipate," "intend," "estimate," "forecast," "project," "plan," "potential," "may," "should," and "expect" and similar expressions identify forward-looking statements.

The forward-looking statements in this document are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management's examination of historical operating trends, data contained in the Company's records and other data available from third parties. Although we believe that these assumptions were reasonable when made, because these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control, we cannot assure you that it will achieve or accomplish these expectations, beliefs or projections.

In addition to these important factors and matters discussed elsewhere in this document, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements include factors related to:

- future operating or financial results;
- the offshore drilling market, including supply and demand, utilization rates, dayrates, customer drilling programs, commodity prices, effects of new rigs on the market and effects of declines in commodity prices and downturn in global economy on market outlook for our various geographical operating sectors and classes of rigs;
- hazards inherent in the drilling industry and marine operations causing personal injury or loss of life, severe damage to or destruction of property and equipment, pollution or environmental damage, claims by third parties or customers and suspension of operations;
- customer contracts, including contract backlog, contract commencements, contract terminations, contract option exercises, contract revenues, contract awards and rig mobilizations, newbuildings, upgrades, shipyard and other capital projects, including completion, delivery and commencement of operations dates, expected downtime and lost revenue;
- political and other uncertainties, including political unrest, risks of terrorist acts, war and civil disturbances, piracy, significant governmental influence over many aspects of local economies, seizure, nationalization or expropriation

of property or equipment;

- repudiation, nullification, modification or renegotiation of contracts;
 - limitations on insurance coverage, such as war risk coverage, in certain areas;
 - foreign and U.S. monetary policy and foreign currency fluctuations and devaluations;
 - the inability to repatriate income or capital;
 - complications associated with repairing and replacing equipment in remote locations;
 - import-export quotas, wage and price controls imposition of trade barriers; regulatory or financial requirements to comply with foreign bureaucratic actions;
 - changing taxation policies and other forms of government regulation and economic conditions that are beyond our control;
 - the level of expected capital expenditures and the timing and cost of completion of capital projects;
 - our ability to successfully employ our drilling units, procure or have access to financing, ability to comply with loan covenants, liquidity and adequacy of cash flow for our obligations;
 - factors affecting our results of operations and cash flow from operations, including revenues and expenses, uses of excess cash, including debt retirement, timing and proceeds of asset sales, tax matters, changes in tax laws, treaties and regulations, tax assessments and liabilities for tax issues, legal and regulatory matters, including results and effects of legal proceedings, customs and environmental matters, insurance matters, debt levels, including impacts of the financial and credit crisis;
-

- the effects of accounting changes and adoption of accounting policies; and
- recruitment and retention of personnel.

We caution readers of this document not to place undue reliance on these forward-looking statements, which speak only as of their dates.

OCEAN RIG UDW INC.
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OCEAN RIG UDW INC.

Consolidated Balance Sheets

As of December 31, 2011 and June 30, 2012 (unaudited)

(Expressed in thousands of U.S. Dollars - except for share and per share data)

	December 31, 2011	June 30, 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 250,878	\$ 191,158
Restricted cash	57,060	59,374
Trade accounts receivable, net of allowance for doubtful receivables of \$18,420 and \$18,458 at December 31, 2011 and June 30, 2012, respectively	123,223	117,133
Other current assets (Note 5)	65,248	142,964
Total current assets	496,409	510,629
FIXED ASSETS, NET:		
Advances for rigs and drillships under construction (Note 6)	754,925	780,418
Drilling rigs, machinery and equipment, net (Note 7)	4,538,838	4,479,597
Total fixed assets, net	5,293,763	5,260,015
OTHER NON CURRENT ASSETS:		
Restricted cash	125,040	113,854
Intangible assets, net	9,062	8,341
Financial instruments (Note 10)	-	138
Other other non-current assets (Note 8)	91,081	101,986
Total non-current assets	225,183	224,319
Total assets	\$ 6,015,355	\$ 5,994,963
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Current portion of long-term debt (Note 9)	\$ 210,166	\$ 235,951
Accounts payable and other current liabilities	37,305	22,148
Due to related party	-	1,983
Accrued liabilities	104,633	125,680
Deferred revenue	34,726	89,070
Financial instruments (Note 10)	40,727	42,808
Total current liabilities	427,557	517,640
NON CURRENT LIABILITIES		
Long term debt, net of current portion (Note 9)	2,525,599	2,406,440
Financial instruments (Note 10)	52,025	42,158
Deferred revenue	9,172	59,873
Other non-current liabilities	2,546	3,246
Total non-current liabilities	2,589,342	2,511,717
COMMITMENTS AND CONTINGENCIES (Note 14)	-	-

STOCKHOLDERS' EQUITY:

Preferred stock \$001 par value, 500,000,000 shares authorized at December 31, 2011 and June 30, 2012, nil issued and outstanding at December 31, 2011 and June 30, 2012	-	-
Common stock, \$001 par value; 1,000,000,000 shares authorized, at December 31, 2011 and June 30, 2012, 131,696,928 issued and outstanding at December 31, 2011 and June 30, 2012, respectively	1,317	1,317
Accumulated other comprehensive loss	(51,126)	(43,964)
Additional paid-in capital	3,469,924	3,479,055
Accumulated deficit	(421,659)	(470,802)
Total stockholders' equity	2,998,456	2,965,606
Total liabilities and stockholders' equity	\$ 6,015,355	\$ 5,994,963

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

OCEAN RIG UDW INC.

Unaudited Interim Condensed Consolidated Statements of Operations

For the six-month periods ended June 30, 2011 and 2012

(Expressed in thousands of U.S. Dollars- except for share and per share data)

	Six-months ended June 30,	
	2011	2012
REVENUES:		
Leasing revenue	\$ 71,357	\$ -
Service revenues and amortization of above market acquired drilling contracts	164,598	426,490
Total revenue	235,955	426,490
EXPENSES:		
Drilling rigs and drillships operating expenses	104,137	230,392
Depreciation and amortization	64,908	111,486
Loss / (Gain) on disposals	87	(43)
General and administrative expenses	17,432	34,126
Legal settlements (Note 14)	-	6,394
Operating income	49,391	44,135
OTHER INCOME / (EXPENSES):		
Interest and finance costs (Note 15)	(22,214)	(62,954)
Interest income	10,394	327
Loss on interest rate swaps (Note 10)	(18,616)	(10,940)
Other, net	1,256	1,917
Total other income/(expenses), net	(29,180)	(71,650)
INCOME/(LOSS) BEFORE INCOME TAXES	20,211	(27,515)
Income taxes (Note 13)	(9,778)	(21,628)
NET INCOME/(LOSS)	\$ 10,433	\$ (49,143)
EARNINGS/(LOSS) PER SHARE, BASIC AND DILUTED	\$ 0.08	\$ (0.37)
WEIGHTED AVERAGE NUMBER OF SHARES, BASIC AND DILUTED	131,696,928	131,696,928

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements

OCEAN RIG UDW INC.

Unaudited Interim Condensed Consolidated Statements of Comprehensive Income/(Loss)

For the six-month periods ended June 30, 2011 and 2012

(Expressed in thousands of U.S. Dollars – except for share and per share data)

	Six-month period ended	
	June 30,	
	2011	2012
Net Income/(Loss)	\$10,433	\$(49,143)
Unrealized interest swap losses	3,272	-
Realized loss on cash flow hedges associated with capitalized interest	(3,272)	-
Reclassification of losses on previously designated cash flow hedges to Consolidated Statement of Operations	3,272	6,544
Amortization of realized loss on previously designated cash flow hedges associated with capitalized interest	207	517
Actuarial gains	140	101
Total Other Comprehensive Income	3,619	7,162
Total Comprehensive Income/(Loss)	\$14,052	\$(41,981)

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements

OCEAN RIG UDW INC.

Unaudited Interim Condensed Consolidated Statements of Cash Flows

For the six-month periods ended June 30, 2011 and 2012

(Expressed in thousands of U.S. Dollars – except for share and per share data)

	Six-months ended June 30,	
	2011	2012
Net Cash Provided by Operating Activities	\$ 93,915	\$ 115,840
Cash Flows from Investing Activities:		
Advances for rigs and drillships under construction	(1,187,747)	(25,493)
Drilling rigs, equipment and other improvements	(10,009)	(61,710)
Decrease in restricted cash	346,919	8,872
Net Cash Used in Investing Activities	(850,837)	(78,331)
Cash Flows from Financing Activities:		
Proceeds from long term debt	1,713,456	-
Proceeds from intercompany loan	175,500	-
Principal payments and repayments of long-term debt	(829,170)	(95,833)
Repayment of intercompany loan	(175,500)	-
Payment of financing costs	(31,327)	(1,396)
Net Cash Provided by/(Used in) Financing Activities	852,959	(97,229)
Net increase/(decrease) in cash and cash equivalents	96,037	(59,720)
Cash and cash equivalents at beginning of period	95,707	250,878
Cash and cash equivalents at end of period	\$ 191,744	\$ 191,158

The accompanying notes are an integral part of these unaudited interim condensed consolidated financial statements.

OCEAN RIG UDW INC.

Notes to unaudited Interim Condensed Consolidated Financial Statements

June 30, 2012

(Expressed in thousands of United States Dollars – except for share and per share data, unless otherwise stated)

1. Basis of Presentation and General Information:

The accompanying unaudited interim condensed consolidated financial statements include the accounts of Ocean Rig UDW Inc and its subsidiaries (collectively, the "Company," "Ocean Rig" or "Group"). Ocean Rig was formed under the laws of the Republic of the Marshall Islands on December 10, 2007, under the name Primelead Shareholders Inc. The Company is controlled by DryShips Inc. ("DryShips"), a publicly company listed on the NASDAQ exchange listed under the symbol "DRYS".

The accompanying unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and applicable rules and regulations from the Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, they do not include all the information and notes required by U.S. GAAP for complete financial statements. These statements and the accompanying notes should be read in conjunction with the Company's Annual Report on Form 20-F for the fiscal year ended December 31, 2011, filed with the SEC on March 14, 2012.

Certain prior period amounts have been reclassified to conform to the current year presentation including: a) the reclassification of part of deferred mobilization expenses and deferred revenue from current assets and current liabilities, respectively, to non-current assets and non-current liabilities and b) the reclassification of foreign exchange gains/losses in the Statement of operations from "General and administrative expenses" to "Other, net".

These unaudited interim condensed consolidated financial statements have been prepared on the same basis as the Company's annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the periods presented. Operating results for the six-month period ended June 30, 2012, are not necessarily indicative of the results that might be expected for the fiscal year ending December 31, 2012.

2. Significant Accounting policies and Recent Accounting Pronouncements:

A discussion of the Company's significant accounting policies can be found in the Company's consolidated financial statements included in the Annual Report on Form 20-F for the fiscal year ended December 31, 2011, filed with the SEC on March 14, 2012 (the "Consolidated Financial Statements for the year ended December 31, 2011"). There have been no material changes to these policies in the six-month period ended June 30, 2012.

3. Working capital:

At June 30, 2012, the Company's current liabilities exceeded its current assets by \$7,011. However, cash expected to be generated from operations assuming that current market drilling rates would prevail in the twelve months ending June 30, 2013 will be sufficient to cover the Company's ongoing working capital requirements.

OCEAN RIG UDW INC.

Notes to unaudited Interim Condensed Consolidated Financial Statements

June 30, 2012

(Expressed in thousands of United States Dollars – except for share and per share data, unless otherwise stated)

4. Transactions with Related Parties:

Global Services Agreement: On December 1, 2010, DryShips entered into a Global Services Agreement with Cardiff Marine Inc. ("Cardiff"), effective December 21, 2010, pursuant to which the Company has engaged Cardiff to act as consultant on matters of chartering and sale and purchase transactions for the offshore drilling units operated by the Company. Under the Global Services Agreement, Cardiff, or its subcontractor, (i) provides consulting services related to identifying, sourcing, negotiating and arranging new employment for offshore assets of the Company and its subsidiaries, including the Company's drilling units; and (ii) identifies, sources, negotiates and arranges the sale or purchase of the offshore assets of the Company and its subsidiaries, including the Company's drilling units. In consideration of such services, DryShips pays Cardiff a fee of 1.0% in connection with employment arrangements and 0.75% in connection with sale and purchase activities. For the six-month periods ended June 30, 2012 and 2011, the Company incurred costs of \$2,815 and \$5,694, respectively, as fees related to the Global Services Agreement, of which \$2,815 and \$801, respectively, were related to employment arrangements and \$0 and \$4,893 were related to sale and purchase activities. The Company does not pay for services provided in accordance with this agreement since equal equity contributions are made by its parent company DryShips. Costs from the Global Services Agreement are expensed in the accompanying unaudited interim condensed consolidated statements of operations or capitalized as a component of "Advances for rigs and drillships under construction", as applicable and as a shareholders contribution to capital.

Vivid Finance Limited: Under the consultancy agreement effective from September 1, 2010, between DryShips and Vivid Finance Limited ("Vivid"), a related party entity incorporated in Cyprus, Vivid provides the Company and its parent, DryShips, with financing-related services such as (i) negotiating and arranging new loans and credit facilities, interest rate swap agreements, foreign currency contracts and forward exchange contracts; (ii) renegotiating existing loan facilities and other debt instruments; and (iii) the raising of equity or debt in the capital markets. In exchange for its services, Vivid is entitled to a fee equal to 0.20% on the total transaction amount. The consultancy agreement has a term of five years and may be terminated (i) at the end of its term unless extended by mutual agreement of the parties; (ii) at any time by the mutual agreement of the parties; and (iii) by DryShips after providing written notice to Vivid at least 30 days prior to the actual termination date. The Company does not pay for services provided in accordance with this agreement; DryShips pays for the services. Accordingly, these expenses are recorded in the accompanying unaudited interim condensed consolidated statements of operations and as a shareholders contribution to capital. For the six-month periods ended June 30, 2012 and 2011, total charges from Vivid were \$5,802 and \$4,240, respectively and were recorded in the accompanying unaudited interim condensed statements of operations and as a shareholders' contribution to capital.

Intercompany loan: In March and April 2011, the Company borrowed an amount of \$175,500, interest free, from DryShips for capital expenditures and general corporate purposes. On April 20, 2011, the loan was repaid.

George Economou: In April 2012, companies affiliated with the Company's Chairman and Chief Executive Officer, George Economou, purchased a total of 2,185,000 common shares of the Company in the public offering of the Company's common shares by DryShips that was completed on April 17, 2012.

Basset Holdings Inc.: Under the Consultancy Agreement effective from June 1, 2012, between the Company and Basset Holdings Inc. ("Basset"), a related party entity incorporated in the Republic of Marshall Islands, Basset provides consultancy services relating to the services of Antony Kandylidis in his capacity as Executive Vice-

President of the Company. The annual remuneration to be awarded to Basset under the consultancy agreement is Euro 0.9 million (\$1.1 million based on the exchange rate as of June 30, 2012). For the six month period ended June 30, 2012, the Company incurred costs of \$1,983 (including sign on bonus of Euro 1.5 million (\$1.9 million based on the exchange rate as of June 30, 2012) related to this agreement.

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OCEAN RIG UDW INC.

Notes to unaudited Interim Condensed Consolidated Financial Statements

June 30, 2012

(Expressed in thousands of United States Dollars – except for share and per share data, unless otherwise stated)

5. Other Current assets:

The amount of other current assets shown in the accompanying consolidated balance sheets is analyzed as follows:

	December 31, 2011	June 30, 2012
Inventories	\$ 10,706	\$ 5,223
Deferred mobilization expenses	38,052	54,941
Prepayments and advances	11,521	12,643
Loss of hire proceeds (Note 14)	-	24,640
Refundable import taxes	-	37,484
Other	4,969	8,033
Balance at end of year/period	\$ 65,248	\$ 142,964

6. Advances for Rigs and Drillships under Construction:

The amounts shown in the accompanying consolidated balance sheets include milestone payments relating to the shipbuilding contracts with the shipyards, supervision costs and any material related expenses incurred during the construction periods, all of which are capitalized in accordance with the accounting policy discussed in Note 2 of the Consolidated Financial Statements for the year ended December 31, 2011.

The amounts in the accompanying consolidated balance sheets are analyzed as follows:

Balance, December 31, 2011	\$754,925
Advances for drillships under construction and related costs	25,493
Balance, June 30, 2012	\$780,418

7. Drilling rigs, machinery and equipment, net:

The amounts in the accompanying consolidated balance sheets are analyzed as follows:

	Cost	Accumulated Depreciation	Net Book Value
Balance at December 31, 2011	\$ 4,889,606	(350,768)	\$ 4,538,838
Additions	51,010	-	51,010
Disposal	(3)	-	(3)
Depreciation	-	(110,248)	(110,248)
Balance at June 30, 2012	\$ 4,940,613	(461,016)	\$ 4,479,597

As of June 30, 2012, all of the Company's drilling rigs and drillships have been pledged as collateral to secure the bank loans (Note 9).

OCEAN RIG UDW INC.

Notes to unaudited Interim Condensed Consolidated Financial Statements

June 30, 2012

(Expressed in thousands of United States Dollars – except for share and per share data, unless otherwise stated)

8. Other non-current assets:

The amounts included in the accompanying consolidated balance sheets are as follows:

	December 31, 2011	June 30, 2012
Security deposits for derivatives	\$ 33,100	\$ -
Option for construction of drillships	24,756	24,756
Deferred mobilization expenses	24,176	59,496
Other	9,049	17,734
Balance at end of year/period	\$ 91,081	\$ 101,986

As of December 31, 2011, security deposits of \$33,100 for the Ocean Rig Poseidon and Ocean Rig Mykonos, were recorded as "Other non-current assets" in the accompanying consolidated balance sheets. These deposits were required by the counterparty due to the market loss in the swap agreements as of December 31, 2011. Following the commencement of operations of the Ocean Rig Mykonos, these deposits were no longer required.

On November 22, 2010, DryShips, entered into an option contract with Samsung Heavy Industries Co., Ltd ("Samsung") for the construction of up to four additional ultra-deepwater drillships, which will be "sister-ships" to the Ocean Rig Corcovado, Ocean Rig Olympia, Ocean Rig Poseidon and Ocean Rig Mykonos, with certain upgrades to vessels design and specifications. The option agreement was novated by DryShips to the Company on December 30, 2010. On May 16, 2011, the Company entered into an addendum to the option agreement for the construction of up to two additional drillships, with the same contract terms, conditions and specifications as the four optional drillships under the original agreement and extended the date to exercise the fourth option under the original agreement and the two additional options under the addendum from November 22, 2011 to January 31, 2012.

The Company has exercised three of the six options under the contract and as a result, has entered into shipbuilding contracts for three seventh generation, ultra-deepwater drillships with deliveries scheduled in July 2013, October 2013 and November 2013, respectively.

In 2012, Ocean Rig entered into addenda to the option contract with Samsung to further extend the date by which Ocean Rig must exercise its three remaining options under the contract to October 4, 2012. Drillship deliveries are at the reasonable discretion of Samsung, declaring the earliest available date based on Samsung's construction schedule.

9. Long-term Debt:

The amount of long-term debt shown in the accompanying consolidated balance sheets is analyzed as follows:

	December 31, 2011	June 30, 2012
Term loans/Credit facilities	\$ 2,279,167	\$ 2,183,333
Senior Notes	500,000	500,000
Less: Deferred financing costs	(43,402)	(40,942)
Total debt	2,735,765	2,642,391

Less: Current portion	(210,166)	(235,951)
Long-term portion	\$ 2,525,599	\$ 2,406,440

Senior Notes

On April 27, 2011, the Company issued \$500,000 aggregate principal amount of its 9.5% senior unsecured notes due 2016 (the "Senior Notes") offered in a private placement, resulting in net proceeds of approximately \$487,500. The Senior Notes are unsecured obligations and rank senior in right of payment to any future subordinated indebtedness and equally in right of payment to all of the Company's existing and future unsecured senior indebtedness.

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OCEAN RIG UDW INC.

Notes to unaudited Interim Condensed Consolidated Financial Statements

June 30, 2012

(Expressed in thousands of United States Dollars – except for share and per share data, unless otherwise stated)

9. Long-term Debt-continued:

The Senior Notes are not guaranteed by any of the Company's subsidiaries. The Company may redeem some or all of the notes as follows: (i) at any time and from time to time from April 27, 2014 to April 26, 2015, at a redemption price equal to 104.5% of the aggregate principal amount, plus accrued and unpaid interest to the date of redemption; or (ii) at any time and from time to time from April 27, 2015, at a redemption price equal to 102.5% of the aggregate principal amount, plus accrued and unpaid interest to the date of redemption. Upon a change of control, which occurs if 50% or more of the Company's shares are acquired by any person or group other than DryShips or its affiliates, the noteholders will have an option to require the Company to purchase all outstanding notes at a redemption price of 100% of the principal amount thereof plus accrued and unpaid interest to the date of purchase.

The total interest expense and debt amortization cost related to the notes in the Company's unaudited interim condensed consolidated statements of operations for the six months periods ended June 30, 2012 and 2011, was \$24,595 and \$8,312, respectively. The contractual semi-annual coupon interest rate is 9.5% on the Senior Notes.

Term bank loans/ Credit facilities

On May 9, 2012, the Company signed an amendment under its \$800,000 secured term loan agreement with Nordea Finland Plc. to, among other things, terminate the guarantee by DryShips and remove the related covenants and cross-acceleration provisions relating to DryShips's indebtedness for its drybulk carrier and tanker fleet and the Company's indebtedness under its other credit facilities. As a result of the amendment, a default by DryShips under one of its loan agreements for its drybulk carrier and tanker fleet or a default by the Company under one of its other credit facilities and the acceleration of the related debt will no longer result in a cross-default under the Company's \$800,000 secured term loan agreement that would provide the Company's lenders with the right to accelerate the outstanding debt under the loan agreement. In addition, under the terms of the loan agreement, as amended, (i) the Company is permitted to buy back its own common shares; (ii) Drillships Holdings Inc. is able to pay dividends to Ocean Rig UDW Inc. as its shareholder; and (iii) the Company is permitted to pay dividends, make distributions and effect redemptions or returns of share capital in an amount of up to 50% of net income, provided it maintains minimum liquidity in an aggregate amount of not less than \$200,000 in cash and cash equivalents and restricted cash and provide evidence to the lenders through cash flow forecasts that Ocean Rig will maintain such level for the next 12 months following the date of the dividend, distribution or redemption or return of share capital. The amendment also provides for a reduction in the amount of minimum free cash required to be maintained by Drillships Holdings Inc. from \$75,000 to \$50,000. Under the original agreement, the Company is also required to maintain minimum free cash of \$100,000.

On May 14, 2012, the Company signed amendments to its two \$495,000 credit facilities with Deutsche Bank Luxembourg SA as agent (the "Deutsche Bank Credit Facilities") to, among other things, remove the payment guarantee of DryShips, subject to reinstatement as discussed below and remove the financial covenants for DryShips and the cross-default provision relating to DryShips' outstanding indebtedness for its drybulk carrier and tanker fleet. As a result of the amendments, a default by DryShips under one of its loan agreements for its drybulk carrier and tanker fleet will no longer result in a cross-default under the Deutsche Bank Credit Facilities that would provide the lenders thereunder with the right to accelerate the Company's outstanding debt. In addition, the amendments removed the automatic prepayment mechanism under the facilities. The Company is also required to increase its debt service reserve account by \$57,000 beginning September 2014. Furthermore, under the amended Deutsche Bank Credit

Facilities, the Company is permitted to pay dividends, make distributions and effect redemptions or returns of share capital in an amount of up to 50% of net income, provided it maintains minimum liquidity in an aggregate amount of not less than \$200,000 in cash and cash equivalents and restricted cash and provides evidence to the lenders through cash flow forecasts that it will maintain such level for the next 12 months following the date of the dividend, distribution or redemption or return of share capital. Under the terms of the amended Deutsche Bank Credit Facilities, in the event of a breach by the Company of the financial covenants contained in the guarantees, the unconditional and irrevocable payment guarantees of DryShips will be reinstated; pursuant to which DryShips will be obligated to pay, upon demand by the lenders, any amount outstanding under the loans upon a failure by the Company to pay such amount. In addition, DryShips will be required to indemnify the lenders in respect of any losses they incur in respect of any amounts due under the loans that are not recoverable from DryShips under the guarantees and that the Company fails to pay. The amount payable by DryShips under the guarantees will be limited to \$214,000 with respect to the facility for the Ocean Rig Poseidon and \$225,000 with respect to the facility for the Ocean Rig Mykonos, in each case plus any other amounts that become payable in connection with the payment of such amount. The guarantees do not include any financial covenants applicable to DryShips or cross-default provisions in relation to DryShips' indebtedness for its drybulk carrier and tanker fleet.

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9. Long-term Debt-continued:

On May 18, 2012, the Company signed an amendment under its \$1,040,000 credit facility with DNB Bank ASA as agent, to amend the facility to among other things, remove the cross-acceleration clause relating to DryShips' indebtedness for its drybulk carrier and tanker fleet. As a result of the amendment, a default by DryShips under one of its loan agreements for its drybulk carrier and tanker fleet and the acceleration of the related debt will not result in a cross-default under the \$1,040,000 credit facility that would provide the lenders with the right to accelerate the outstanding debt under the facility. Under the terms of the facility, as amended, the cross acceleration relating to the DryShips' outstanding indebtedness for its drybulk carrier and tanker fleet. is replaced with a cross acceleration relating to the outstanding indebtedness of Ocean Rig UDW Inc., which now provides a guarantee under the facility. Furthermore, under the amended credit facility, Drill Rigs Holdings Inc. is restricted from paying or declaring a dividend without the prior written consent of the lenders if the employment contract for the Leiv Eiriksson with the consortium coordinated by Rig Management Norway has expired or been terminated, cancelled or rescinded until it has been replaced to the satisfaction of the majority of the lenders.

The Company's weighted average interest rates for the six-month periods ended June 30, 2011 and 2012, were 4.73% and 4.62%, respectively.

The Company's outstanding bank loans are secured by first priority mortgages over the Company's drilling units, corporate guarantees, and first assignments of all freights, earnings, insurances and requisition compensation. The loans contain covenants including restrictions, without the bank's prior consent, as to the payment of dividends, changes in management and ownership of the drilling units, additional indebtedness and mortgaging of drilling units and change in the general nature of the Company's business.

As of June 30, 2012, the Company was in compliance with the financial covenants contained in its credit facilities.

Total interest cost and amortization of debt issuance costs incurred on long-term debt (including the Senior Notes discussed above) for the six-month periods ended June 30, 2011 and 2012, amounted to \$48,269 and \$80,747, respectively, of which \$30,939 and \$19,614, respectively, were capitalized as part of the cost of the drillships under construction. Total interest incurred and amortization of debt issuance cost on long-term debt, net of capitalized interest, are included in "Interest and finance costs" in the accompanying unaudited interim condensed consolidated statement of operations.

The annual principal payments required to be made after June 30, 2012, including balloon payments, totaling \$2,683,333 due through December 2020, are as follows:

June 30, 2013	\$246,667
June 30, 2014	594,167
June 30, 2015	176,667
June 30, 2016	1,143,332
June 30, 2017 and thereafter	522,500
Total principal payments	2,683,333
Less: Financing fees	(40,942)
Total debt	\$2,642,391

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10. Financial Instruments and Fair Value Measurements:

All derivatives are carried at fair value on the accompanying consolidated balance sheets at each period end.

As of June 30, 2012 the Company had outstanding nine interest rate swap and cap and floor agreements, with a notional amount of \$1.6 billion maturing from September 2013 through November 2017.

Tabular disclosure of financial instruments is as follows:

Fair Values of Derivative Instruments in the Statement of Financial Position:

Derivatives not designated as hedging instruments	Balance Sheet Location	December 31, 2011 Fair value	June 30, 2012 Fair value
Interest rate swaps	Financial Instruments Non-current assets	\$ -	\$ 138
Interest rate swaps	Financial Instruments current liabilities	(40,727)	(42,808)
Interest rate swaps	Financial Instruments non-current liabilities	(52,025)	(42,158)
Total derivatives		\$ (92,752)	\$ (84,828)

During the six-month periods ended June 30, 2011 and 2012, the losses transferred from accumulated other comprehensive loss to the statement of operations were \$3,479 and \$7,061, respectively. The estimated net amount of existing losses at June 30, 2012, that will be reclassified into earnings within the next twelve months relating to previously designated cash flow hedges is \$14,122.

The effects of derivative instruments not designated or qualifying as hedging instruments on the unaudited interim condensed consolidated statements of operations is as follows:

Derivatives not designated as hedging instruments	Location of Gain or (Loss) Recognized	Amount of Gain/(Loss) Six-month period ended June 30, 2011	Six-month period ended June 30, 2012
Foreign currency forward contracts	Other, net	\$ (446)	\$ -
Interest rate swaps	Loss on interest rate swaps, net	(18,616)	(10,940)
Total		\$ (19,062)	\$ (10,940)

ASC 815, 'Derivatives and Hedging' requires companies to recognize all derivatives instruments as either assets or liabilities at fair value in the balance sheet. Effective January 1, 2011, the Company removed the designation of the cash flow hedges and discontinued hedge accounting for the associated interest rate swaps.

Changes in the fair value of derivative instruments that have not been designated as hedging instruments are reported in the accompanying unaudited interim condensed consolidated statement of operations.

The Company enters into interest rate swap transactions to manage interest costs and risk associated with changing interest rates with respect to its variable interest rate loans and credit facilities.

The carrying amounts of cash and cash equivalents, restricted cash, trade accounts receivable and accounts payable reported in the accompanying consolidated balance sheets approximate their respective fair values because of the short term nature of these accounts. The carrying value approximates the fair market value for the floating rate loans. The fair value of the interest rate swaps was determined using a discounted cash flow method based on market-based LIBOR swap yield curves, taking into account current interest rates and the creditworthiness of both the financial instrument counterparty and the Company.

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OCEAN RIG UDW INC.

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(Expressed in thousands of United States Dollars – except for share and per share data, unless otherwise stated)

10. Financial Instruments and Fair Value Measurements-(continued):

The Senior Notes have a fixed rate and their estimated fair values are determined through Level 2 inputs of the fair value hierarchy (quoted price in the over-the counter-market). The fair value of the outstanding balance of the Deutsche Bank credit facilities which have a fixed rate, is estimated through Level 2 inputs of the fair value hierarchy by discounting future cash flows using rates currently available for debt with similar terms, credit risk and remaining maturities. The estimated fair value of the above Senior Notes and loans at June 30, 2012, is approximately \$485,000 and \$542,650, respectively compared to a carrying value net of finance fees of \$490,677 and \$477,688, respectively.

The guidance for fair value measurements applies to all assets and liabilities that are being measured and reported on a fair value basis. This guidance enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The statement requires that assets and liabilities carried at fair value be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3: Unobservable inputs that are not corroborated by market data.

The following table summarizes the valuation of assets and liabilities measured at fair value on a recurring basis as of the valuation date.

	June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Recurring measurements:				
Interest rate swaps- net liability position	\$ (84,828)	-	\$ (84,828)	-
Total	\$ (84,828)	-	\$ (84,828)	-

11. Shareholders' equity

Restricted stock awards

On February 14, 2012, the Company's Compensation Committee approved the grant of 112,950 shares of non-vested common stock to officers and key employees as a bonus for their services rendered during 2011. The shares vest over a period of three years, one third on each of December 31, 2012, 2013 and 2014. The stock-based compensation is being recognized to expenses over the vesting period and based on the fair value of the shares on the grant date of \$16.50 per share.

On March 21, 2012, the Company's Board of Directors approved the 2012 Equity Incentive Plan (the "Plan") and reserved a total of 2,000,000 shares. Under the Plan, officers, key employees, and directors are eligible to receive awards of stock options, stock appreciation rights, restricted stock, restricted stock units, phantom stock units and unrestricted stock.

On May 15, 2012, Ocean Rig's Compensation Committee approved the grant of 4,500 shares of non-vested common stock to an officer as an additional bonus for his services rendered during 2011. The shares vest over a period of three years, one third on each of December 31, 2012, 2013 and 2014. At the same date, Ocean Rig's Compensation Committee also approved the grant of 28,200 shares of non-vested common stock to new recruited employees as a sign-up stock bonus. The stock-based compensation is being recognized to expenses over the vesting period and based on the fair value of the Ocean Rig shares on the grant date of \$15.92 per share.

As of June 30, 2012, none of these shares have vested, while 3,000 shares were forfeited due to a resignation.

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(Expressed in thousands of United States Dollars – except for share and per share data, unless otherwise stated)

11. Shareholders' equity-(continued):

The movement during the six-month period ended June 30, 2012, is presented below.

	Number of non vested shares	Weighted average grant date fair value per non vested shares
Balance as at January 1, 2012	-	\$ -
Granted	145,650	16.37
Forfeited	(3,000)	16.50
Balance as at June 30, 2012	142,650	\$ 16.37

As of June 30, 2012, there was \$1,821 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted by the Company. That cost is expected to be recognized over a period of three years. The amount of \$514 represents the stock based compensation expense for the period and is recorded in "General and administrative expenses", in the accompanying unaudited interim condensed consolidated statements of operations for the six-month period ended June 30, 2012.

12. Accumulated other comprehensive loss:

The amounts in the accompanying balance sheets are analyzed as follows:

	December 31, 2011	June 30, 2012
Cash flows hedges unrealized loss	\$ (22,904)	\$ (16,360)
Cash flows hedges realized loss	(30,326)	(29,809)
Actuarial pension gain	2,104	2,205
Total	\$ (51,126)	\$ (43,964)

13. Income Tax

Ocean Rig operates through its various subsidiaries in a number of countries throughout the world. Income taxes have been provided based upon the tax laws and rates in the countries in which operations are conducted and income is earned. The countries in which Ocean Rig operates have taxation regimes with varying nominal rates or no system of corporate taxation, as well different deductions, credits and other tax attributes. Consequently, there is not an expected relationship between the provision for/or benefit from income taxes and income or loss before income taxes.

14. Commitments and Contingencies

14.1 Legal proceedings

Various claims, suits, and complaints, including those involving government regulations and product liability, arise in the ordinary course of the offshore drilling business.

The Company has obtained insurance for the assessed market value of the rigs. However, such insurance coverage may not provide sufficient funds to protect the Company from all liabilities that could result from its operations in all situations. Risks against which the Company may not be fully insured or insurable for include environmental liabilities, which may result from a blow-out or similar accident, or liabilities resulting from reservoir damage alleged to have been caused by the negligence of the Company.

The Company's loss of hire insurance coverage does not protect against loss of income from day one, but will be effective after 45 days' off-hire. The occurrence of casualty or loss, against which the Company is not fully insured, could have a material adverse effect on the Company's results of operations and financial condition.

The insurance covers approximately one year for the loss of hire. In the first half of 2012, the Ocean Rig Corcovado incurred off-hire which was a covered event under the Company's loss of hire policy that resulted in \$24.6 million being recognized as revenue during the six month period ended June 30, 2012.

As part of the Company's normal course of operations, the Company's customer may disagree on amounts due to the Company under the provision of the contracts which are normally settled through negotiations with the customer. Disputed amounts are normally reflected in revenues at such time as the Company reaches agreement with the customer on the amounts due.

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OCEAN RIG UDW INC.

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June 30, 2012

(Expressed in thousands of United States Dollars – except for share and per share data, unless otherwise stated)

14. Commitments and Contingencies- (continued):

14.1 Legal proceedings- (continued):

The Leiv Eiriksson operated in Angola during the period from 2002 to 2007. Ocean Rig's manager in Angola during this period made a legal claim for reimbursement of import/export duties for two export/importation events in the period 2002 to 2007 retroactively levied by the Angolan government. Agreement was reached between the parties to this claim for an amount of \$6.1 million which was paid by the Company's relevant subsidiary on May 24, 2012, to the claimant, in full and final settlement of the London Court Proceedings. The Company recorded a charge of \$6.1 million during the six month period ended June 30, 2012, which is included under "Legal settlements" in the consolidated statement of operations.

Except for the matters discussed above, the Company is not a party to any material litigation where claims or counterclaims have been filed against the Company other than routine legal proceedings incidental to its business.

14.2 Contractual revenue

Future minimum contractual revenue, based on rigs committed to non-cancelable, long-term contracts as of June 30, 2012, amounted to \$1,019,670 for twelve months ending June 30, 2013, \$737,057 for twelve months ending June 30, 2014, \$670,175 for twelve months ending June 30, 2015 and \$124,963 for twelve months ending June 30, 2016. These amounts do not include any assumed off-hire.

14.3 Purchase obligations

As of June 30, 2012, the Company made an aggregate of \$726,681 of construction and construction-related payments for the Company's seventh generation drillships under construction and has remaining total construction and construction-related payments for its seventh generation drillships of approximately \$1,096,826 in the aggregate, due in the third and fourth quarter of 2013.

14.4 Rental payments

Ocean Rig entered into two three-year office lease agreements with an unrelated third party which commenced on September 1, 2011 and October 1, 2011, respectively. These leases include an option for an additional two and three-year term, respectively, which must be exercised at least six months prior to the end of the term of the contract which expires in September 2014 and October 2014, respectively. Ocean Rig also entered into a three-year office lease with a third party in Nicosia, Cyprus which commenced on September 1, 2010 and expires in 2014. The lease agreements relating to office space are considered to be operating lease contracts. As of June 30, 2012, the future obligations amount to \$1,232 for the twelve months ending June 30, 2013, and 2014, and \$272 for the twelve months ending June 30, 2015. The contracts expire in 2014.

15. Interest and Finance costs:

The amounts in the accompanying unaudited interim condensed consolidated statements of operations are analyzed as follows:

	Six-month period ended	
	June 30,	
	2011	2012
Interest incurred on long-term debt	\$ 31,997	\$ 69,522
Amortization of financing fees	16,272	11,225
Other	4,884	1,821
Capitalized interest	(30,939)	(19,614)
Total	\$ 22,214	\$ 62,954

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OCEAN RIG UDW INC.

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16. Subsequent Events:

On August 7, 2012, the Company entered into an amortizing interest rate swap agreement for an initial notional amount of \$450,000 maturing in July 2017. This agreement was entered into to hedge the Company's exposure to interest rate fluctuations by fixing the interest rate at 1.0425% from July 2013 until July 2017.

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