Shelf Drilling, Ltd.

Consolidated financial statements
for the year ended December 31, 2016

SHELF DRILLING, LTD.
CONSOLIDATED FINANCIAL STATEMENTS
YEAR ENDED DECEMBER 31, 2016
INDEX

Independent Auditor's Report

To the Board of Directors

We have audited the accompanying consolidated financial statements of Shelf Drilling, Ltd. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2016 and December 31, 2015, and the related consolidated statements of operations, comprehensive income, equity, and cash flows for the years ended December 31, 2016, 2015 and 2014.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant 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 provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Shelf Drilling, Ltd. and its subsidiaries at December 31, 2016 and December 31, 2015, and the results of their operations and their cash flows for the years ended December 31, 2016, 2015 and 2014 in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers

Dubai, United Arab Emirates
February 22, 2017

PricewaterhouseCoopers (Dubai Branch), License no. 102451,
Emaar Square, Building 4, Level 8, P O Box 11987, Dubai - United Arab Emirates
T: +971 (0)4 304 3100, F: +971 (0)4 346 9150, www.pwc.com/me

SHELF DRILLING, LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share data)

	Years ended December 31,		
	2016	**2015**	**2014**
Revenues			
Operating revenues	$ 668,649	$ 1,012,757	$ 1,213,700
Amortization of drilling contract intangibles	-	983	31,522
Other operating revenue	15,668	17,558	20,804
	684,317	1,031,298	1,266,026
Operating costs and expenses			
Operating and maintenance	353,802	534,156	667,162
Depreciation	71,780	87,421	81,711
Amortization of deferred costs	91,763	80,984	48,809
General and administrative	46,889	139,722	107,093
	564,234	842,283	904,775
Gain on insurance recovery	-	25,432	-
Loss on impairment of assets	(47,094)	(271,469)	-
Loss on disposal of assets	(4,826)	(11,299)	(2,921)
Operating income / (loss)	68,163	(68,321)	358,330
Other (expense) / income, net			
Interest income	356	102	21
Interest expense and financing charges	(80,120)	(80,537)	(88,928)
Other, net	1,522	(873)	(329)
	(78,242)	(81,308)	(89,236)
(Loss) / income before income taxes	(10,079)	(149,629)	269,094
Income tax expense	19,757	30,373	43,032
Net (loss) / income	$ (29,836)	$ (180,002)	$ 226,062
(Loss) / earnings per share:			
Basic - Class A shares	$ (66.99)	$ (403.12)	$ 506.40
Diluted - Class A shares	$ (66.99)	$ (403.12)	$ 506.24
Basic and Diluted - Class B shares	nil	nil	nil
Basic and Diluted - Class C shares	nil	nil	nil
Weighted average shares outstanding:			
Basic - Class A shares	445,386	446,525	446,407
Diluted - Class A shares	445,386	446,525	446,553
Basic - Class B shares	17,500	15,142	12,419
Diluted - Class B shares	20,954	23,297	23,152
Basic - Class C shares	5,119	5,133	5,131
Diluted - Class C shares	5,119	5,774	5,969

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

SHELF DRILLING

SHELF DRILLING, LTD.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(In thousands)

	Years ended December 31,		
	2016	**2015**	**2014**
Net (loss) / income	$ (29,836)	$ (180,002)	$ 226,062
Other comprehensive income, net of tax			
Foreign currency forward exchange contracts			
Changes in unrealized gains	427	-	-
Reclassification of net gain from other comprehensive income to net income	(427)	-	-
	$ -	$ -	$ -
Total comprehensive (loss) / income	$ (29,836)	$ (180,002)	$ 226,062

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

SHELF DRILLING, LTD.
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	December 31, 2016	December 31, 2015
Assets		
Cash and cash equivalents	$ 213,139	$ 115,685
Accounts and other receivables, net	125,312	166,109
Other current assets	95,235	118,500
Total current assets	433,686	400,294
Property and equipment	1,326,361	1,175,054
Less accumulated depreciation	295,685	230,421
Property and equipment, net	1,030,676	944,633
Deferred tax assets	3,137	3,697
Other assets	118,441	135,259
Total assets	$ 1,585,940	$ 1,483,883
Liabilities and equity		
Accounts payable	$ 70,605	$ 89,968
Accrued income taxes	-	546
Interest payable	15,773	15,773
Obligations under sale and leaseback	15,977	-
Other current liabilities	32,665	46,672
Total current liabilities	135,020	152,959
Long-term debt	809,016	803,053
Obligations under sale and leaseback	228,728	74,703
Deferred tax liabilities	8,525	8,788
Other long-term liabilities	25,197	33,601
Total long-term liabilities	1,071,466	920,145
Commitments and contingencies		
Ordinary shares of $0.01 par value; 5,000,000 shares authorized at December 31, 2016 and 2015; 475,768 and 477,326 shares issued and outstanding at December 31, 2016 and 2015, respectively	5	5
Shares held in trust of $0.01 par value; 15,844 and 15,487 shares at December 31, 2016 and 2015, respectively	-	-
Additional paid-in capital	462,914	464,403
Accumulated losses	(83,465)	(53,629)
Total equity	379,454	410,779
Total liabilities and equity	$ 1,585,940	$ 1,483,883

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

SHELF DRILLING, LTD.
CONSOLIDATED STATEMENTS OF EQUITY
(In thousands, except share data)

	Years ended December 31,			Years ended December 31,		
	2016	2015	2014	2016	2015	2014
		Shares			Amount	
Ordinary shares						
Balance, beginning of year	477,326	477,717	474,540	$ 5	$ 5	$ 5
Issuance of shares under share-based compensation plans	-	-	1,350	-	-	-
Shares issued to trust	2,835	-	2,274	-	-	-
Repurchase and retirement of shares	(4,393)	(391)	(447)	-	-	-
Balance, end of year	475,768	477,326	477,717	$ 5	$ 5	$ 5
Shares held in trust						
Balance, beginning of year	15,487	15,678	13,751	$ -	$ -	$ -
Shares issued to trust	2,835	-	2,274	-	-	-
Retirement of shares	(2,478)	(191)	(347)	-	-	-
Balance, end of year	15,844	15,487	15,678	$ -	$ -	$ -
Additional paid-in capital						
Balance, beginning of year				$ 464,403	$ 464,005	$ 460,774
Capital contributions				-	-	1,350
Share-based compensation expense, net of forfeitures				179	638	1,981
Repurchase and retirement of shares				(1,668)	(240)	(100)
Balance, end of year				$ 462,914	$ 464,403	$ 464,005
(Accumulated losses) / retained earnings						
Balance, beginning of year				$ (53,629)	$ 126,443	$ 23,091
Ordinary shares dividend				-	-	(122,710)
Repurchase and retirement of shares				-	(70)	-
Net (loss) / income				(29,836)	(180,002)	226,062
Balance, end of year				$ (83,465)	$ (53,629)	$ 126,443
Total equity						
Balance, beginning of year				$ 410,779	$ 590,453	$ 483,870
Capital contributions				-	-	1,350
Issuance of shares under share-based compensation plans				-	-	-
Share-based compensation expense, net of forfeitures				179	638	1,981
Repurchase and retirement of shares				(1,668)	(310)	(100)
Ordinary shares dividend				-	-	(122,710)
Total comprehensive (loss) / income				(29,836)	(180,002)	226,062
Balance, end of year				$ 379,454	$ 410,779	$ 590,453

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

SHELF DRILLING, LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Years ended December 31, 2016	2015	2014
Cash flows from operating activities			
Net (loss) / income	$ (29,836)	$ (180,002)	$ 226,062
Adjustments to reconcile net (loss) / income to net cash provided by operating activities			
Depreciation	71,780	87,421	81,711
Amortization of deferred costs	91,763	80,984	48,809
Loss on impairment of assets	47,094	271,469	-
Gain on foreign currency forward exchange contracts	(427)	-	-
Gain on insurance recovery	-	(25,432)	-
Amortization of deferred revenue	(23,511)	(41,026)	(33,330)
(Reversal of) / provision for doubtful accounts, net	(401)	87,431	22,600
Amortization of drilling contract intangibles	-	(983)	(31,522)
Share-based compensation expense, net of forfeitures	179	638	1,981
Amortization of debt issue costs and discounts	7,663	9,232	13,514
Loss on disposal of assets	4,826	11,299	2,921
Deferred tax expense / (benefit)	297	1,292	(3,724)
Proceeds from settlement of foreign currency forward exchange contracts	427	-	-
Changes in operating assets and liabilities	22,523	(7,757)	55,301
Net cash provided by operating activities	192,377	294,566	384,323
Cash flows from investing activities			
Additions to property and equipment *	(53,541)	(157,193)	(168,404)
Additions to deferred costs *	(55,845)	(161,553)	(147,752)
Proceeds from disposal of property and equipment	1,490	547	844
Proceeds from sale and leaseback	16,880	18,515	-
Payments of transaction costs for sale and leaseback	-	(7,555)	-
Proceeds from insurance recovery	-	45,000	-
Change in restricted cash	(421)	(6,827)	-
Net cash used in investing activities	(91,437)	(269,066)	(315,312)
Cash flows from financing activities			
Payments for redemption of ordinary shares	(1,668)	(310)	(100)
Payments for obligations under sale and leaseback	(1,818)	-	-
Ordinary shares dividend paid	-	-	(122,710)
Payments to retire long-term debt	-	-	(74,250)
Payments of debt issuance costs	-	(551)	(6,720)
Advanced to related party	-	-	(30,039)
Received from related party	-	-	30,039
Net cash used in financing activities	(3,486)	(861)	(203,780)
Net increase / (decrease) in cash and cash equivalents	97,454	24,639	(134,769)
Cash and cash equivalents at beginning of year	115,685	91,046	225,815
Cash and cash equivalents at end of year	$ 213,139	$ 115,685	$ 91,046

* See Note 21 – Supplemental Cash Flow Information for a reconciliation of cash payments for additions to property and equipment and deferred costs to total capital expenditures and deferred costs.

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

SHELF DRILLING, LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1 — Nature of Business

Business

Shelf Drilling, Ltd ("SDL") was incorporated on August 14, 2012 ("inception") as a private corporation in the Cayman Islands and is a holding company with no significant operations or assets other than owned interests in its direct and indirect subsidiaries. SDL and its majority owned subsidiaries (together, the "Company") provide shallow-water drilling services to the oil and natural gas industry. The Company's corporate offices are in Dubai, United Arab Emirates ("UAE"), geographically close to its operations in the Middle East, South East Asia, India, West Africa and the Mediterranean. The principal investors in the Company are affiliates of Castle Harlan, Inc., CHAMP Private Equity and Lime Rock Partners (together, the "Sponsors").

SDL, through its majority and wholly owned subsidiaries, provides safe and reliable fit-for-purpose independent cantilever jackup drilling services. The Company is primarily engaged in development and workover activity on producing assets in shallow water of up to 400 feet in water depth. The Company owns 35 independent cantilever jackup rigs, one swamp barge and one new build jackup under construction.

In May 2014, the Company signed a contract with Lamprell Energy Limited (the "Builder") to construct two new build high specification jackup rigs (the "Newbuilds"). On September 29, 2016, the Company took delivery of one of the Newbuilds from the Builder and on December 1, 2016, the rig commenced a five-year contract with Chevron Thailand Exploration and Production, Ltd ("Chevron"). The second rig under construction is expected to be delivered and to commence a five-year contract with Chevron during the second quarter of 2017. See Note 8 – Property and Equipment and Note 11 – Sale and Leaseback.

Acquisition Related Matters

On September 9, 2012, the Company entered into definitive agreements with Transocean Inc. (the "Seller"), providing for the acquisition (the "Acquisition"), both directly and through the purchase of certain of the Seller's affiliates, of 37 shallow water drilling rigs and one swamp barge (the "business"). The Acquisition closed on November 30, 2012.

Through a number of individual rig operating agreements entered into with the Seller concurrently with the closing of the Acquisition ("Operating Agreements"), the Seller agreed on behalf of the Company to operate, for a transitional period of time, certain rigs acquired by the Company, and to submit invoices and collect revenue from the customers under the associated drilling contracts and pay direct costs and expenses incurred while operating the rigs. Pursuant to the Operating Agreements, the Seller also agreed to transfer the net amount of each drilling contract (customer collections less direct costs and expenses and taxes paid by the Seller) to the Company on a monthly basis. In addition, the Company agreed to pay the Seller a daily pre-determined fixed fee for in country onshore support and a daily fixed fee per rig for corporate services. The Operating Agreements for each individual rig remained in effect until the expiration, novation, or assignment to the Company of the underlying drilling contracts that were in place at the time of the Acquisition, originally resulting in effective terms ranging from 9 months to 27 months. Until the expiration, novation, or assignment of the underlying drilling contracts, the Seller retained possession of the materials and supplies associated with the rigs that the Seller operated under the Operating Agreements. Upon novation, assignment or expiration of the related drilling contracts, the individual rig Operating Agreements were terminated and the Company assumed operation of the rigs. One rig was subject to the Operating Agreements as of December 31, 2014. No rig remained subject to the Operating Agreements as of January 1, 2015.

Under a separate Transition Services Agreement entered into with the Seller concurrently with the closing of the Acquisition, the Seller agreed to provide various corporate and local services to the Company for Company operated rigs. These services were generally provided on a daily fixed fee. The services included use of the Seller's enterprise resource planning ("ERP") system for accounting, fixed assets, treasury, supply chain management, maintenance scheduling, human resource systems, information technology infrastructure and helpdesk support. The Seller agreed to provide certain of these transition services for a period of up to 18 months following the completion of the Acquisition. As of December 31, 2014, all services previously provided under the Transition Services Agreement were assumed by the Company.

To fund the Acquisition, in addition to equity contributions of $450 million from the Sponsors, SDL used a combination of debt and Seller financing. On October 24, 2012, Shelf Drilling Holdings, Ltd. ("SDHL"), an indirect wholly owned subsidiary of SDL, completed the issuance and sale of $475 million aggregate principal amount of senior secured notes at a coupon rate of 8.625% due November 1, 2018 ("8.625% Senior Secured Notes").

On November 30, 2012, SDHL also entered into a credit agreement, which consisted of a $75 million term loan facility and a $50 million credit facility to issue fully cash collateralized letters of credit. This facility was fully repaid on February 28, 2014 out of existing funds and the credit agreement, along with the associated $50 million cash collateralized letter of credit facility, was cancelled. There were no issued or outstanding letters of credit against the facility at that time.

Concurrent with the Acquisition, on November 30, 2012, Shelf Drilling Intermediate, Ltd ("SDIL"), an indirect wholly-owned subsidiary of SDL, issued 195,000 preferred shares for a deemed value of $195 million to the Seller. These preferred shares were fully redeemed on October 8, 2013. On the same date, SDIL also settled in cash all accumulated and outstanding dividends on the outstanding preferred shares.

2016 Events

In April, 2016, the Company sold two stacked rigs, Adriatic V and Adriatic VI. See Note 8 – Property and Equipment.

On December 1, 2016, one of the Newbuilds which is part of the sale and leaseback transactions, commenced a five-year contract with Chevron. See Note 8 – Property and Equipment.

On December 2, 2016, SDL and its wholly owned subsidiaries, Shelf Drilling Midco, Ltd. ("Midco") and SDHL signed an Amended and Restated Transaction Support Agreement with certain equity sponsors and holders, in the aggregate, of (a) approximately 85.6% of principal amount of the 8.625% Senior Secured Notes and (b) 100% of principal amount of the $350 million Midco Term Loan to support certain transactions to refinance the Company's debt facilities. On January 12, 2017, the Company successfully concluded the refinancing of its debt facilities. See Note 26 – Subsequent Events.

At December 31, 2016, the Company recorded a non-cash impairment loss of $47.1 million in relation to three rigs out of which one rig was impaired to salvage value. This non-cash impairment was included in loss on impairment of assets in the consolidated statements of operations. See Note 8 – Property and Equipment.

Note 2 — Significant Accounting Policies

Basis of Presentation — The Company has prepared its consolidated financial statements in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP"). The consolidated financial statements include the Company's accounts, those of the Company's wholly-owned subsidiaries and entities in which the Company holds a controlling financial interest. Entities that meet the criteria for variable interest entities for which the Company is deemed to be the primary beneficiary for accounting purposes are consolidated. As of December 31, 2016, the Company's consolidated financial statements include four joint ventures that meet the definition of variable interest entities. Intercompany transactions and accounts are eliminated in consolidation. The Company applies the equity method of accounting for investments in which it has the ability to exercise significant influence but for which; (i) the entity does not meet the variable interest entity criteria, or; (ii) the entity meets the variable interest entity criteria but the Company is not deemed the primary beneficiary. As of December 31, 2016, none of the Company's investments meet the criteria established for application of the equity method of accounting. Certain amounts in prior periods have been reclassified to conform to the current year presentation.

Accounting Estimates — The preparation of consolidated financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosures of contingent assets and liabilities. As of the date of the Acquisition, the Company used "Hein & Associates LLP", an independent third party expert, to estimate the fair market value of the acquired rigs including inventory and drilling contract intangibles.

On an ongoing basis, these estimates and assumptions are evaluated, including those related to allowance for doubtful accounts, property and equipment, income taxes, other post-retirement benefits and contingencies. The Company bases its estimates and assumptions on various factors that management believes are reasonable, the results of which form the basis for making judgments about the carrying amounts of assets and liabilities that are not readily apparent from other sources. While management believes current estimates are appropriate and reasonable, actual results could materially differ from those estimates.

Fair Value Measurements — Fair value is estimated at a price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the principal market for the asset or liability. Fair value measurements are based on a hierarchy which prioritizes valuation technique inputs into three levels. The fair value hierarchy is composed of: (i) Level 1 measurements, which are fair value measurements using quoted unadjusted market prices in active markets for identical assets or liabilities; (ii) Level 2 measurements, which are fair value measurements using inputs, other than Level 1 inputs, which are directly or indirectly observable for the asset or liability and; (iii) Level 3 measurements, which are fair value measurements which use unobservable inputs. The fair value hierarchy gives the highest priority to Level 1 measurements and the lowest priority to Level 3 measurements.

Revenue Recognition — Revenues generated by rigs owned by the Company and operated by the Seller under the Operating Agreements were recorded as net revenue. Net revenue represents the customer revenue less the expenses related to the operation of the rigs (including personnel, asset management and maintenance, operating, miscellaneous and administration expenses), shore based fixed fees, corporate services fixed fee and taxes paid by the Seller. The Company deemed the Seller as the principal regarding the drilling service contracts during the term of the Operating Agreements based on the following:

- The Seller is the contractual primary obligor under the drilling services contracts with customers; and
- The Seller is responsible for fulfillment of drilling services under the contracts subject to the Operating Agreements, including the provision of rigs, rig crew, and all of the related goods and services including general inventory risk.

While the Seller effectively earned no profit under the Operating Agreements and the Company retained the general credit risks, indicating that the Company may be the principal, the Company views the other factors discussed above as more indicative and determined that net revenue presentation was appropriate.

Operating revenues generated by the Company owned and operated rigs under the Transition Services Agreement are recorded on a gross basis. Revenue is recognized when earned and realizable, based on contractual dayrates.

Upon completion of the transition periods related to the Operating Agreements with the Seller, revenue is recognized on a gross basis as earned and realizable, based on contractual dayrates. Amounts earned prior to the beginning of a drilling contract period, such as for mobilization, contract preparation and capital upgrades, are deferred and recognized on a straight-line basis over the primary term of the contract to which they relate. Upon completion of drilling contracts, any demobilization fees are immediately recognized as revenue when collectability is reasonably assured.

Other operating revenue consists of amounts billed for goods and services which are acquired by the Company from other sources and re-billed to customers.

Operating and Deferred Costs — Operating costs are recognized when incurred. Mobilization and demobilization costs of relocating drilling units without contracts are expensed as incurred.

Periodic survey and inspection in lieu of drydock costs incurred in connection with obtaining regulatory certifications to operate the rigs are deferred and amortized on a straight-line basis over the period until the next survey or inspection - generally for periods of between 30 to 60 months. Contract preparation and mobilization expenditures incurred specifically for a rig entering a drilling services contract are deferred and amortized on a straight-line basis over the primary period of the contract to which the costs relate. Periodic major overhauls of equipment are deferred and amortized on a straight-line basis over the period between regularly scheduled overhauls of the same nature.

Foreign Currency — The Company's functional currency is the U.S. dollar. As is customary in the oil and gas industry, the majority of the Company's revenues and expenditures are denominated in U.S. dollar. As such, the Company's exposure to non U.S. dollar denominated currency exchange rate fluctuations is limited. Certain revenues and expenditures incurred by certain subsidiaries are denominated in currencies other than the U.S. dollar. Non U.S. dollar revenues and costs are recorded in U.S. dollars at the prevailing exchange rate as of the date of recognition. Cash receipts and payments made in other currencies are recorded in U.S. dollars at the prevailing exchange rate as of the transaction date. Transaction gains or losses are recorded in net income and include, where applicable, unrealized gains and losses to record the carrying value of foreign currency forward exchange ("forex") contracts not designated as accounting hedges, as well as realized gains and losses from the settlement of such contracts. Monetary assets and liabilities denominated in foreign currency are re-measured to U.S. dollars at the rate of exchange in effect at the end of each month and unrealized exchange gains or losses are recognized in the consolidated statements of operations.

Cash and Cash Equivalents — Cash and cash equivalents is comprised of cash on hand, cash in banks and highly liquid funds with an original maturity of three months or less. Other bank deposits, if any, with maturity of less than a year are classified as short-term bank deposits within other current assets in the consolidated balance sheets. Bank overdrafts, if any, are shown within other current liabilities in the consolidated balance sheets.

Accounts Receivable and Allowance for Doubtful Accounts — Receivables, including accounts receivable, are recorded in the consolidated balance sheets at their nominal amounts less allowance for doubtful accounts. An allowance for doubtful accounts is established on a case-by-case basis, considering changes in the financial position of a customer, when it is believed that the required payment of specific amounts owed is unlikely to occur.

Drilling Contract Intangibles — In connection with the Acquisition, the Company acquired certain existing drilling contracts for future contract drilling services. The terms of these contracts include fixed dayrates that were above or below the market dayrates that were estimated to be available for similar contracts as of the date of the Acquisition. Drilling contract intangibles were recorded as current and non-current assets and liabilities and amortized on a straight-line basis over the respective contract periods.

Property and Equipment — Property and equipment was stated at fair market value as of the date of the Acquisition. Inventory acquired with the business was capitalized as part of the rigs and is maintained at a level to support the operations of the rig. Costs incurred that substantially enhance, improve or increase the useful lives of existing assets are capitalized. Routine expenditures for repairs and maintenance are expensed as incurred.

Construction in progress is stated at cost. Cost consists of direct costs of construction, interest capitalized during the period of rig construction and other direct costs necessary to bring the asset to the condition and location necessary for its intended use. When the asset is ready, it is transferred from construction in progress to the appropriate category under property and equipment. Depreciation commences upon capitalization.

Land is not depreciated.

Depreciation on other items of property and equipment is computed using the straight-line method, after allowing for salvage value of 10% where applicable, over the estimated useful lives of the assets.

The estimated useful lives of property and equipment are as follows:

	Years
Drilling rigs	30
Drilling equipment and Spares	9-13
Building	30
Other	3-5

The remaining estimated average useful life of existing drilling rigs in the Company's fleet at December 31, 2016 and 2015 is 10 and 11 years, respectively.

The Company evaluates property and equipment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. An impairment loss on property and equipment exists when the estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. Any actual impairment loss recognized represents the excess of the asset's carrying value over the estimated fair value. The Company estimates the fair values of property and equipment by applying a combination of income and market approaches, using projected discounted cash flows and estimates of the exchange price that would be received for the assets in the principal or most advantageous market for the assets in an orderly transaction between market participants as of the measurement date.

When assets are sold, retired or otherwise disposed of, the cost and related accumulated depreciation are written off, net of any proceeds received, and any gain or loss is reflected in the consolidated statements of operations.

Capitalization of Interest — The Company capitalizes interest costs in connection with major construction programs, including the Newbuilds. Capitalized interest is recorded as part of the asset to which it relates and is subsequently depreciated over the asset's useful life.

Goodwill — Impairment testing for goodwill, if any, is performed annually in the fourth quarter, or when an event occurs or circumstances change that may indicate a reduction in the fair value of a reporting unit below its carrying value. A segment constitutes a business for which financial information is available and is regularly reviewed by management. The Company has one reportable segment that is contract drilling services. The individual drilling rigs are components of the segment.

Testing for goodwill impairment is a multi-step process. The Company first assesses for potential impairment on a qualitative basis, and if there is an indication of possible impairment, the following two steps must be completed to measure the amount of impairment loss, if any. The Company assesses qualitative factors to determine whether the existence of events or circumstances leads to the determination that it is more likely than not that the fair value of the segment is less than its carrying amount. If, as the result of the qualitative assessment, the Company determines that the next step of impairment test is required, or alternatively, elects to forgo the qualitative assessment, the Company tests goodwill for impairment by comparing the carrying amount of the segment to the estimated fair value of the segment to determine that it is more likely than not that the goodwill is impaired. The fair value is estimated using projected discounted future cash flows, publicly traded company multiples and / or acquisition multiples. If the estimated fair value of the Company's goodwill is less than the carrying value, the Company considers goodwill impaired and performs a second step to measure the amount of the impairment loss, if any.

Sale and Leaseback — Leases that transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item are capitalized at the commencement of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between interest expense and reduction of the lease liability. Interest cost is disclosed as part of interest expense and financing charges in the consolidated statements of operations.

Leased capital assets are depreciated over the useful lives of the assets. However, if there is no reasonable certainty that the Company will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful lives of the assets and the lease term.

Any loss arising on sale and leaseback transaction as a result of sale price lower than fair value is recognized immediately in the consolidated statements of operations. In situations where loss on sale of asset under sale and leaseback is compensated for by future lease payments at below market price, it is deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used.

Where the sale price is above fair value, the excess over fair value is deferred and amortized over the period for which the asset is expected to be used. In the case of profits arising on sale and leaseback transactions resulting in capital leases, the excess of sale proceeds over the carrying amount is deferred and amortized over the lease term.

When the Company determines that a sale and leaseback transaction is a financing activity, no gain or loss is recognized.

Lease classification is changed only if, at any time during the lease, the parties to the lease agreement agree to change the provisions of the lease (without renewing it) in a way that it would have been classified differently at inception had the changed terms been in effect at that time. The revised agreement is considered as a new agreement and accounted for prospectively over the remaining term of the lease.

Operating Lease — Operating leases are recognized as an operating expense in the consolidated statements of operations on a straight-line basis over the lease term.

Income Taxes — Income taxes are provided for based on relevant tax laws and rates in effect in the countries in which the Company operates and earns income or in which the Company is considered resident for income tax purposes. The current income tax expense reflects an estimate of the Company's income tax liability for the current year, including changes in prior year tax estimates as returns are filed, and any tax audit adjustments. Deferred income tax assets and liabilities, including net operating loss carry-forwards which the Company anticipates utilizing at the subsidiary level, reflect anticipated future tax effects of differences between the financial statement basis and tax basis of assets and liabilities based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. When necessary, valuation allowances are established to reduce deferred income tax assets to the amount expected to be realized. Reserves are recorded to offset tax benefits related to tax positions that have been taken that are more likely than not to ultimately be denied upon examination or audit by tax authorities. Any interest and penalties related to such reserves are included as a component of the income tax expense.

The Company is subject to the tax laws, including relevant regulations, treaties, and court rulings, of the countries and jurisdictions in which the Company operates. The provision for income taxes is based upon interpretation of the relevant tax laws in effect at the time the expense was incurred. If the relevant taxing authorities do not agree with the Company's interpretation and application of such laws, or if any such laws are changed retroactively, additional tax may be imposed which could significantly increase the Company's effective tax rate related to its worldwide earnings.

Contingencies — Assessments of contingencies are performed on an ongoing basis to evaluate the appropriateness of liabilities and disclosures for such contingencies. Liabilities are established for estimated loss contingencies when a loss is believed to be probable and the amount can be reasonably estimated. Corresponding assets are recognized for those loss contingencies that are assessed as probable of being recovered through insurance. Once established, the carrying amount of a contingent liability is adjusted upon the occurrence of a recognizable event when facts and circumstances change which alter previous assumptions with respect to the likelihood or amount of loss. Legal costs are expensed as incurred in the consolidated statements of operations.

Share-based Compensation — Share-based compensation is recognized in the consolidated statements of operations based on its fair value and the estimated number of shares or units that are ultimately expected to vest. For awards which vest based on service conditions, the value of the portion of the award that is ultimately expected to vest is recognized as an expense over a five year vesting period. For awards which vest only after an exit event or Initial Public Offering ("IPO"), compensation expense is recognized upon the occurrence of the event.

Employee Benefits — Statutory requirements of certain countries in which the Company operates mandate the payment of various benefits to employees who terminate employment and who have met certain minimum service requirements. The Company recognizes period costs associated with these benefits and accrues a liability for their ultimate payment. Actuarial assumptions based on employee census and historical data are incorporated into the calculation of these benefits costs. These end of service liabilities are not funded and are included in other current and other long-term liabilities in the consolidated balance sheets.

Certain employees are covered under a plan which is accounted for as a defined benefit plan. Elements of benefit obligations, net periodic benefit costs and funded status of the plan were calculated based on census and related data provided by the Company.

The Company makes contributions to a Trust fund and defined contribution savings plans which cover certain employees. Benefits under these plans vary and are generally tied to service years. These amounts are expensed as incurred.

Deferred Financing Costs — Financing costs are deferred and amortized over the life of the associated debt. In the event of early retirement of debt, any unamortized financing costs associated with the retired debt are immediately expensed.

Earnings / (Loss) Per Share — The Company presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the net income attributable to ordinary shares by the weighted average number of those shares outstanding during the period, adjusted for any treasury shares held. Diluted EPS adjusts the figures used in the determination of basic EPS to take into account the effect associated with dilutive potential ordinary shares and the weighted average number of shares assumed to have been issued for no consideration in relation to dilutive potential ordinary shares.

Basic and diluted EPS are computed in conformity with the two class method and applied to the three classes of common shares issued by the Company. Earnings are allocated to the three classes based on a "Waterfall" methodology which specifies the accretion of earnings to the three classes at different rates, giving effect to total cumulative earnings since issuance of the shares. This Waterfall treatment was established and defined in the Amended and Restated Memorandum and Articles of Association (the "Articles") of the Company.

Derivative Financial Instruments – The Company's derivative financial instruments consist of forex contracts which the Company may designate as cash flow hedges. In accordance with U.S. GAAP, each derivative contract is stated in the balance sheet at fair value with gains and losses reflected in the consolidated statements of operations except that, to the extent the derivative qualifies for and is designated as an accounting hedge, the gains and losses are reflected in income in the same period as offsetting gains and losses on the qualifying hedged positions. Designated hedges are expected to be highly effective, and therefore, adjustments to record the carrying value of the effective portion of the derivative financial instruments to their fair value are recorded as a component of accumulated other comprehensive income / (loss) ("AOCIL"), in the consolidated balance sheets. The effective portion of the cash flow hedge will remain in AOCIL until it is reclassified into earnings in the period or periods during which the hedged transaction affects earnings or it is determined that the hedged transaction will not occur. The Company reports such realized gains and losses as a component of operating and maintenance expenses in the consolidated statements of operations to offset the impact of foreign currency fluctuations of the expenditures in local currencies in the countries in which the Company operates. Derivatives with asset fair values and derivatives with liability fair values are reported in other current assets or other assets and other current liabilities or other long-term liabilities, respectively, on the consolidated balance sheets depending on their maturity date.

Comprehensive Income / (Loss) - Comprehensive income / (loss) is the change in equity of a business enterprise during a period due to transactions and other events and circumstances except transactions resulting from investments by and distributions to owners. Comprehensive income / (loss) includes net income / (loss) and unrealized holding gains and losses on financial derivatives designated as cash flow accounting hedges.

Subsequent Events — Subsequent events are evaluated through the date of issuance of the financial statements.

Note 3 — New Accounting Pronouncements

Recently adopted accounting standards

In January 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-01, Income Statement – Extraordinary and Unusual Items. This ASU simplifies income statement classification by removing the concept of extraordinary items from U.S. GAAP. As a result, items that are both unusual and infrequent will no longer be separately reported net of tax after continuing operations. The guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015 and early adoption is permitted. The Company has adopted this ASU from its effective date with no impact on the consolidated financial statements. However, if the Company has extraordinary or unusual items in the future, the adoption could have a material impact on the consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03 ("ASU 2015-03"): Interest – Imputation of Interest; Simplifying the Presentation of Debt Issuance Costs, effective for annual and interim periods beginning after December 15, 2015 for public entities. This ASU 2015-03 requires that all costs incurred to issue debt be presented in the balance sheet as a direct deduction from the carrying value of the debt. It is applied retrospectively for all prior periods presented in the financial statements prepared after the adoption. In August 2015, the FASB issued ASU 2015-15 to specifically address the presentation and subsequent measurement of debt issuance costs related to line-of-credit arrangements. ASU 2015-15 allows entities to defer and present debt issuance costs related to line-of-credit arrangements as an asset and amortize the costs ratably over the term of the line-of-credit arrangement. The Company has adopted ASU 2015-03 and ASU 2015-15 from their effective dates and has applied the new guidance to debt issuance costs. As a result of this adoption, the Company has reclassified debt issuance cost of $5.4 million and $10.1 million from other current assets and other assets, respectively, to long-term debt on the consolidated balance sheets as of December 31, 2015. See Note 10 - Debt.

Recently issued accounting standards

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The amendments require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents and amounts generally described as restricted cash or restricted cash equivalents. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The amendments do not provide a definition of restricted cash or restricted cash equivalents. The amendments should be applied using a retrospective transition method to each period presented. This update is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, with early adoption permitted. The Company does not intend to early adopt this standard. Management believes that the adoption will not have material effect on the consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15 Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. The amendments provide guidance on eight specific cash flow issues thereby addressing the diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The eight specific cash flow issues include: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments should be applied retrospectively effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, with early adoption permitted. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The Company does not intend to early adopt this standard and is currently evaluating the impact of this standard on the consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The main objective of this ASU is to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments and to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments with enhanced disclosures that are held by a reporting entity at each reporting date. The guidance is effective for annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company does not intend to early adopt this standard and is currently evaluating the impact of this standard on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). Under the new guidance, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date:

- A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and
- A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term.

Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers.

This ASU is effective for fiscal years beginning after December 15, 2018 and December 15, 2019 for public and private entities, respectively. The Company does not intend to early adopt this standard and is evaluating the impact of this standard on the consolidated financial statements.

In May 2014, FASB issued ASU 2014-09, Revenues from Contracts with Customers, a new guidance intended to change the criteria for recognition of revenue. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, an additional guidance ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date was issued to delay the effective date by one year. ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) is now effective for annual and interim periods for fiscal years beginning after December 15, 2018, though companies have an option of adopting the standard for fiscal years beginning after December 15, 2017.

In March 2016 and April 2016, the FASB issued ASU No. 2016-08 Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net) and ASU No. 2016-10 Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, respectively. The amendments in ASU No. 2016-08 and ASU No. 2016-10 do not change the core principle of ASU No. 2014- 09, but instead clarify the implementation guidance on principal versus agent considerations and identify performance obligations and the licensing implementation guidance, respectively. In addition, in May 2016 and December 2016, FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients and ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, respectively which are intended to provide clarifying guidance in certain narrow areas and add some practical expedients.

The Company does not intend to early adopt this standard. The Company is evaluating the impact of this standard on the consolidated financial statements.

Note 4 — Operating Revenues

The Company earned operating revenues from i) rigs operated by the Company and ii) rigs operated by the Seller under the Operating Agreements. See Note 1 – Nature of Business and Note 2 – Significant Accounting Policies. As of January 1, 2015, all rigs formerly operated by the Seller under the Operating Agreements are being operated by the Company. In addition, the Company earned revenue from one of its rigs under an operating lease which is reported under other operating revenue.

Operating revenues were as follows (in thousands):

	Years ended December 31,		
	2016	2015	2014
Operating revenues			
Revenue from rigs operated by the Company	$ 668,649	$ 1,012,757	$ 1,173,441
Net revenue from rigs under Operating Agreements	-	-	40,259
	$ 668,649	$ 1,012,757	$ 1,213,700

Net revenue from rigs under Operating Agreements is comprised of (in thousands):

	Years ended December 31,		
	2016	2015	2014
Gross revenue from rigs under Operating Agreements	$ -	$ -	$ 115,485
Costs and expenses			
Operating and maintenance	-	-	(64,946)
General and administrative	-	-	(1,986)
Income tax expense	-	-	(8,307)
Other income	-	-	13
Net revenue from rigs under Operating Agreements	$ -	$ -	$ 40,259

Effective January 1, 2015, the Company entered into an extension of a fixed dayrate contract with one of its customers which included a dayrate linked to the Brent crude oil price. The Company qualifies for an exemption on derivative accounting due to the correlation of the Brent crude oil price with the global offshore drilling unit dayrates. Therefore, the Company is not required to separate the embedded derivative from the drilling contract. The Company records revenue under this contract similarly to other drilling contracts.

During April 2016, the Company signed a contract amendment with the customer agreeing that the dayrate is no longer linked to the Brent crude oil price.

Note 5 — Variable Interest Entities

The Company, through its wholly owned indirect subsidiary SDHL, is the primary beneficiary of four variable interest entities which are included in these consolidated financial statements.

Note 6 — Goodwill

Goodwill represents the excess of consideration paid over the fair value of net assets acquired in the Acquisition by applying the acquisition method of accounting. For the year ended December 31, 2015, the Company has determined that the goodwill was fully impaired and recognized a non-cash impairment charge of $9.3 million which was included in the loss on impairment of assets in the consolidated statements of operations. As a result, the carrying value of the goodwill as of December 31, 2015 was nil. In 2014, there were no impairment indicators identified hence no impairment of goodwill was recognized.

Note 7 — Acquired Drilling Contract Intangibles

As of December 31, 2015, all of the drilling contract intangibles acquired at the time of Acquisition, which were recorded at fair market values, had been fully amortized. The gross carrying amounts of the acquired drilling contracts and accumulated amortization were as follows (in thousands):

	Year ended December 31, 2015		
	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired drilling contracts - assets			
Beginning Balance	$ 36,258	$ (31,936)	$ 4,322
Amortization	-	(4,322)	(4,322)
Ending Balance	$ 36,258	$ (36,258)	$ -

	Year ended December 31, 2015		
	Gross carrying amount	Accumulated amortization	Net carrying amount
Acquired drilling contracts - liabilities			
Beginning Balance	$ 123,624	$ (118,319)	$ 5,305
Amortization	-	(5,305)	(5,305)
Ending Balance	$ 123,624	$ (123,624)	$ -

Note 8 — Property and Equipment

Property and equipment as of December 31, 2016 and 2015 consisted of the following (in thousands):

	December 31,	
	2016	**2015**
Drilling rigs and equipment	$ 1,138,016	$ 955,640
Construction in progress	136,834	179,261
Spares	33,866	23,947
Land and building	1,228	-
Other	16,417	16,206
Total property and equipment	$ 1,326,361	$ 1,175,054
Less: Accumulated depreciation	(295,685)	(230,421)
Total property and equipment, net	$ 1,030,676	$ 944,633

The Company added one new build rig to its drilling fleet during 2016 while there were no rig additions in 2015. As a result of this addition, the Company transferred $228.6 million from construction in progress to drilling rigs and equipment. Total capital expenditures for the years ended 2016 and 2015 were $202.8 million and $171.9 million, respectively. This includes $190.0 million and $95.3 million related to progress payments, internal project costs, change orders, owner furnished equipment and capitalized interest for the Newbuilds during 2016 and 2015, respectively. This also includes land and building acquired in 2016 for a total cost of $1.2 million, of which $564 thousand was allocated to the cost of the land which is not depreciated. The purchases of inventory are expensed as the impact on the consolidated statements of operations is broadly commensurate with the expense that would have been recorded had inventory been separately recorded on the consolidated balance sheets.

Total capital expenditures through December 31, 2016 and 2015 on the Newbuilds were $361.5 million and $171.5 million, respectively, of which $239.1 million and $74.1 million, respectively, were paid by the Lessor (see Note 11 – Sale and Leaseback).

Interest capitalized on the Newbuild rigs totaled $16.9 million and $9.4 million for the years ended December 31, 2016 and 2015, respectively. Interest capitalized during 2016 and 2015 includes $9.9 million and $1.8 million, respectively, related to the sale and leaseback financing agreements.

The Company sold two stacked rigs, Adriatic V and Adriatic VI, for $750 thousand during 2016. The carrying value of both rigs was $1.6 million and disposal costs were $260 thousand, which resulted in a loss on disposal of $1.1 million. No rig was sold by the Company during 2015. Disposals of other property and equipment were $7.5 million and $15.5 million at cost and $4.7 million and $12.0 million at net book value which resulted in a loss on disposal of assets of $3.7 million and $11.3 million during 2016 and 2015, respectively.

On March 22, 2015, a fire broke out on one of the Company's jackup drilling rigs. There was neither human casualty nor environmental damage. The rig was covered under the Company's Hull and Machinery and Excess Liability coverage for an insured value of $45 million. On August 26, 2015, the Company insurance underwriters declared the rig a Constructive Total Loss at a value of $45 million. As a result, the Company recognized an overall net gain of $25.4 million during the year ended December 31, 2015. The Company wrote-off $10.6 million net book value and $1.2 million of unamortized deferred costs, and recorded $6.8 million direct and $977 thousand other indirect costs, partly offset with the insurance proceeds received as of December 31, 2015.

Drilling rigs under capital and operating leases

The net carrying amount of property and equipment includes the newbuild rig held under a capital lease and one rig held under a bareboat charter contract accounted as an operating lease. The rig under operating lease commenced its three year bareboat charter contract (with two 12 month extension options) with a private limited liability company on February 8, 2016. These rigs are included under drilling rigs and equipment as of December 31, 2016 (2015: nil).

As of December 31, 2016, the drilling rig under capital lease had a total cost of $228.6 million and accumulated depreciation of $1.1 million and the rig under bareboat charter contract had a carrying value of $16.4 million and accumulated depreciation of $7.0 million. There were no such transactions for the year ended December 31, 2015.

As of December 31, 2016, following is the summary of future minimum rentals on operating lease (in thousands):

For the twelve months ending December 31,		
2017	$	7,759
2018		8,395
2019		713
Thereafter		-
Total future minimum rentals	$	16,867

Loss on Impairment of Assets - The Company assesses the recoverability of the Company's long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. During the fourth quarter ended December 31, 2016, the Company identified indicators of impairment impacting the Company, including the reduction in the number of new contract opportunities, lower dayrates and utilization rates due to significantly lower crude oil prices, a decrease in global demand and increase in global supply of jackup drilling rigs. As a result of these indicators, the Company concluded that a triggering event existed and an impairment assessment on the fleet of drilling rigs was required.

An impairment loss on property and equipment exists when the estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Any actual impairment loss recognized represents the excess of the asset's carrying value over the estimated fair value.

The fair value of the drilling rigs using the income approach is based on estimated discounted cash flows expected to result from the use of the rigs. The estimate of fair value required the Company to use significant unobservable inputs, representative of a Level 3 fair value measurement, including assumptions related to the future performance of the rigs, such as projected demand, rig utilization rates and dayrates. Such estimates of future undiscounted cash flows are highly subjective and are based on numerous assumptions about future operations and market conditions. The Company determined the fair value of the fleet by using the income approach and utilizing a weighted average cost of capital of 11.6% for all the rigs including the Newbuilds.

As a result of the analysis and impairment testing, the Company recognized an impairment loss of $47.1 million on three of the Company's rigs, out of which one rig was impaired to salvage value and $262.2 million on 13 of the Company's rigs, out of which five rigs were impaired to salvage values, which were included in loss on impairment of assets in the consolidated statements of operations for the years ended December 31, 2016 and 2015, respectively. The impairment loss includes the write-off of current deferred costs of $4.1 million and $11.1 million and non-current deferred costs of $4.4 million and $25.6 million for the years ended December 31, 2016 and 2015, respectively. There was no impairment recorded for the year ended December 31, 2014.

Note 9 — Income Taxes

Tax Rate — SDL is exempt from all income taxation in the Cayman Islands.

The provision for income taxes is based on the tax laws and rates applicable in the jurisdictions in which the Company operates and earns income or is considered resident for income tax purposes. The relationship between the provision for or benefit from income taxes and the income or loss before income taxes can vary significantly from period to period considering, among other factors, (a) the overall level of income before income taxes, (b) changes in the blend of income that is taxed based on gross revenues rather than income before taxes, (c) rig movements between taxing jurisdictions and (d) rig operating structures.

The annual effective tax rate for the Company's continuing operations was (196.0)%, (20.3)% and 16.0% for 2016, 2015 and 2014, respectively. The effective tax rate for the 2014 period does not include taxes attributed to the rigs operated by the Seller as such taxes were the legal liability of the Seller. As of January 1, 2015, the Seller no longer operates any rig owned by the Company.

Income Tax Expense — Income tax expense was $19.8 million, $30.4 million and $43.0 million for 2016, 2015 and 2014, respectively. The components of the provisions for income taxes were as follows (in thousands):

SHELF DRILLING, LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

	Years ended December 31,		
	2016	2015	2014
Current tax expense	$ 19,461	$ 29,081	$ 46,756
Deferred tax expense / (benefit)	296	1,292	(3,724)
Income tax expense	$ 19,757	$ 30,373	$ 43,032

The following is a reconciliation of the differences between the income tax expense for the Company's operations computed at the Cayman statutory rate of zero percent and the Company's reported provision for income taxes (in thousands):

	Years ended December 31,		
	2016	2015	2014
Income tax expense at the Cayman statutory rate	$ -	$ -	$ -
Taxes on earnings subject to rates different than Cayman statutory rate	17,604	33,051	42,046
Change in reserve for uncertain tax positions, including interest and penalties	1,098	(2,962)	-
Other	1,055	284	986
Income tax expense	$ 19,757	$ 30,373	$ 43,032

Deferred Taxes — The significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

	December 31,	
	2016	2015
Deferred tax assets		
Net operating loss carry-forwards of subsidiaries	$ 4,112	$ 3,697
Valuation allowance	(975)	-
	$ 3,137	$ 3,697

	December 31,	
	2016	2015
Deferred tax liabilities		
Unremitted earnings	$ 8,525	$ 8,788

At December 31, 2016 and 2015, the Company's deferred tax liabilities include liabilities related to the future income tax cost of repatriating the unremitted earnings of certain subsidiaries that are not indefinitely reinvested or that will not be indefinitely reinvested in the future. If unforeseen law changes or other facts and circumstances cause a change in expectations regarding the future tax cost of repatriating these earnings, the resulting adjustments to the deferred tax balances could have a material effect on the Company's consolidated financial statements. The Company's deferred tax assets include subsidiary level net operating loss carry-forwards which are expected to be utilized in future periods. To the extent that insufficient taxable income is generated by the relevant subsidiaries in future years to fully utilize these net operating loss carry-forwards, any remaining carry-forwards will expire by 2024.

Liabilities for Uncertain Tax Positions — The Company has tax liabilities related to various tax positions that have been taken on the tax returns of certain subsidiaries that have resulted in a reduction in tax liabilities for those subsidiaries. In management's judgment, these tax positions are "uncertain" in that they are likely to be successfully challenged by the relevant tax authorities in the future. As such, the tax benefits related to these uncertain tax positions have been offset by a corresponding tax liability. The Company acquired a portion of these liabilities from the Seller as part of the Acquisition and is fully indemnified by the Seller for all such acquired liabilities, including any related interest and penalties. Any interest and penalties related to such liabilities are included as a component of income tax expense. Not considering any indemnification, the liabilities related to uncertain tax positions, including related interest and penalties, were as follows (in thousands):

SHELF DRILLING, LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

	December 31,	
	2016	2015
Liabilities for uncertain tax positions, excluding interest and penalties	$ 2,455	$ 1,357
Interest and penalties	-	-
Liabilities for uncertain tax positions, including interest and penalties	$ 2,455	$ 1,357

The changes to liabilities for uncertain tax positions, excluding interest and penalties, were as follows (in thousands):

	December 31,	
	2016	2015
Balance, beginning of year	$ 1,357	$ 3,734
(Reductions) / additions for prior period tax positions	(458)	333
Reductions related to statute of limitation expirations	(100)	(2,710)
Additions for current period tax positions	1,656	-
Balance, end of year	$ 2,455	$ 1,357

The Company engages in ongoing discussions with tax authorities regarding the resolution of tax matters in the various jurisdictions in which it operates. Both the ultimate outcome of these tax matters and the timing of any resolution or closure of the tax audits are uncertain. While the Company cannot predict or provide assurance as to the final outcome of these proceedings, it does not expect the ultimate liability to have a material adverse effect on its consolidated financial statements. Further, the Company is indemnified from any tax liabilities of subsidiaries previously owned by the Seller related to the periods prior to the Acquisition.

Tax Returns — The Company is currently subject to or expects to be subject to income tax examinations in various jurisdictions where the Company operates or has previously operated. While the Company cannot predict or provide assurance as to the final outcome of any tax proceedings, the Company does not expect the ultimate tax liability to have a material adverse effect on its consolidated balance sheets or consolidated statements of operations. Any tax liability relating to entities acquired by the Company from the Seller and relating to periods prior to the Acquisition are indemnified by the Seller.

Other Tax Matters — Operations are conducted through various subsidiaries in a number of countries throughout the world. Each country has its own tax regimes with varying nominal rates, deductions and tax attributes. From time to time, changes to previously evaluated tax positions may be identified that could result in adjustments to the current recorded assets and liabilities. Although it is not possible to predict the outcome of these changes, it is not expected that the effect, if any, resulting from these assessments to have a material adverse effect on the consolidated balance sheets, statements of operations or statements of cash flows.

Note 10 — Debt

Debt is comprised of the following (in thousands):

	December 31,	
	2016	2015
8.625% Senior Secured Notes, due November 1, 2018 (see note (i) below)	$ 466,857	$ 464,204
Term Loan Facility, due October 8, 2018 (see note (ii) below)	342,159	338,849
Revolving Credit Facility, due April 30, 2018 (see note (iii) below)	-	-
Total debt	$ 809,016	$ 803,053

The following is a summary of scheduled long-term debt maturities by year (in thousands):

For the twelve months ending December 31,	
2017	$ -
2018	809,016
Total debt	$ 809,016

SHELF DRILLING, LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The following tables provide details of principal amount and carrying values of debt (in thousands):

	December 31, 2016		
	Principal Amount	Unamortized Discount and Debt Issuance Costs	Carrying Value
8.625% Senior Secured Notes, due November 1, 2018	$ 475,000	$ 8,143	$ 466,857
Term Loan Facility, due October 8, 2018	350,000	7,841	342,159
Total	$ 825,000	$ 15,984	$ 809,016

	December 31, 2015		
	Principal Amount	Unamortized Discount and Debt Issuance Costs	Carrying Value
8.625% Senior Secured Notes, due November 1, 2018	$ 475,000	$ 10,796	$ 464,204
Term Loan Facility, due October 8, 2018	350,000	11,151	338,849
Total	$ 825,000	$ 21,947	$ 803,053

The following tables summarized the total interest on debt (in thousands):

	Year ended December 31, 2016			
	Coupon Interest	Amortization of Discount	Amortization of Debt Issuance Costs	Total Interest
8.625% Senior Secured Notes, due November 1, 2018	$ 40,969	$ -	$ 2,653	$ 43,622
Term Loan Facility, due October 8, 2018	35,583	2,131	1,179	38,893
	$ 76,552	$ 2,131	$ 3,832	$ 82,515

	Year ended December 31, 2015			
	Coupon Interest	Amortization of Discount	Amortization of Debt Issuance Costs	Total Interest
8.625% Senior Secured Notes, due November 1, 2018	$ 40,969	$ -	$ 3,528	$ 44,497
Term Loan Facility, due October 8, 2018	35,486	1,911	1,533	38,930
	$ 76,455	$ 1,911	$ 5,061	$ 83,427

The outstanding debt balances as of December 31, 2016 and 2015 reflect the adoption of ASU 2015-03 as discussed in Note 3 – New Accounting Pronouncements. The effective interest rates on 8.625% Senior Secured Notes and Midco Term Loan Facility are 9.79% and 10.79%, respectively.

(i) 8.625% Senior Secured Notes, due November 2018

On October 24, 2012, SDHL completed the issuance and sale of $475 million aggregate principal amount of the 8.625% senior secured notes due November 1, 2018. The 8.625% Senior Secured Notes were sold at par and SDHL received net proceeds from the offering of the 8.625% Senior Secured Notes of $452.8 million after deducting the offering expenses of $22.2 million. Interest on the 8.625% Senior Secured Notes accrues from October 25, 2012 at a rate of 8.625% per year and is payable semi-annually in arrears on May 1 and November 1 of each year, beginning May 1, 2013.

SDHL’s obligations under the 8.625% Senior Secured Notes are guaranteed by a majority of SDHL’s subsidiaries (collectively, the “Note Guarantors”), subject to certain exceptions. The obligations of the Note Guarantors are secured by liens on the rigs and other assets owned by the Note Guarantors. These liens are subordinate to the liens securing the obligations of the Note Guarantors under the Revolving Credit Facility (“SDHL Revolver”).

SDHL may redeem the 8.625% Senior Secured Notes, in whole or part, at the redemption prices set forth below, together with accrued and unpaid interest to the redemption date.

Period	Redemption Price
On or after May 1, 2015	104.313%
On or after November 1, 2016	102.156%
On or after November 1, 2017 and thereafter	100.000%

If SDHL experiences a change of control, as defined in the indenture governing the 8.625% Senior Secured Notes (the "Indenture"), it must offer to repurchase the 8.625% Senior Secured Notes at an offer price in cash equal to 101% of their principal amount, plus accrued and unpaid interest. Furthermore, following certain asset sales, SDHL may be required to use the proceeds to offer to repurchase the 8.625% Senior Secured Notes at an offer price in cash equal to 100% of their principal amount, plus accrued and unpaid interest.

On January 12, 2017, the Company exchanged and cancelled $444.585 million of 8.625% Senior Secured Notes at 100% redemption price. See Note 26 – Subsequent Events.

(ii) Term Loan Facility, due October 2018

On October 8, 2013, Midco entered into a credit agreement ("Midco Term Loan") providing for a $350 million five-year term loan facility issued at an original discount of 3% (issue price 97%). All borrowings under the term loan facility mature on October 8, 2018.

Midco received $331.2 million proceeds net of discount and $8.3 million of transaction costs. Borrowings under the Midco Term Loan agreement bear interest, at Midco's option, at either (i) the Alternate Base Rate ("ABR") which is defined as the highest of the base rate of interest, as determined by the administrative agent, 2% per year, the federal funds rate plus 0.5%, or the one-month Adjusted LIBOR Rate (which is subject to a floor of 1% and is defined in the Midco Term Loan) plus 1%, plus an applicable margin of 8% per year, or (ii) the Adjusted Libor Rate plus an applicable margin of 9% per year. Interest is paid semi-annually on March 31 and September 30. The first and last interest installments must be paid in cash; other interest installments may be paid in kind at the option of the Company if certain conditions are met. Interest paid in kind accrues at the otherwise applicable interest rate plus 0.75% per year.

Midco may, at its option, redeem all or part of the term loan a) at any time during the third year of the loan at a price of 102% of the principal being redeemed; b) at any time during the fourth year of the loan at a price of 101% of the principal being redeemed; and (c) thereafter at a price of 100% of the principal being redeemed. These redemption prices do not apply to redemptions from the net cash proceeds of one or more qualified or public equity offerings. The net cash proceeds from qualified equity offerings can be used to redeem up to 35% of the aggregate principal of the loan outstanding without any premium and the net cash proceeds of public equity offerings can be used to redeem up to 100% of the aggregate principal of the loan outstanding at a price of 102% of the principal being redeemed. Redemption from equity offerings must occur within 180 days after the closing of the equity offering.

Midco's obligations under the Midco Term Loan are secured by liens on the majority of Midco's assets, including Midco's shares in SDIL, subject to certain exceptions.

On January 12, 2017, the Company fully settled the outstanding balance of $350 million under its term loan facility. See Note 26 – Subsequent Events.

(iii) Revolving Credit Facility, due April 2018

On February 24, 2014, SDHL entered into a $150 million Revolving Credit Facility which was available for utilization on February 28, 2014. The SDHL Revolver can be drawn as cash, letters of credit or bank guarantees, or a mixture of cash, letters of credit and guarantees, subject to the satisfaction of customary conditions set forth in the underlying credit agreement. All borrowings under the SDHL Revolver mature on April 30, 2018, and letters of credit and bank guarantees issued under the SDHL Revolver expire no later than five business days prior to April 30, 2018. On June 11, 2014 in accordance with the terms of the SDHL Revolver, the Company sought and was granted, an increase in the total amount available under the SDHL Revolver to $200 million.

The Company issued bank guarantees and performance bonds totalling $28.5 million and $48.3 million as of December 31, 2016 and 2015, respectively, against the SDHL Revolver. As a result, the remaining available balance under the Revolving Credit Facility is $171.5 million and $151.7 million as of December 31, 2016 and 2015, respectively. The second lien note indenture currently restricts the SDHL Revolver capacity to $170 million, as such the available amount for drawdown under the SDHL Revolver as of December 31, 2016 was $141.5 million.

Cash borrowings under the SDHL Revolver bear interest, at SDHL's option, at either (i) the Adjusted Libor Rate plus Applicable Margin, as defined in the SDHL Revolver or (ii) the Alternate Base Rate ("ABR", the highest of the prime rate, the federal funds rate plus 0.5% per year, or the one-month Adjusted LIBOR Rate (as defined in the SDHL Revolver) plus 1% per year), plus Applicable Margin. During the years ended December 31, 2016 and 2015, the amortization of debt issuance costs on the SDHL Revolver amounted to $1.7 million and $1.8 million, respectively.

Participation fees accrue on financial letters of credit and bank guarantees at the Applicable Margin for borrowings at the Adjusted LIBOR Rate and on non-financial letters of credit and bank guarantees at 50% of the Applicable Margin for borrowings at the Adjusted LIBOR Rate. The Applicable Margin is calculated based on credit ratings of SDL by Standard and Poor's and Moody's; currently the Applicable Margin is 4.75% per year for borrowings at the Adjusted LIBOR Rate.

The Applicable Margin can range from a maximum of 5.0% per year and a minimum of 3.5% per year for borrowings at the Adjusted LIBOR Rate and from a maximum of 4.0% per annum and a minimum of 2.5% per year for borrowings at the Alternate Base Rate. SDHL is liable to pay a commitment fee to the administrative agent on the daily unused amount of the SDHL Revolver at 30% of the Applicable Margin for borrowings at the Adjusted LIBOR Rate. The facility is cancellable by SDHL at any time with no penalty or premium.

Additionally, if SDHL as of the last day of any fiscal quarter is using more than 25% of the SDHL Revolver (excluding non-financial or cash-collateralized letters of credit and bank guarantees), then the SDHL Revolver requires that SDHL and the Guarantors (as defined below) have a total net leverage ratio (consolidated net indebtedness to consolidated EBITDA, as defined in the SDHL Revolver) of not greater than 3:1 for the four consecutive fiscal quarters ended on such last day. This covenant did not apply as the Company had not met the more than 25% threshold during the years ended December 31, 2016 and 2015.

SDHL's obligations under the SDHL Revolver are guaranteed by the majority of SDHL's subsidiaries (collectively, the "Guarantors"), subject to certain exceptions. The obligations of the Guarantors are secured by liens on the rigs and other assets owned by the Guarantors. The liens securing the SDHL Revolver are senior to the liens securing the 8.625% Senior Secured Notes.

On January 12, 2017, the Company successfully amended its revolving credit agreement. See Note 26 – Subsequent Events.

Terms Common to All Indebtedness

The Indenture, the Midco Term Loan and the SDHL Revolver contain customary events of default. These agreements also contain a provision under which an event of default by SDHL or by any restricted subsidiary (under the SDHL Revolver and the Indenture) and by Midco or by any restricted subsidiary (under the Midco Term Loan) on any other indebtedness exceeding $25 million would be considered an event of default if such default: a) is caused by failure to pay the principal or interest when due after the applicable grace period, or b) results in the acceleration of such indebtedness prior to maturity.

The Indenture, the SDHL Revolver and the Midco Term Loan contain covenants that, among other things, limit SDHL's and, in the case of the Midco Term Loan, SDIL's and Midco's ability and the ability of their restricted subsidiaries to:

- incur additional indebtedness or issue certain preferred stock;
- make restricted payments or investments;
- sell assets;
- create liens;
- engage in transactions with affiliates; and
- consolidate, merge or transfer all or substantially all of its assets.

The Company incurred a total of $8.3 million of transaction costs related to the Midco term loan facility agreement, $7.2 million of transaction costs related to the SDHL Revolver and $22.2 million of transaction costs related to issuance of 8.625% Senior Secured Notes. These costs are amortized over the life of the associated debt and the unamortized portion is netted off against the debt's carrying value, except for the $7.2 million transaction costs for the SDHL Revolver which are carried as both short-term and long-term term assets on the consolidated balance sheets and are being amortized over the life of the associated debt.

Note 11 — Sale and Leaseback

On October 10, 2015, two wholly owned subsidiaries of SDL, Shelf Drilling TBN I, Ltd and Shelf Drilling TBN II, Ltd (collectively, the "Lessee"), whose assets consist solely of the two under construction fit-for-purpose new build jackup rigs entered into a combined minimum of $296.2 million and maximum of $330.0 million (“Purchase Price”) sale and leaseback financing transactions (the “Sale and Leaseback Transactions”) with Hai Jiao 1502 Limited and Hai Jiao 1503 Limited (collectively, the “Lessor”), both wholly owned subsidiaries of Industrial and Commercial Bank of China Leasing. In connection with these transactions, the Lessee executed Memorandum of Agreements and Bareboat Charter agreements to sell the rigs and bareboat charter the rigs back from the Lessor upon expected delivery date for a period of 5 years and 90 days. See Note 8 – Property and Equipment.

The Company, in substance, is the accounting owner of the Newbuilds during the construction period due to being the primary obligor on the construction contract and its involvement during the construction period. The Company effectively receives the Purchase Price over the construction period from the Lessor in the form of construction milestone payments paid directly by the Lessor to the Builder on various due dates as per the construction contracts and the remaining balance reimbursed to the Company on the Bareboat Charter commencement dates. The Company records these payments as construction in progress and long-term liabilities on its consolidated balance sheets until the assets are completed and delivered. The Company, being the accounting owner of the Newbuilds, has also recorded $7.6 million as construction in progress payments for set-up fees, legal fees, brokerage fees and handling fees related to these sale and leaseback transactions. No profit and loss is recognized on these sale and leaseback transactions as the Company retains substantially all the benefits and risks incidental to the ownership of the property sold.

The Company is liable to pay a commitment fee of 1.20% per annum to the Lessor calculated on undrawn amount of Purchase Price calculated from October 10, 2015 until the Purchase Price is paid in full for each rig, payable on the date of first installment payment of Purchase Price and quarterly in arrears thereafter. The milestone payments bear interest at 3 months LIBOR plus an applicable margin of 4% annually. Such interest is capitalized at intervals of three months from the date of payment of each installment until the lease commencement date.

The Bareboat Charter agreements require scheduled monthly rent payments (“Rent”) with variable and fixed payment components from the Bareboat Charter commencement dates through its estimated maturities on December 28, 2021 and June 30, 2022 at which time the Lessee will have the obligation to acquire the Newbuilds from the Lessor for $82.5 million each (“Purchase Obligation Price”). The fixed monthly average payments for each rig at the inception of the bareboat charter period are calculated using the Prepaid Purchase Price (Purchase Price and capitalized interest on milestone payments net of Purchase Obligation) over the lease term. The average variable payments over the lease term for each rig are calculated on each payment date using a projected 3 months LIBOR rate plus applicable margin of 4% annually on the Notional Rent Outstanding (Prepaid Purchase Price reduced by fixed payments). The charter payments will be made in advance every 5th day of the month.

On December 1, 2016, after completion of the final customer acceptance requirements, the rig commenced a five-year contract with Chevron. The Company accounted for this sale and leaseback transaction as a capital lease and transferred $228.6 million from construction in progress to drilling rigs and equipment in property and equipment. See Note 8 – Property and Equipment. The capital lease contract has an estimated average interest rate of 5.823% and requires scheduled monthly average principal payments of $1.4 million and average interest payments of $607 thousand through December 5, 2021.

As of December 31, 2016, the following is a summary of the estimated future rental payments on capital lease (in thousands):

For the twelve months ending December 31,		
2017	$	23,698
2018		25,680
2019		25,102
2020		24,318
2021		105,293
Thereafter		-
Total future rental payments	$	204,091

The Company made rental payments, including interest, of $2.7 million during the year ended December 31, 2016. This includes pre-payments of principal and interest of $1.5 million and $729 thousand, respectively.

The outstanding balance of obligations under sale and leaseback is $244.7 million and $74.7 million as of December 31, 2016 and 2015, respectively. The current year balance consists of $16.0 million which represents the scheduled monthly principal installments for the newbuild rig which started its drilling contract on December 1, 2016 and $228.7 million as long term obligations. The long term obligations comprise of $152.0 million for the newbuild rig under capital lease and $76.7 million for the newbuild rig still under construction. The prior year balance of $74.7 million represents the long term obligations for the newbuilds under construction.

The Lessor paid $165.0 million ($148.1 million was paid directly to the Builder and $16.9 million to the Company for costs incurred) and $74.1 million ($55.5 million was paid directly to the Builder and $18.5 million to the Company related to milestone payment) during the years ended December 31, 2016 and 2015, respectively. In addition, the Company recorded $6.8 million and $643 thousand for interest in kind on the obligations under the sale and leaseback during the years ended December 31, 2016 and 2015.

The Company has the right to purchase either of the rigs on an "as is where is" basis, after the delivery date and without any default during the bareboat charter agreement period, at redemption prices as follows:

Period	Redemption Price
Year 1	Notional Rent Outstanding * (1+3%)
Year 2	Notional Rent Outstanding * (1+2%)
Year 3	Notional Rent Outstanding * (1+2%)
Year 4	Notional Rent Outstanding * (1+1%)
Year 5	Notional Rent Outstanding * (1+1%)

Besides the redemption price, the Company is required to pay any rent and other amounts due, and the broken funding costs as defined in the Bareboat Charter agreements.

The Lessor also has the right to compel the Company to purchase the relevant rig when there is a termination event at a price of an aggregate of the Notional Rent Outstanding plus a 3% fee on the Notional Rent Outstanding. The Company is also required to pay any rent and other amounts due, and the broken funding costs as defined in the Bareboat Charter agreements. This option is not exercisable by the Lessor when the relevant rig is in service under its contract with Chevron.

The Company's obligation under the sale and leaseback transactions is secured by pledge over all bank accounts specific to this transaction and pledge of shares of certain wholly owned subsidiaries of the Company. The Company has also assigned to Lessor the construction contracts with the Builder, the advance payment guarantee covering 30% of the contract price received from the Builder which is valid during the construction period, an additional payment guarantee covering 10% of the contract price which is also valid during the construction period, and the receivable and earnings from the Chevron contracts.

The Company is also required to maintain (1) a minimum of 90 days of Rent in a Debt Reserve Account; (2) 120% of Security Coverage Ratio (Fair Value of the rig and associated drilling service contract to the Notional Rent Outstanding); and (3) a Consolidated Net Debt to Consolidated EBITDA Ratio not to exceed 4:1, as defined in the Bareboat Charter agreement. As of December 31, 2016 and 2015, the Company was in compliance with all above mentioned requirements as applicable.

The lease agreements contain certain representations, warranties, obligations, conditions, indemnification provisions and termination provisions customary for sale and leaseback financing transactions. The lease agreements contain certain affirmative and negative covenants that, subject to exceptions, limit the Lessee's ability to, among other things, incur additional indebtedness and guarantee indebtedness, pay dividends or make other distributions or repurchase or redeem capital stock, make loans and investments, sell, transfer or otherwise dispose of certain assets, create or incur liens and enter into certain types of transactions with affiliates, consolidate, merge or sell all or substantially all of its assets.

Note 12 — Employee Benefit Plans

The Company makes regular monthly cash contributions to defined contribution retirement and savings plans. The Company also makes cash payments whenever the departure of an employee triggers the requirement to pay an end of service payment under local labor laws or the Company policy.

Retirement and Savings Plans — The Company contributes between 4.5% and 6.5% of certain employees' base salaries each month into an employee's retirement plan. The actual percentage rate contribution is determined by the number of years of service with the Company, including, for certain employees, the number of years of service with the Seller. The Company has no further obligations for these retirement plans and the Company's contributions are expensed as incurred.

Certain employees have the option to contribute a percentage of their base salary to an individual savings plan. The Company will match up to 6% of the employee's base salary and pay it into the savings plan. The Company has no further obligations for this savings plan and the Company's contribution is expensed as incurred.

The Company has recorded approximately $5.3 million, $7.3 million and $7.5 million in expense related to defined contribution retirement and savings plans for 2016, 2015 and 2014, respectively.

Retirement plan under a Trust fund – On August 1, 2016, the Company replaced the end of service benefit covering certain employees previously reported under a defined benefit plan with a defined retirement contribution plan managed under a trust fund. The remeasured end of service liability under the new plan was $1.3 million, which resulted in a gain of $248 thousand during the year ended December 31, 2016.

Contributions are made on a monthly basis by the Company irrespective of fund performance and are not pooled, but are separately identifiable and attributable to each employee. The Company has no further obligation for this retirement plan and the Company's contributions are expensed as incurred.

Contribution expense related to this plan is $122 thousand from the effective date of August 1, 2016 to December 31, 2016. The expenses were previously recorded as end of service benefit expense during the years ended 2014, 2015 and through to July 31, 2016.

End of Service Plans — The Company offers end of service plans to employees in certain countries in accordance with the labor laws in these countries or the Company policy.

The Company has recorded approximately $6.3 million, $6.7 million and $1.2 million in expense related to employee end of service plans for 2016, 2015 and 2014, respectively. The 2014 expense amount includes a gain resulting from a change in the accounting estimate related to the Company's initial actuarial valuation performed in 2014 of the benefits due which indicated a reduction in the previously estimated liability by approximately $6.5 million. Additionally, the Seller paid the Company $4.4 million in 2014 to settle a portion of its future liabilities under these plans.

Countries in which management estimates that the liabilities are significant in amount are subject to an analysis which considers specific actuarial assumptions for those countries. The discount rate used in the analyses ranged from 4.2% to 16.5% and the assumed average annual rate of compensation increase ranged from 2% to 5%.

The estimated total liability for the end of service plans was $8.8 million and $15.1 million at December 31, 2016 and 2015, respectively.

Defined Benefit Plan — As a result of the Acquisition described in Note 1 — Nature of Business, the Company agreed to replicate certain employee benefits for the employees of the Seller who joined the Company. Benefits under this plan vest immediately and are paid in a single lump sum cash payment when a participant has both reached the age of 55 and is no longer employed by the Company. The single sum paid is calculated taking into account employee's base salary and various other factors. The Company has removed the restriction of the minimum age of 55 related to this plan as of January 1, 2016.

The number of employees who were eligible for benefits under this plan totaled 63, 99 and 120 at December 31, 2016, 2015 and 2014, respectively. The plan freeze date is December 31, 2015 and the Company stopped accruing service awards benefits as of January 1, 2016. The plan is currently unfunded.

A reconciliation of the changes in benefit obligation is as follows (in thousands):

	Years ended December 31,	
	2016	2015
Change in Benefit Obligation		
Benefit obligation, beginning of year	$ 4,913	$ 3,346
Service cost	-	2,960
Interest cost	146	79
Plan changes	-	-
Benefits paid	(1,737)	(1,078)
Actuarial gain	(156)	(394)
Curtailment	-	-
Benefit obligation, end of year	$ 3,166	$ 4,913

The Company has recorded $481 thousand and $739 thousand as current, and $2.7 million and $4.2 million as non-current obligations for this plan as of December 31, 2016 and 2015, respectively.

The benefit cost includes the following components (in thousands):

	Years ended December 31,		
	2016	**2015**	**2014**
Net periodic benefit (gain) / costs			
Service cost	$ -	$ 2,960	$ 2,795
Interest cost	146	79	23
Expected return on plan assets	-	-	-
Amortization of prior service cost	-	-	-
Actuarial gain	(156)	(394)	(315)
Net periodic benefit (gain) / costs, end of year	$ (10)	$ 2,645	$ 2,503

The plan does not have any assets, nor does the Company intend to fund the plan. The Company has elected to immediately recognize any gains and losses from this plan and as such no amounts have been recorded in accumulated other comprehensive income related to the plan.

The key assumptions for the plan are summarized below:

	Years ended December 31,	
	2016	**2015**
Weighted-average assumptions used to determine benefit obligations:		
Discount rate	3.00%	3.21%
Rate of compensation increase	N/A	N/A

	Years ended December 31,		
	2016	**2015**	**2014**
Weighted-average assumptions used to determine net periodic benefit costs:			
Discount rate	3.00%	3.21%	2.35%
Rate of compensation increase	N/A	N/A	4.00%
Expected long-term rate of return on assets	N/A	N/A	N/A

The future estimated payouts are as follows (in thousands):

	Projected benefit payments
Years ending December 31,	
2017	$ 481
2018	471
2019	523
2020	265
2021	348
2022 - 2026	1,140

Retention Plans — The Company also sponsors medium term cash incentive programs for certain employees. The plans generally vest over a period ranging from one to two years, and associated payouts are made over a two year period provided the participant is still employed. The pay outs under existing plans are expected to occur in March, 2017 and March, 2018. The Company recorded approximately $3.0 million, $3.0 million and $5.3 million expense under the plans for the years ended December 31, 2016, 2015 and 2014, respectively. The estimated total cash payments under the retention plans for 2017 and 2018 are $2.7 million and $3.3 million, respectively.

Note 13 — Commitments and Contingencies

Operating Lease Obligations – The Company has operating lease commitments expiring at various dates, principally for office space, expatriate employee accommodation and office equipment.

Sale and Leaseback Obligations – This represents minimum annual rental payments and Purchase Obligation Price assuming average estimated interest rates pursuant to the sale and leaseback transactions as of December 31, 2016. See Note 11 - Sale and Leaseback.

As of December 31, 2016, contractual payments related to those matters were as follows (in thousands):

	Operating leases	Sale and leaseback obligations	Total commitments
For the twelve months ending December 31,			
2017	$ 6,367	$ 37,379	$ 43,746
2018	4,207	52,082	56,289
2019	474	50,946	51,420
2020	189	49,387	49,576
2021	82	129,337	129,419
Thereafter	-	93,705	93,705
Total	$ 11,319	$ 412,836	$ 424,155

Legal Proceedings — The Company is involved in various claims and lawsuits in the normal course of business, some of which existed at the time of Acquisition and are indemnified by the Seller. As of December 31, 2016 and 2015, management has determined that there are no significant claims or lawsuits to disclose including claims and lawsuits fully indemnified by the Seller and no provisions were necessary.

Insurance

The Company's hull and machinery, property, cargo and equipment and excess liability insurance consists of commercial market policies that the Company renewed on November 30, 2016 for one year. The Company periodically evaluates its risks, insurance limits and self-insured retentions. As of December 31, 2016, the insured value of the Company's drilling rig fleet was $1.6 billion, which includes the newbuild rig which commenced its drilling contract on December 1, 2016.

Hull and Machinery Coverage — At December 31, 2016, under the Company's hull and machinery insurance policies, the Company maintained a $5 million deductible per occurrence, with no deductible in the event of loss greater than 75% of the insured value of the rig. The Company also has insurance coverage for costs incurred for wreck removal for the greater of 25% of the rig's insured value or $20 million (plus an additional $25 million per occurrence) with a nil deductible. The hull and machinery policy also covers war risk, which is cancellable either immediately or with 7 days' notice by the underwriters in certain circumstances. To protect against this cancellation risk, the Company also insures, through commercial market policies, a Political Risks Policy covering acts of war and terrorism with a $250,000 deductible per occurrence (an additional $2.75 million in certain countries) and a limit of $175 million.

Excess Liability Coverage — At December 31, 2016, the Company carried $400 million of commercial market excess liability coverage, exclusive of the deductibles, which generally covered onshore and offshore risks such as personal injury, third-party property claims, and third-party non-crew claims, including pollution from the rig and non-owner aviation liability. The Company's excess liability coverage generally has a $1 million deductible per occurrence.

At December 31, 2016, the Company also carried $100 million of additional insurance per occurrence that generally covered expenses that would otherwise be assumed by the well owner, such as costs to control the well, re-drill expenses and pollution from the well. This additional insurance provides coverage for such expenses in circumstances in which the Company has a legal or contractual liability arising from gross negligence or willful misconduct. The deductible is $1 million per occurrence.

Self-Insured Medical Plan —The Company offers a self-insured medical plan ("the Medical Plan") for U.S. resident rig based expatriates employees and their eligible dependents to provide medical, vision, dental within the U.S. and security evacuation and repatriation. The maximum potential liability related to the plan excluding dental benefits is $1.7 million as of December 31, 2016, as the Company is reinsured for the excess amount by a third party insurance provider.

Surety Bonds — It is customary in the contract drilling business to have various surety bonds in place that secure customs obligations relating to the temporary importation of rigs and equipment and certain contractual performance and other obligations.

The Company has surety bond facilities in either U.S. dollars or local currencies of approximately $85.0 million provided by several banks to guarantee various contractual, performance, and customs obligations. The Company entered into these facilities in India, Egypt, UAE and Nigeria. The outstanding surety bonds were $33.3 million and $64.2 million at December 31, 2016 and 2015 (including $7.8 million surety bonds for which the credit facility was not in place which were secured by 100% cash deposits in 2015), respectively.

In addition, the Company had outstanding bank guarantees and performance bonds amounting to $28.5 million and $48.3 million as of December 31, 2016 and 2015, respectively, against the $200 million SDHL Revolver.

Therefore, the total outstanding bank guarantees and surety bonds issued by the Company were $61.8 million and $112.5 million as of December 31, 2016 and 2015, respectively.

Under the terms of the Acquisition, the Seller agreed to continue to provide financial support by maintaining letters of credit, surety bonds and other performance and obligation guarantees. This agreement with the Seller to provide financial support expired on November 30, 2015. The Seller did not issue any new letter of credits, surety bonds and other performance and obligation guarantees after November 30, 2015. All outstanding surety bonds provided by the Seller on the Company's behalf of $23.7 million as of December 31, 2015 were cleared and replaced by the Company's issued surety bonds in 2016.

Note 14 — Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, approximate their fair market values due to the short-term nature of the instruments.

The following table represents the estimated fair value and carrying value of the Company's long-term debt (in thousands):

	December 31 , 2016		December 31 , 2015	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
8.625% Senior Secured Notes, due November 1, 2018	$ 466,857	$ 399,000	$ 464,204	$ 361,000
Term Loan Facility, due October 8, 2018	342,159	258,620	338,849	192,063
Total debt..	$ 809,016	$ 657,620	$ 803,053	$ 553,063

The estimated fair value of the Company's long-term debt was determined using quoted market prices. Where more than one quoted market price was obtained, the average of all the quoted market prices was applied (Level 2 measurement).

Derivative financial instrument was measured at fair value on a recurring basis using Level 2 inputs. See Note 19 – Derivative Financial Instruments. At December 31, 2016, there were no outstanding derivative contracts.

Note 15 — Financial Instruments and Risk Concentration

Interest Rate Risk — Financial instruments that potentially subject the Company to concentrations of interest rate risk include cash and cash equivalents, debt and the obligation under sale and leaseback. Exposure to interest rate risk may occur in relation to cash and cash equivalents, as the interest income earned on these balances changes with market interest rates. Floating rate debt, where the interest rate may be adjusted annually or more frequently over the life of the instrument, exposes the Company to short-term changes in market interest rates. Fixed rate debt, where the interest rate is fixed over the life of the instrument and the instrument's maturity is greater than one year, exposes the Company to changes in market interest rates if and when refinancing of maturing debt with new debt occurs.

Foreign Currency Risk — The Company's functional currency is the U.S. dollar and its international operations expose it to currency exchange rate risk. This risk is primarily associated with the compensation costs of the Company's employees and purchasing costs from non-U.S. suppliers, which are generally denominated in currencies other than the U.S. dollar.

The Company's primary currency exchange rate risk management strategy involves structuring customer contracts to provide for payment in U.S. dollars and local currency. The payment portion denominated in local currency is based on anticipated local currency requirements over the contract term. Due to various factors, including customer acceptance, local banking laws, other statutory requirements, local currency convertibility and the impact of inflation on local costs, actual local currency needs may vary from those anticipated in the customer contracts, resulting in partial exposure to currency exchange rate risk. The currency exchange effect resulting from the Company's international operations generally has not had a material impact on its operating results. The Company recognized $1.9 million gain, $1.7 million gain and $1.4 million loss related to net foreign currency exchange during 2016, 2015 and 2014, respectively, which are included in other, net in the consolidated statements of operations.

Further, the Company may utilize forex contracts to manage foreign exchange risk, for which the Company has documented policies and procedures to monitor and control the use of the derivative instruments. The Company does not engage in derivative transactions for speculative or trading purposes. The Company's forex contracts generally require it to net settle the spread between the contracted foreign currency exchange rate and the spot rate on the contract settlement date. As of December 31, 2016, the Company had no forex contracts outstanding. There were no such transactions as of December 31, 2015.

Credit Risk — Financial instruments that potentially subject the Company to concentrations of credit risk are cash and cash equivalents and accounts receivables.

The Company generally maintains cash and cash equivalents at commercial banks with high credit ratings.

The market for the Company's services is the offshore oil and natural gas industry. The Company's customers primarily consist of government owned or controlled energy companies, publicly listed integrated oil companies or independent exploration and production companies. Periodic credit evaluations of the Company's customers are performed and generally do not require material collateral. The Company may from time to time require its customers to issue a bank guarantee in its favor to cover non-payment under drilling contracts.

Allowance for doubtful accounts are based upon expected collectability on a contract by contract basis where the required payment of specific amounts owed to the Company is unlikely to occur. At December 31, 2016 and 2015, the allowance for doubtful accounts was $99.6 million and $110.2 million, respectively.

Note 16 — Restricted Cash

The Company maintained a restricted cash deposit of $9.3 million and $8.8 million as of December 31, 2016 and 2015, respectively, which is included in other current assets and other assets in the consolidated balance sheets. Restricted cash is primarily used as collateral for bid tenders and performance bonds. The increase in restricted cash in 2016 was related to the reserve requirements for the sale and leaseback transaction amounting to $6.4 million, partly offset by the $5.9 million cash collateral released in the first quarter of the current year.

Note 17 — Shareholders' Equity

The Company is authorized to issue up to 5,000,000 ordinary shares with a par value of $0.01 per share for a total amount of $50 thousand. Following is the summary of ordinary shares authorized:

	Year ended December 31, 2016			
	Number of ordinary shares authorized			
	Class A	Class B	Class C	Total
Number of ordinary shares authorized	4,666,080	269,560	64,360	5,000,000
Amount of ordinary shares authorized	$ 46,660	$ 2,696	$ 644	$ 50,000

	Year ended December 31, 2015			
	Number of ordinary shares authorized			
	Class A	Class B	Class C	Total
Number of ordinary shares authorized	4,666,080	269,560	64,360	5,000,000
Amount of ordinary shares authorized	$ 46,660	$ 2,696	$ 644	$ 50,000

SHELF DRILLING, LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

During the year ended December 31, 2016, the Company granted 2,835 ordinary shares (2,659 Class B shares and 176 Class C shares) under the time and performance based share compensation plan to members of the Company's senior management (see Note 18 – Share-based Compensation). These shares were issued to a Trust for further issuance to the employee upon fulfilling the vesting conditions. There were no issuance of ordinary shares during the year ended December 31, 2015.

During the years ended December 31, 2016 and 2015, 1,915 ordinary shares (1,851 Class A shares, 43 Class B shares and 21 Class C shares) and 200 ordinary shares (193 Class A shares, 5 Class B shares and 2 Class C shares) were repurchased and retired for an aggregate consideration of $1.7 million and $270 thousand, respectively. In 2016, of the cancelled 1,915 ordinary shares, 850 ordinary shares were issued in March 2014 at a lower value compared to the fair value at the date of exercise, which resulted in a benefit of $433 thousand recorded to share-based compensation, 750 ordinary shares were cancelled at a lower consideration than the cost for these shares at the issuance date, which resulted in $155 thousand in additional paid-in capital, and the remaining 315 ordinary shares were cancelled at issuance cost. In 2015, the 200 ordinary shares cancelled were issued at higher consideration than the cost for these shares at issuance date, which resulted in $70 thousand charged to retained earnings. See Note 18 – Share-based Compensation.

During the years ended December 31, 2016 and 2015, 2,478 ordinary shares (2,306 Class B shares and 172 Class C shares) and 158 ordinary shares (146 Class B shares and 12 Class C shares) previously issued under share-based compensation plans were forfeited for nil consideration. In addition, 33 ordinary Class B shares issued under the share-based compensation plans were repurchased and retired for a consideration of approximately $40 thousand during 2015. See Note 18 – Share-based Compensation.

Holders of all classes of vested shares are entitled to such dividends as may be declared by the board of directors of the Company out of legally available funds. The A, B, and C ordinary shares participate in cumulative distributions based on preference, and are allocated to the three classes based on the Waterfall methodology which specifies the accretion of earnings to the three classes at different rates, giving effect to total cumulative distributions since issuance of the shares. This Waterfall treatment was established and is defined in the Articles. The Waterfall specifies an increasingly disproportionate distribution accretion rate with Class A shares ranking highest in terms of preference, followed by B and C, respectively.

The Company did not pay any dividend during years ended December 31, 2016 and 2015. During 2014, SDL declared and paid dividend on its Class A ordinary shares totalling $122.7 million. This dividend, which was paid at various times during 2014, represented a distribution of $274.88 per share, computed on the basis of average Class A shares outstanding.

Holders of all classes of ordinary shares are also entitled to, in the event of liquidation, to share in the distribution of assets remaining after payment of liabilities as set out in the Articles.

Following is the summary of all classes of ordinary shares issued and outstanding (in thousands, except share data):

	Year ended December 31, 2016			
	Number of ordinary shares issued and outstanding			
	Class A	Class B	Class C	Total
Balance, beginning of year	446,445	24,789	6,092	477,326
Issuance of shares under share-based compensation plans	-	-	-	-
Shares issued to trust	-	2,659	176	2,835
Repurchase and retirement of shares	(1,851)	(2,349)	(193)	(4,393)
Balance, end of year	444,594	25,099	6,075	475,768

	Year ended December 31, 2016			
	Amount of ordinary shares issued and outstanding (at par value)			
	Class A	Class B	Class C	Total
Balance, beginning of year	$ 5	$ -	$ -	$ 5
Issuance of shares under share-based compensation plans	-	-	-	-
Shares issued to trust	-	-	-	-
Repurchase and retirement of shares	-	-	-	-
Balance, end of year	$ 5	$ -	$ -	$ 5

	Year ended December 31, 2015			
	Number of ordinary shares issued and outstanding			
	Class A	Class B	Class C	Total
Balance, beginning of year	446,638	24,973	6,106	477,717
Issuance of shares under share-based compensation plans	-	-	-	-
Shares issued to trust	-	-	-	-
Repurchase and retirement of shares	(193)	(184)	(14)	(391)
Balance, end of year	446,445	24,789	6,092	477,326

	Year ended December 31, 2015			
	Amount of ordinary shares issued and outstanding (at par value)			
	Class A	Class B	Class C	Total
Balance, beginning of year	$ 5	$ -	$ -	$ 5
Issuance of shares under share-based compensation plans	-	-	-	-
Shares issued to trust	-	-	-	-
Repurchase and retirement of shares	-	-	-	-
Balance, end of year	$ 5	$ -	$ -	$ 5

In accordance with the Articles, in the event of an IPO, the board may take such actions as it deems necessary to effect the conversion or exchange, directly or indirectly of each class of ordinary shares into another class of shares, or other equity security and/or other equity instruments issued or contemplated for issuance by SDL.

Note 18 — Share-based Compensation

The Company has a share-based compensation plan under which it issues Class B time based restricted shares, and Class C performance based shares. Such shares were awarded to certain members of the Company's management as remuneration for future service of employment.

The Company has recorded a share-based compensation expense related to the share-based compensation plan of $179 thousand (net of a $487 thousand gain related to forfeitures and an additional expense of $23 thousand for repurchased vested shares), $638 thousand (net of a $34 thousand gain related to forfeitures and an additional expense of $18 thousand for repurchased vested shares) and $2.0 million (net of a $47 thousand gain related to forfeitures) in 2016, 2015 and 2014, respectively. No income tax benefit was recognized for these plans.

Time Based Restricted Class B Ordinary Shares

Time based restricted shares are awarded as Class B ordinary shares which typically vest in equal proportion over a period of five years from the grant date provided the grantee remains employed by the Company. Upon vesting these shares are non-transferable. In the event of an IPO or other exit event, all Class B shares, regardless of grant date, vest immediately. Following an IPO or other exit event, Class B shares held by members of management continue to be non-transferable pursuant to the terms of a management-shareholder agreement. These transfer restrictions lapse ratably over three years, at one year intervals beginning twelve months after an IPO or other exit event. Compensation cost is recognized over a period of five years from the grant date subject to acceleration as discussed above in the event of an IPO or other exit event.

Performance Based Class C Ordinary Shares

Performance based shares are awarded as Class C ordinary shares which have rights to dividends or distributions at certain pre-defined amounts of aggregate distributions which are junior to holders of the Class A and Class B shares. The specifics of these rights are set forth in the Articles. Upon an exit event or IPO, Class C shares vest immediately and are subject to the same transferability restrictions as described above regarding Class B shares with those restrictions being lifted ratably over a three year period beginning on the first anniversary of the IPO or exit event. At the end of the third year after the IPO or exit event, all the restrictions would have been lifted. Compensation expense related to the grant date fair value of the Class C shares will be recognized upon vesting.

The fair value of awards made under the share-based compensation plans is estimated at the grant date using standard quantitative modeling techniques performed by an independent third party. The estimates are established using a zero premium option, with reference to the volatility of a group of broadly similar offshore drilling service companies. The following assumptions were used in the valuation calculations for shares awarded in 2016. There were no shares awarded in 2015, therefore the assumptions were not applicable:

	Years ended December 31,			
	2016		2015	
	Class B	Class C	Class B	Class C
Valuation assumptions:				
Expected term	2 years	2 years	N/A	N/A
Risk free interest rate	2 Year US Treasury Bond	2 Year US Treasury Bond	N/A	N/A
Expected volatility	60.0%	60.0%	N/A	N/A
Dividend yield	Nil	Nil	N/A	N/A

Expected Term: The expected term represents the period from the grant date to the expected date of vesting, either through an IPO or other exit event.

Risk Free interest rate: The US Treasury Bond rate as of the grant date over a similar period to the Expected Term.

Expected Volatility: The average historical 36-month period volatility of the quoted share prices of a group of broadly similar publicly quoted offshore drilling service companies. The variables are adjusted to reflect the gross debt to capitalization ratio of each company.

Dividend Yield: The Company has not historically issued any dividends on these classes of shares and does not expect to in the future nor are the unvested shares entitled to dividends.

The following table summarizes the awards held by the Company's management under the Company's two share-based compensation plans:

	Time based restricted shares	Performance based shares	Weighted average grant date fair value per share	
	Class B	Class C	Class B	Class C
Non-vested shares at January 1, 2016……	9,041	961	$ 261.93	$ 4,259.24
Granted……	2,659	176	456.22	4,677.20
Vested……	(2,503)	-	245.62	-
Forfeited……	(1,493)	(172)	185.23	4,217.58
Non-vested shares at December 31, 2016……	7,704	965	$ 357.05	$ 5,808.48

	Time based restricted shares	Performance based shares	Weighted average grant date fair value per share	
	Class B	Class C	Class B	Class C
Non-vested shares at January 1, 2015……	12,125	973	$ 273.25	$ 4,829.14
Granted……	-	-	-	-
Vested……	(2,905)	-	213.50	-
Forfeited……	(179)	(12)	1,814.00	51,100.00
Non-vested shares at December 31, 2015……	9,041	961	$ 261.93	$ 4,259.24

Total unrecognized compensation expense related to non-vested Class B and C shares was $8.4 million and $7.6 million at December 31, 2016 and December 31, 2015, respectively.

Note 19 — Derivative Financial Instruments

Foreign Currency Forward Exchange Contracts

The Company may enter into forex contracts when management believes that market conditions are favorable to purchase contracts for future settlement with the expectation that such contracts, when settled, will reduce the exposure to foreign currency gains and losses on future foreign currency expenditures. The amount and duration of such contracts are based on the monthly forecast of expenditures in the foreign currencies in which the Company conducts significant business and for which there is a financial market. These forward contracts are derivatives and any change in fair value resulting from ineffectiveness is recognized immediately in earnings.

During the year ended December 31, 2016, the Company settled forex contracts with aggregate notional values of approximately $21.6 million, of which the aggregate amounts were designated as an accounting hedge. There were no such transactions for the year ended December 31, 2015 and 2014, respectively. There were no forex contracts outstanding as of December 31, 2016.

The following table presents the amounts recognized in the Company's consolidated statements of operations related to the derivative financial instruments designated as cash flow hedges (in thousands). The effective portion of gain / (loss) reclassified from AOCIL is recorded under operating and maintenance.

	Gain recognized through AOCIL		
	Years ended December 31,		
	2016	2015	2014
Cash flow hedges			
Foreign currency forward contracts	$ 427	$ -	$ -

	Gain reclassified from AOCIL to "Operating and maintenance"		
	Years ended December 31,		
	2016	2015	2016
Cash flow hedges			
Foreign currency forward contracts	$ 427	$ -	$ -

Note 20 — Supplemental Balance Sheet Information

Accounts and other receivables consisted of the following (in thousands):

	December 31,	
	2016	2015
Accounts and other receivables, net		
Accounts receivables	$ 217,741	$ 263,384
Allowance for doubtful accounts	(99,606)	(110,251)
Accounts receivables, net	118,135	153,133
VAT receivables	5,802	10,798
Other	1,375	2,178
	$ 125,312	$ 166,109

Other current assets consisted of the following (in thousands):

	December 31, 2016	December 31, 2015
Other current assets		
Deferred costs	$ 61,140	$ 86,803
Prepayments	18,810	18,455
Income tax receivable	7,200	-
Deferred financing fee	1,706	1,721
Restricted cash	626	5,985
Other	5,753	5,536
	$ 95,235	$ 118,500

Other assets consisted of the following (in thousands):

	December 31, 2016	December 31, 2015
Other assets		
Deferred costs	$ 101,933	$ 122,420
Restricted cash	8,630	2,850
Retention receivable	4,148	3,503
Deposits	2,432	2,644
Deferred financing fee	568	2,289
Other	730	1,553
	$ 118,441	$ 135,259

Other current liabilities consisted of the following (in thousands):

	December 31, 2016	December 31, 2015
Other current liabilities		
Deferred revenue	$ 12,964	$ 18,566
Incentive compensation and bonus accruals	9,196	11,848
Accrued taxes, other than income	5,663	5,955
Accrued payroll and employee benefits	2,867	6,574
End of service benefits	1,274	2,989
Defined benefit obligation	481	739
Other	220	1
	$ 32,665	$ 46,672

Other long-term liabilities consisted of the following (in thousands):

	December 31, 2016	December 31, 2015
Other long-term liabilities		
Deferred revenue	$ 12,266	$ 15,729
End of service benefits	7,541	12,108
Defined benefit obligation	2,685	4,174
Income taxes	2,455	1,357
Other	250	233
	$ 25,197	$ 33,601

Note 21 — Supplemental Cash Flow Information

The net effect of changes in operating assets and liabilities on cash flows from operating activities was as follows (in thousands):

	Years ended December 31, 2016	2015	2014
Decrease / (increase) in operating assets			
Accounts and other receivables, net	$ 41,443	$ 29,306	$ 32,968
Other current assets	(7,497)	(25,941)	849
Other assets	1,469	35,337	21,947
(Decrease) / increase in operating liabilities			
Accounts payable and other current liabilities	(16,772)	(40,316)	(14,785)
Accrued interest	-	-	567
Accrued income taxes	(546)	(8,391)	2,487
Other long-term liabilities	4,426	2,248	11,268
	$ 22,523	$ (7,757)	$ 55,301

Additional cash flow information was as follows (in thousands):

	Years ended December 31, 2016	2015	2014
Cash payments for			
Interest, net of amounts capitalized	$ 72,997	$ 68,894	$ 74,673
Income taxes	26,125	40,669	45,958

As part of the sale and leaseback agreements for the Newbuilds, contractual commitments totalling $148.1 million and $55.5 million were paid by third party financial institution directly to the Builder during the years ended December 31, 2016 and 2015, respectively, and $6.8 million and $643 thousand of interest in kind were recorded as obligations under sale and leaseback, respectively. Therefore, these non-cash transactions were not reflected on the consolidated statements of cash flows during the years ended December 31, 2016 and 2015. There were no such transactions for the year ended December 31, 2014.

The following table reconcile the cash payments related to additions to property and equipment and deferred costs to the total capital expenditures and deferred costs (in thousands):

	Years ended December 31,		
	2016	2015	2014
Cash payments for additions to property and equipment	$ 53,541	$ 157,193	$ 168,404
Net change in accrued but unpaid additions to property and equipment.	(5,080)	(60,034)	23,004
	$ 48,461	$ 97,159	$ 191,408
Add: Asset addition related to sale and leaseback transactions	154,306	74,703	-
Total capital expenditures	$ 202,767	$ 171,862	$ 191,408
Cash payments for additions to deferred costs	$ 55,845	$ 161,553	$ 147,752
Net change in accrued but unpaid additions to deferred costs	(1,300)	(10,216)	(5,826)
Total deferred costs	$ 54,545	$ 151,337	$ 141,926
Total capital expenditures and deferred costs	$ 257,312	$ 323,199	$ 333,334

Note 22 — (Loss) / Earnings Per Share

The following table set forth the computation of basic and diluted net (loss) / income per share for each class of SDL (in thousands, except share data):

	Years ended December 31,								
	2016			2015			2014		
	Class A	Class B	Class C	Class A	Class B	Class C	Class A	Class B	Class C
Numerator for (loss) / earnings per share									
Net (loss) / income attributable to ordinary shares	$(29,836)	$ -	$ -	$ (180,002)	$ -	$ -	$226,062	$ -	$ -
Denominator for (loss) / earnings per share									
Weighted average shares:									
Basic outstanding per Class	445,386	17,500	5,119	446,525	15,142	5,133	446,407	12,419	5,131
Effect of stock options and other share-based awards.	-	3,454	-	-	8,155	641	146	10,733	838
Diluted per Class	445,386	20,954	5,119	446,525	23,297	5,774	446,553	23,152	5,969
Basic (loss) / earnings per share per Class	$ (66.99)	$ -	$ -	$ (403.12)	$ -	$ -	$ 506.40	$ -	$ -
Diluted (loss) / earnings per share per Class	$ (66.99)	$ -	$ -	$ (403.12)	$ -	$ -	$ 506.24	$ -	$ -

Net (loss) / income is allocated to the three classes of common stock under the provisions of the distribution Waterfall set forth in the Articles.

Note 23 — Segment and Related Information

Operating segments are defined as components of an entity for which separate financial statements are available and are regularly evaluated by the chief operating decision maker (“CODM”) in deciding how to allocate resources and assess performance. The Company has one reportable segment, contract drilling services, which reflects how the Company manages its business, and the fact that all the drilling fleet is dependent upon the worldwide oil industry. The mobile offshore drilling units comprising the offshore rig fleet operate in a single global market for contract drilling services and are often redeployed globally due to changing demands of the customers, which consist largely of integrated oil and gas companies, independent exploration and production companies and government owned/controlled oil and gas companies in the Middle East, South East Asia, India, West Africa and the Mediterranean.

The accounting policies of our reportable segment are the same as those described in the summary of significant accounting policies (see Note 2 – Significant Accounting Policies). The Company evaluates the performance of the operating segment based on revenues from external customers and segment Adjusted EBITDA. Adjusted EBITDA as used herein represents net income plus interest expense and financing charges, income tax expense, depreciation, loss on impairment of assets, amortization of drilling contract intangibles, amortization of deferred costs, transaction costs, severance costs, sponsors' fees, IPO readiness costs, rig reactivation costs, rig inventory acquisition costs, rig preparation and relocation costs, gain on insurance recovery, loss on disposal of assets, exclusion of non-income tax related costs, start-up costs and others. The Company's CODM uses "Adjusted EBITDA" as the primary measure of segment's reporting performance.

Summarized financial information for the Company reportable segment for 2016, 2015 and 2014 is shown in the following schedule (in thousands):

	Years ended December 31,		
	2016	**2015**	**2014**
Drilling Segment Revenue	$ 684,317	$ 1,030,315	$ 1,309,730
Net revenue from rigs under Operating Agreements	-	-	40,259
Gross revenue from rigs under Operating Agreements	-	-	(115,485)
Amortization of drilling contract intangibles	-	983	31,522
As Reported Revenues	$ 684,317	$ 1,031,298	$ 1,266,026
Adjusted EBITDA	$ 295,361	$ 371,499	$ 540,137
Amortization of deferred costs for rigs operated by the Company	(91,763)	(80,984)	(48,809)
Amortization of deferred costs for rigs under Operating Agreements	-	-	(153)
Interest expense and financing charges	(80,120)	(80,537)	(88,928)
Depreciation	(71,780)	(87,421)	(81,711)
Loss on impairment of assets	(47,094)	(271,469)	-
Income tax expense for the Company	(19,757)	(30,373)	(43,032)
Income tax expense for rigs under Operating Agreements	-	-	(8,307)
Severance costs	(4,786)	-	-
Loss on disposal of assets	(4,826)	(11,299)	(2,921)
Sponsors' fee	(4,500)	(4,500)	(4,500)
Transaction costs	(1,611)	-	-
Exclusion of non-income tax related costs	(699)	769	(2,940)
Share-based compensation expense, net of forfeitures	(179)	(638)	(1,981)
Rig reactivation costs	-	(4,185)	(37,233)
Rig preparation and relocation costs	-	(6,448)	-
Rig inventory acquisition costs	-	(59)	(4,018)
Gain on insurance recovery	-	25,432	-
Amortization of drilling contract intangibles	-	983	31,522
IPO readiness costs	-	-	(12,383)
Start-up costs	-	-	(8,756)
Others	1,918	(772)	75
Net (loss) / income	$ (29,836)	$ (180,002)	$ 226,062

Through December 31, 2014 the Company has incurred $25.4 million of costs related to preparation of an IPO and operating as a public company. These costs are included in IPO readiness costs and start-up costs. The costs were principally incurred on legal, accounting, external audit, consultancy and travel expenses. There were no costs incurred related to IPO readiness and start-up in 2015 and 2016.

SHELF DRILLING, LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Total revenues by country based on the location of the service provided were as follows (in thousands):

	Years ended December 31,		
	2016	2015	2014
India	$ 193,202	$ 159,754	$ 180,156
Saudi Arabia	165,280	184,653	215,625
United Arab Emirates	78,279	33,349	-
Nigeria	76,473	195,948	233,505
Thailand	57,578	150,531	96,629
Egypt	49,044	83,069	101,142
Qatar	40,704	63,937	63,854
Other countries	23,757	159,074	418,819
Gross revenue from rigs	$ 684,317	$ 1,030,315	$ 1,309,730
Adjustment to reconcile 'Gross revenue from rigs' to Operating revenues			
Amortization of drilling contract intangibles	-	983	31,522
Costs and expenses of rigs under Operating Agreements			
Operating and maintenance	-	-	(64,946)
General and administrative	-	-	(1,986)
Income tax expense	-	-	(8,307)
Other income	-	-	13
Total	$ 684,317	$ 1,031,298	$ 1,266,026

Although the Company is incorporated under the laws of the Cayman Islands, the Company does not conduct any operations and does not have any operating revenues in the Cayman Islands.

Total long-lived assets, net of impairment, by location based on the country in which the assets were located at the balance sheet date were as follows (in thousands):

	December 31,	
	2016	2015
United Arab Emirates	$ 233,967	$ 336,799
Saudi Arabia	228,331	244,606
Thailand	227,400	71,224
India	140,180	158,023
Cameroon	67,535	-
Egypt	59,032	64,347
Nigeria	55,660	121,107
Other countries	181,644	157,750
Total long-lived assets	$ 1,193,749	$ 1,153,856

A substantial portion of the Company's assets are mobile. The assets in the UAE include $134.1 million (31 December 2015: $171.5 million) relating to the Newbuild under construction. See Note 8 – Property and Equipment. Asset locations at the end of the year are not necessarily indicative of the geographic distribution of the revenue generated by such assets during the year.

Major Customers — During the year ended December 31, 2016, three customers (2015: three; 2014: two) accounted for approximately 64% (2015: 44%; 2014: 30%) of the Company's consolidated operating revenues. No other customer accounted for more than 10% of consolidated operating revenues during the years presented.

Note 24 — Related Parties

In connection with the Company's operations of a foreign subsidiary, a related party provided goods and services to drilling rigs owned by one of the Company's foreign subsidiaries. These goods and services totaled $3.3 million, $4.3 million and $5.9 million during 2016, 2015 and 2014, respectively.

The Company recorded $5.2 million, $5.1 million and 5.7 million during 2016, 2015 and 2014, respectively, for Sponsors' costs related to the $375 thousand monthly fee, directors' fees and reimbursement of costs incurred by Sponsors and directors for attendance at meetings relating to the management and governance of the Company.

Note 25 — Comparative Information

The amortization of deferred costs, which was previously presented as part of the operating and maintenance expenses, has been presented as a separate line item in the consolidated statements of operations in the comparative years for 2015 and 2014 to conform with the current year presentation. These changes neither impact the financial position nor the cash flows of the Company.

The changes are as follows (in thousands):

	Year ended December 31, 2015		Year ended December 31, 2014	
	As previously presented	Reclassified amounts	As previously presented	Reclassified amounts
Operating costs and expenses				
Operating and maintenance	$ 615,140	$ 534,156	$ 715,971	$ 667,162
Amortization of deferred costs	-	80,984	-	48,809

Note 26 — Subsequent Events

On January 12, 2017 ("Closing Date"), the Company successfully refinanced its long term debt. As a result, SDHL issued $502.835 million of new 9.5% Senior Secured Notes due November 2020 ("9.5% Senior Secured Notes"). These notes were issued in exchange and cancellation of $444.585 million of 8.625% Senior Secured Notes due November 2018 in accordance with the terms and conditions of the Offering Memorandum to Exchange Notes and Solicit Consents (of which $28.5 million were settled for cash), and $86.75 million in exchange for partial settlement of the $350 million Midco Term Loan. As of the Closing Date, $30.415 million of 8.625% Senior Secured Notes remain outstanding after issuance of $416.085 million 9.5% Senior Secured Notes, principal payment of $28.5 million in cash and incentive fee payment of $5.7 million in cash.

At the Closing Date, the Company also fully settled the outstanding $350 million Midco Term Loan. The term loan was settled in exchange for the issuance of $166.7 million of SDL Preferred Shares to certain equity Sponsors, issuance of $86.75 million of new 9.5% Senior Secured Notes and $85.75 million in cash. This settlement resulted in a gross gain of $10.8 million (excluding transaction costs and unamortized original issue discount and deferred financing costs write off). The equity Sponsors paid $100 million in cash directly to the Midco lenders in exchange for the purchase of $166.7 million of the term loan.

Simultaneously, the Company successfully amended the SDHL Revolver to extend the maturity date to April 2020, permanently reduce the facility from $200 million to $160 million and amend certain other terms of this agreement.