SHELF DRILLING, LTD.
INDEX TO INTERIM REPORT
THREE MONTHS ENDED MARCH 31, 2018 AND 2017
(UNAUDITED)

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

	Three months ended March 31,	
	2018	2017
Revenues		
Operating revenues	$ 144,604	$ 142,408
Other revenue	2,906	3,845
	147,510	146,253
Operating costs and expenses		
Operating and maintenance	90,269	68,549
Depreciation	21,868	18,369
Amortization of deferred costs	19,008	16,844
General and administrative	12,607	9,086
Gain on disposal of assets	(120)	(138)
	143,632	112,710
Operating income	3,878	33,543
Other (expense) / income, net		
Interest income	183	147
Interest expense and financing charges	(38,960)	(30,360)
Other, net	1,040	(314)
	(37,737)	(30,527)
(Loss) / income before income taxes	(33,859)	3,016
Income tax expense	4,658	4,550
Net loss	$ (38,517)	$ (1,534)
Less: Preferred shares dividend	4,495	3,805
Net loss attributable to common and ordinary shares	$ (43,012)	$ (5,339)
Loss per share:		
Basic and Diluted - Common shares	$ (0.53)	$ -
Basic and Diluted - Class A shares	$ -	$ (12.01)
Basic and Diluted - Class B shares	$ -	$ -
Basic and Diluted - Class C shares	$ -	$ -
Weighted average shares outstanding:		
Basic and Diluted - Common shares	81,651,566	-
Basic and Diluted - Class A shares	-	444,594
Basic and Diluted - Class B shares	-	18,147
Basic and Diluted - Class C shares	-	5,110

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

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

	Three months ended March 31,			
	2018		**2017**	
Net loss	$	(38,517)	$	(1,534)
Other comprehensive income, net of tax				
Change in unrealized (losses) / gains on derivative financial instruments				
Changes in unrealized losses		(568)		-
Reclassification of net loss from other comprehensive income to net income		98		-
	$	(470)	$	-
Total comprehensive loss	$	(38,987)	$	(1,534)

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

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

	March 31, 2018 (Unaudited)	December 31, 2017 (Audited)
Assets		
Cash and cash equivalents	$ 120,598	$ 84,563
Accounts and other receivables, net	128,035	137,785
Other current assets	98,903	96,960
Total current assets	347,536	319,308
Property and equipment	1,625,456	1,620,830
Less accumulated depreciation	392,574	370,840
Property and equipment, net	1,232,882	1,249,990
Deferred tax assets	690	1,321
Other assets	107,194	112,331
Total assets	$ 1,688,302	$ 1,682,950
Liabilities and equity		
Accounts payable	$ 76,465	$ 95,098
Interest payable	7,446	8,399
Obligations under sale and leaseback	35,115	35,115
Current maturities of debt	14,164	30,167
Accrued income taxes	5,878	4,822
Other current liabilities	22,536	36,681
Total current liabilities	161,604	210,282
Long-term debt	601,761	496,503
Obligations under sale and leaseback	270,156	278,815
Deferred tax liabilities	4,257	4,407
Other long-term liabilities	18,580	17,719
Total long-term liabilities	894,754	797,444
Mezzanine equity, net of issuance costs	165,978	165,978
Commitments and contingencies (Note 10)		
Common shares of $0.01 par value; 200,000,000 shares authorized at March 31, 2018 and December 31, 2017; 83,115,394 and 83,125,000 issued and outstanding at March 31, 2018 and December 31, 2017, respectively	831	831
Additional paid-in capital	658,797	663,090
Accumulated other comprehensive income	(470)	-
Accumulated losses	(193,192)	(154,675)
Total equity	465,966	509,246
Total liabilities and equity	$ 1,688,302	$ 1,682,950

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

SHELF DRILLING

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

	Three months ended March 31,		Three months ended March 31,	
	2018	2017	2018	2017
	Shares		Amount	
Common and ordinary shares				
Balance, beginning of period	83,125,000	475,768	$ 831	$ 5
Shares issued to trust	-	243	-	-
Repurchase and retirement of shares	(9,606)	-	-	-
Balance, end of period	83,115,394	476,011	$ 831	$ 5
Additional paid-in capital				
Balance, beginning of period			$ 663,090	$ 462,914
Preferred shares dividend			(4,495)	(3,805)
Share-based compensation expense, net of forfeitures			202	220
Repurchase and retirement of shares			-	-
Balance, end of period			$ 658,797	$ 459,329
Accumulated other comprehensive income				
Balance, beginning of period			$ -	$ -
Net unrealized loss on derivative financial instruments			(470)	-
Balance, end of period			$ (470)	$ -
Accumulated losses				
Balance, beginning of period			$ (154,675)	$ (83,465)
Net loss			(38,517)	(1,534)
Balance, end of period			$ (193,192)	$ (84,999)
Total equity				
Balance, beginning of period			$ 509,246	$ 379,454
Preferred shares dividend			(4,495)	(3,805)
Share-based compensation expense, net of forfeitures			202	220
Repurchase and retirement of shares			-	-
Total comprehensive loss			(38,987)	(1,534)
Balance, end of period			$ 465,966	$ 374,335

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

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

	Three months ended March 31, 2018	Three months ended March 31, 2017
Cash flows from operating activities		
Net loss	$ (38,517)	$ (1,534)
Adjustments to reconcile net loss to net cash (used in) / provided by operating activities		
Depreciation	21,868	18,369
Loss on derivative financial instruments, net	98	-
Provision for / (reversal of) doubtful accounts, net	85	(2,316)
Amortization of deferred revenue	(3,426)	(3,779)
Share-based compensation expense, net of forfeitures	202	220
Non-cash portion of loss on debt extinguishment	6,320	4,371
Debt extinguishment costs	12,505	9,785
Payment of original issue discount	-	(10,500)
Amortization of debt issue costs and discounts	822	1,070
Gain on disposal of assets	(120)	(138)
Deferred tax expense, net	481	913
Payments for settlement of derivative financial instruments, net	(98)	-
Changes in deferred costs, net *	6,723	11,554
Changes in operating assets and liabilities	(16,570)	(25,052)
Net cash (used in) / provided by operating activities	(9,627)	2,963
Cash flows from investing activities		
Additions to property and equipment *	(9,309)	(7,423)
Proceeds from disposal of property and equipment	291	198
Net cash used in investing activities	(9,018)	(7,225)
Cash flows from financing activities		
Proceeds from short-term debt, net	2,159	-
Proceeds from issuance of debt	625,000	-
Payments for obligations under sale and leaseback	(8,659)	(2,822)
Payments to retire long-term debt	(533,250)	(103,750)
Payments of debt issuance costs	(9,739)	(10,351)
Payments of debt extinguishment costs	(12,505)	(9,785)
Payments of preferred shares issuance costs	-	(688)
Preferred shares dividend paid	(8,906)	(957)
Net cash provided by / (used in) financing activities	54,100	(128,353)
Net increase / (decrease) in cash, cash equivalents and restricted cash	35,455	(132,615)
Cash, cash equivalents and restricted cash at beginning of period*	99,826	222,395
Cash, cash equivalents and restricted cash at end of period*	$ 135,281	$ 89,780

* See Note 16 – Supplemental Cash Flow Information for a reconciliation of cash payment for additions to property and equipment and changes in deferred costs, net to total capital expenditures and deferred costs and a reconciliation of cash, cash equivalents and restricted cash balances.

The accompanying notes are an integral part of these condensed consolidated interim 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. On September 9, 2012, the Company entered into a definitive agreement to acquire 37 jackup rigs and one swamp barge (the "Acquisition") from Transocean Inc. (the "Seller") which closed on November 30, 2012. 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 listed on the Norwegian over-the-counter market in May 2017.

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. As of March 31, 2018, the Company owns 38 independent cantilever jackup rigs, two of which are stacked, and one stacked swamp barge.

Basis of Preparation

The Company has prepared the accompanying condensed consolidated interim financial statements in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") for interim financial information. Pursuant to such rules and regulations, these financial statements do not include all disclosures required by U.S. GAAP for complete financial statements. The condensed consolidated interim financial statements reflect all adjustments, which are, in the opinion of management, necessary for a fair statement of financial position, results of operations and cash flows for the interim periods. Such adjustments are considered to be of a normal recurring nature unless otherwise noted. Operating results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 or for any future period. The accompanying condensed consolidated interim financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and notes thereto as of December 31, 2017.

Summary of Significant Accounting Policies

These condensed consolidated interim financial statements include the following accounting policies in addition to the significant accounting policies described in the annual consolidated financial statements for the year ended December 31, 2017.

Revenue Recognition — The revenue relating to the provision of the rigs and drilling related services, collectively "integrated drilling services", is recognized as operating revenue as services are performed. Any up-front lump-sum fees or similar compensation for the mobilization of equipment, contract preparation and capital upgrades received prior to the commencement of drilling services are deferred and recognized over the contract period and are included in operating revenue.

Any demobilization fee received upon completion of the contract is accrued as operating revenue over the contract duration, if it is unconditional and there is no significant risk of potential material revenue reversal in the future, otherwise it is recorded when earned. Contractual termination fees due from the customer are recognized as operating revenue when services have been completed under the terms of the contract.

Other revenue consists of revenue from lease rentals and amounts billed for goods and services such as personnel, catering or accommodation which are generally invoiced to customers at a margin. These revenues are recognized when the goods have been delivered and services have been rendered. See Note 3 – Revenue.

Derivative Financial Instruments — The Company's derivative financial instruments consist of foreign exchange ("forex") contracts and interest rate swaps which the Company may designate as cash flow hedges. 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.

For forex contracts, the Company reports 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. For interest rate swaps, the Company reports realized gains and losses as a component of interest expense and financing charges in the consolidated statements of operations. 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 condensed consolidated interim balance sheets depending on their maturity date.

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.

Note 2 — Recently Adopted and Issued Accounting Pronouncements

Recently adopted accounting standards

In May 2017, the FASB issued ASU No. 2017-09, Compensation — Stock Compensation (Topic 718): Scope of Modification. The amendments apply to entities that change the terms or conditions of a share-based payment award. The FASB Accounting Standards Codification currently defines the term modification as "a change in any of the terms or conditions of a share-based payment award".

These amendments require the entity to account for the effects of a modification unless all of the following conditions are met:

- The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or value using an alternative measurement method) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification;
- The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and
- The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The amendments are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017, with early adoption permitted. The Company has adopted this standard as of January 1, 2018 with no impact on the condensed consolidated interim financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The amendments require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. The amendments also allow only the service cost component to be eligible for capitalization when applicable. The amendments are effective for fiscal years beginning after December 15, 2017 with early adoption permitted. The Company has adopted this standard as of January 1, 2018. As a result, the Company has disaggregated the other components of net periodic benefit (gain) / costs from other compensation costs included in operating costs and expenses and has presented these costs under other, net on the condensed consolidated interim statement of operations in 2018. The amounts in prior periods were immaterial, therefore no changes to prior periods were made.

In February 2017, the FASB issued ASU No. 2017-05, Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20): Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. The amendments clarify that nonfinancial assets within the scope of Subtopic 610-20 may include nonfinancial assets transferred within a legal entity to a counterparty and that an entity should identify each distinct nonfinancial asset or in substance nonfinancial asset promised to a counterparty and derecognize each asset when a counterparty obtains control of it. The amendments are effective for annual and interim periods for fiscal years beginning after December 15, 2017. The Company has adopted this standard as of January 1, 2018 with no material impact on the condensed consolidated interim financial statements.

In January 2017, the FASB has issued ASU No. 2017-01, Business Combinations (Topic 805): Clarifying the Definition of a Business. The amendments affect all companies and other reporting organizations that must determine whether they have acquired or sold a business. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The amendments are intended to help companies and other organizations evaluate whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments provide a more robust framework to use in determining when a set of assets and activities is a business. They also provide more consistency in applying the guidance, reduce the costs of application, and make the definition of a business more operable. The amendments are effective for annual periods beginning after December 15, 2017 for public entities, including interim periods within that period. The Company has adopted this standard as of January 1, 2018 with no impact on the condensed consolidated interim financial statements.

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 and is effective beginning after December 15, 2017. The Company has adopted this standard as of January 1, 2018 and has applied the new guidance for restricted cash presentation. As a result of this adoption, the Company has included restricted cash of $14.7 million and $8.7 million as part of cash, cash equivalents and restricted cash on the condensed consolidated interim statements of cash flows for the three months ended March 31, 2018 and 2017, respectively. Also, the change in restricted cash of $0.6 million during the three months ended March 31, 2017 previously reported as cash flows from investing activities has been presented as part of cash and cash equivalents and restricted cash.

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, 2017. The Company has adopted this standard as of January 1, 2018. As a result, the debt extinguishment costs of $9.8 million during the three months ended March 31, 2017 are now presented as cash flows from financing activities under the retrospective treatment of this ASU.

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, 2017 for public business entities.

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 has adopted this standard as of January 1, 2018 using the cumulative effect approach. The Company has applied this standard retrospectively to 28 drilling contracts with customers that were not completed as of January 1, 2018. As a result of the initial application of this standard, there was no necessary adjustment to retained earnings as of January 1, 2018.

The adoption of this standard does not result in any significant changes to the revenue recognition policy The Company will continue to record the dayrate revenue earned with the provision of the integrated drilling services as operating revenue.

Recently issued accounting standards

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This ASU refines and expands hedge accounting for both financial (e.g. interest rate) and commodity risks and creates more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes, for investors and analysts. The amendments are effective for annual periods beginning after December 15, 2018 for public entities, including interim periods within that period, with early adoption permitted. The Company does not intend to early adopt this standard. The Company is currently evaluating the impact of this standard on the condensed consolidated interim 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 condensed consolidated interim 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. The amendment is effective for annual and interim periods for fiscal years beginning after December 15, 2018 with an option of early adoption.

In January 2018, the FASB issued ASU No. 2018-01, Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842. The amendment clarifies the application of the new leases guidance to land easements and improves adoption efforts for some land easements. This ASU is expected to reduce the cost of adopting the new leases standard for certain land easements and it is also an attempt to help ensure that companies can make a successful transition to the standard without compromising the quality of information provided to investors about these transactions. Land easements (also commonly referred to as rights of way) represent the right to use, access, or cross another entity’s land for a specified purpose.

Based on the initial assessment, with respect to the Company’s leases as a lessee, any impact on the net assets included in the balance sheet as a result of recording the Company’s operating lease as right-of-use assets and lease liability is not expected to be material. The Company also does not expect any material changes with respect to its finance leases. However, the adoption of this standard will result in additional quantitative and qualitative disclosures. The Company does not intend to early adopt this standard.

Note 3 – Revenue

A significant portion of the Company’s revenue is generated from rigs operated by the Company through dayrates charged to the customers for the provision of integrated drilling services. The Company’s contracts with customers contain multiple dayrates and the actual dayrate earned during a particular period could vary based on the actual operations. The lowest dayrate in the drilling contract that the customer could choose at any given point of time is typically the standby rate.

The Company may earn lump-sum fees relating to mobilization, contract preparation, capital upgrades and demobilization in certain drilling contracts. The mobilization, contract preparation and capital upgrade revenues are typically received at the commencement of the contract. In addition, the Company may receive demobilization revenue at the end of the contract.

The Company’s integrated drilling service provided under each drilling contract is a single performance obligation satisfied over time utilizing the input method and comprised of a series of distinct time increments, or service periods. Total revenue is determined for each individual drilling contract by estimating both fixed and variable considerations expected to be earned over the contract term. Substantially all the Company’s revenues are recorded over time. Fixed consideration generally relates to activities such as rig mobilization, contract preparation, capital upgrades and is recognized on a straight-line basis over the contract term. In some cases, demobilization fees may be contingent upon the occurrence or non-occurrence of a future event and this may result in cumulative-effect adjustments to demobilization revenues upon changes in our estimates of future events during the contract term. Variable consideration generally relates to distinct service periods during the contract term and is recognized in the period when services are performed. We have applied the disclosure practical expedient in ASC 606-10-50-14(b) and have not disclosed consideration related to remaining performance obligations.

The Company also provides catering and accommodation services and additional equipment, consumables and personnel on an as needed basis at the request of the customer and may use third parties for the provision of such goods and services. The Company generally acts as a principal in the provision of catering and accommodation services and additional personnel, and as an agent in the provision of additional equipment and consumables. The consideration with respect to the provision of goods or services is recognized when the control of goods or services is transferred to a customer.

Many drilling contracts have termination and/or extension options at the option of the customer. In most cases, if the contract is terminated by the customer, the Company is able to charge an early termination fee to the customer. The extension options are typically at agreed prices and terms. The contract modifications typically have an increase in scope and a commensurate increase in price and are accounted for as a termination of the existing contract and creation of a new contract. In such cases, any remaining deferred revenue and costs are recorded to the condensed consolidated interim statement of operations upon such termination.

The Company typically invoices its customers monthly for the dayrates and any other goods and services provided, and a receivable is then recognized. Any unbilled revenue is recognized as accrued income at the end of the month. The payment terms are generally 30 to 60 days from billing. There is no significant financing component in the Company's revenue. The Company typically has no obligations for returns, refunds or other similar obligations and does not provide warranties.

Significant judgements are involved in identifying the performance obligations in the customer contracts and determining whether the Company is a principal or an agent in the provision of certain equipment and consumables to the customers.

See condensed consolidated interim statements of operations for the amounts of Operating and other revenues.

See Note 18 – Segment and Related Information for disclosure of total revenues by country based on the location of the service provided.

Contract liabilities

Contract liabilities represent fees received for mobilization or capital upgrades. Current contract liabilities are included in other current liabilities and noncurrent contract liabilities are included in other long-term liabilities on the condensed consolidated balance sheets. Contract liabilities are amortized on a straight-line basis over the contract term.

Following are the details of the contract liabilities (in thousands):

	March 31, 2018	December 31, 2017
Current contract liabilities	$ 9,006	$ 11,276
Non-current contract liabilities	$ 5,203	$ 4,985

Significant changes in contract liabilities during the period are as follows (in thousands):

	Contract liabilities
Balance as of December 31, 2017	$ 16,261
Increase due to contractual additions	1,374
Decrease due to amortization of deferred revenue	(3,426)
Balance as of March 31, 2018	$ 14,209

Deferred contract costs

Costs incurred for upfront rig mobilizations and certain contract preparation are attributable to the Company's future performance obligation under each drilling contract. Such costs are deferred and amortized on a straight-line basis over the contract term. Deferred contract costs were included in other current assets and other assets on the condensed consolidated balance sheets and totaled $49.9 million and $53.2 million as of March 31, 2018 and December 31, 2017, respectively. During the three months ended March 31, 2018 and 2017, amortization of deferred contract costs were $9.7 million and $8.1 million, respectively.

Note 4 — Consolidated Variable Interest Entities

The Company, through its wholly owned indirect subsidiary Shelf Drilling Holdings Ltd ("SDHL"), is the primary beneficiary of four variable interest entities ("VIEs") which are Shelf Drilling Ventures Malaysia Sdn. Bhd. ("SDVM"), PT Hitek Nusantara Offshore Drilling ("PT Hitek"), Shelf Drilling Nigeria Ltd. ("SDNL") and Shelf Drilling Offshore Services Limited ("SDOSL"), which are included in these condensed consolidated interim financial statements. These VIEs are incorporated in jurisdictions where majority or significant foreign ownership of domestic companies is restricted or, commercially incompatible with local content requirements. To comply with such foreign ownership and/or local content restrictions, the Company and the relevant third parties have contractual arrangements to convey decision-making and economic rights to the Company. These VIEs provide drilling and other services.

SDVM is a Malaysian incorporated entity that is 60% owned by a Malaysian third party. The Company has the power to direct the operating and marketing activities of SDVM, which are the activities that most significantly impact SDVM's economic performance. The Malaysian third party is not in a position to provide additional financing and does not participate in any gains or losses of SDVM.

PT Hitek is an Indonesian incorporated entity that is 20% owned by an Indonesian partner. The Company has the power to direct the operating and marketing activities of PT Hitek, which are the activities that most significantly impact such entity's economic performance. The Indonesian partner does not participate in any gains or losses of PT Hitek, does not have capital at risk and is not in a position to provide additional financing.

SDNL is 51% owned by Nigerian third parties. The Company has the power to direct the operating and marketing activities of SDNL, which are the activities that most significantly impact SDNL's economic performance and has the obligation to absorb losses.

SDOSL is 20% owned by Nigerian third parties. The Company is responsible to provide additional subordinated financial support to SDOSL to carry on its activities because the equity contributed by the third parties collectively at risk in times of distress is not sufficient.

Based on the facts discussed above, the Company has determined that these four entities met the criteria of VIEs for accounting purpose because the Company has the power to direct the operating and marketing activities, which are the activities that most significantly impact each entity's economic performance, and has the obligation to absorb losses or the right to receive a majority of the benefits that could be potentially significant to these VIEs.

The carrying amounts associated with the VIEs, after eliminating the effect of intercompany transactions, were as follows (in thousands):

	Shelf Drilling Ventures (Malaysia) Sdn. Bhd	PT Hitek Nusantara Offshore Drilling	Shelf Drilling (Nigeria) Ltd.	Shelf Drilling Offshore Services Limited	Total
March 31, 2018					
Total assets	$ 154	$ 13,452	$ 12,802	$ 2,334	$ 28,742
Total liabilities	414	554	11,564	1,118	13,650
Net carrying amount	$ (260)	$ 12,898	$ 1,238	$ 1,216	$ 15,092
December 31, 2017					
Total assets	$ 78	$ 14,421	$ 14,696	$ 2,787	$ 31,982
Total liabilities	406	781	7,720	864	9,771
Net carrying amount	$ (328)	$ 13,640	$ 6,976	$ 1,923	$ 22,211

Note 5 — Property and Equipment

Property and equipment as of March 31, 2018 and December 31, 2017 consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Drilling rigs and equipment	$ 1,560,386	$ 1,554,045
Spares	41,065	36,120
Construction in progress	4,234	12,642
Land and building	1,354	1,354
Other	18,417	16,669
Total property and equipment	$ 1,625,456	$ 1,620,830
Less: Accumulated depreciation	(392,574)	(370,840)
Total property and equipment, net	$ 1,232,882	$ 1,249,990

There were no rigs added to the Company's drilling rig fleet during the three months ended March 31, 2018 and 2017.

Total capital expenditures for the three months ended March 31, 2018 and 2017 were $4.9 million and $10.7 million, respectively. This included $9.8 million related to progress payments, internal project costs, change orders, owner furnished equipment and capitalized interest for the new build high specification jackup rigs ("Newbuilds") during the three months ended March 31, 2017. There were no such transactions during the three months ended March 31, 2018. The two Newbuilds were delivered in April 2017 and September 2016 and started drilling operations after completion of final customer acceptance requirements in June 2017 and December 2016, respectively.

Total capital expenditures through March 31, 2017 on the Newbuilds were $371.3 million, of which $239.1 million were paid by the Lessor (see Note 8 – Sale and Leaseback).

Interest capitalized on the Newbuild rigs totaled $2.6 million for the three months ended March 31, 2017, which included $1.2 million related to the sale and leaseback financing agreements. There were no such transactions during the three months ended March 31, 2018.

Disposals of other property and equipment with a net carrying amount of $0.1 million and $67 thousand were sold for $0.2 million and $0.2 million and resulted in a gain on disposal of assets of $0.1 million during each of the three months ended March 31, 2018 and 2017, respectively.

The Company did not record an impairment charge during the three months ended March 31, 2018 and 2017.

Drilling rigs under capital and operating leases — The net carrying amount of drilling rigs and equipment as of March 31, 2018 and December 31, 2017 includes two Newbuild rigs held under a capital lease and one rig leased to a customer under an operating lease.

The drilling rigs under a capital lease had a total cost of $455.7 million and $455.8 million, and accumulated depreciation of $16.2 million and $12.7 million, as of March 31, 2018 and December 31, 2017, respectively. The total costs included capital equipment transfers from other rigs.

As of March 31, 2018 and December 31, 2017, the rig under an operating lease had a net carrying value of $14.1 million and $14.5 million, and accumulated depreciation of $9.4 million and $8.9 million, respectively. This rig commenced a three-year bareboat charter contract (with two 12 month extension options) with a private limited liability company on February 8, 2016.

As of March 31, 2018, following is the summary of future minimum rentals receivable on the operating lease (in thousands):

For the twelve months ending March 31,		
2019	$	7,038
2020		-
2021		-
Thereafter		-
Total future minimum rentals	$	7,038

Due to payment delays by the lessee, the Company has temporarily ceased revenue recognition from May 2017 onwards.

Note 6 — 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 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) changes in rig operating structures which may alter the basis on which the Company is taxed in a particular jurisdiction.

The effective income tax rate for the Company's continuing operations was (13.8)% and 150.9% for the three months ended March 31, 2018 and 2017, respectively. The difference in effective tax rate for the three months ended March 31, 2018 as compared to the three months ended March 31, 2017 is primarily due to an increased proportion of expenses in 2018 for which there will be no tax benefit as such expenses are either incurred in jurisdictions which impose tax based on gross revenue rather than on net income or are incurred in jurisdictions in which the Company does not pay tax or which do not allow for a tax deduction for such expenses. As a result, the Company has an income tax expense for the three months ended March 31, 2018, despite having a loss before income taxes, resulting in a negative effective tax rate.

Income Tax Expense — Income tax expense was $4.7 million for the three months ended March 31, 2018, compared to $4.6 million for the three months ended March 31, 2017. Income tax expense in Q1 2018 is higher than in Q1 2017 despite having a loss before income taxes in Q1 2018 as compared to income before income taxes in Q1 2017, primarily due to an increased proportion of expenses in 2018 for which there will be no tax benefit as such expenses are either incurred in jurisdictions which impose tax based on gross revenue rather than on net income or are incurred in jurisdictions in which the Company does not pay tax or which do not allow for a tax deduction for such expenses.

Income tax expense for the three months ended March 31, 2018 is calculated using a discrete approach whereby income tax expense is determined by estimating the actual income tax liability that will result from earnings from continued operations for the three months ended March 31, 2018 rather than by using an estimated annual effective income tax rate as applied to year-to-date income before income taxes, primarily due to management's view that it is not possible to reliably estimate an annual 2018 effective tax rate given the sensitivity of the estimated annual effective tax rate to any changes in annual income or losses before income tax.

The Company's deferred tax liabilities as of March 31, 2018 and December 31, 2017 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 condensed consolidated interim financial statements. The Company considers a portion of the earnings of a certain subsidiary to be indefinitely reinvested. As such, the Company has not provided for taxes on these unremitted earnings. As of March 31, 2018 and December 31, 2017, the amount of indefinitely reinvested earnings was approximately $12.5 million and $13.9 million, respectively. Should the Company make a distribution from these unremitted earnings in the future, such distributions may be subject to withholding taxes; however, it is not practicable to determine precisely the amount of withholding tax that may be payable on the eventual distribution of these earnings.

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. Any interest and penalties related to such liabilities are included as a component of income tax expense. The liabilities for uncertain tax positions include certain amounts which were acquired from the Seller as part of the Acquisition. The Company is fully indemnified by the Seller for all such acquired liabilities. The indemnity related receivable is recorded in other assets. Not considering any indemnification, the liabilities related to uncertain tax positions, including related interest and penalties, recorded as other long-term liabilities, were as follows (in thousands):

	March 31, 2018	December 31, 2017
Liabilities for uncertain tax positions, excluding interest and penalties	$ 2,355	$ 2,248
Interest and penalties	-	-
Liabilities for uncertain tax positions, including interest and penalties	$ 2,355	$ 2,248

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

	March 31, 2018	December 31, 2017
Balance, beginning of period	$ 2,248	$ 2,455
Reductions for prior period tax positions	-	(273)
Reductions related to statute of limitation expirations	-	(81)
Additions for current period tax positions	107	147
Balance, end of period	$ 2,355	$ 2,248

Liabilities for uncertain tax positions may change from quarter to quarter based on various factors, including, but not limited to, favorable or unfavorable resolution of tax audits or disputes, expiration of relevant statutes of limitations, changes in tax laws or changes to the interpretation of existing tax laws due to new legislative guidance or court rulings, or new uncertain tax positions taken on recently filed tax returns. Although the Company has recorded liabilities against all tax benefits resulting from tax positions which, in management's judgment, are more likely than not to be successfully challenged by the relevant tax authorities in the future, the Company cannot provide assurance as to the final tax liability related to its tax positions as it is not possible to predict with certainty the ultimate outcome of any related tax disputes. Thus, it is reasonably possible that ultimate tax liabilities related to such tax positions could substantially exceed recorded liabilities related to such tax positions, resulting in a material adverse effect on the Company's earnings and cash flows from operations.

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. If any tax authority successfully challenges the Company's tax positions, including, but not limited to, the validity of various intercompany transactions, or the taxable presence of the Company's key subsidiaries in certain countries, or if the terms of certain income tax treaties are interpreted in an adverse manner, or if the Company loses a material tax dispute in any country, the Company's income tax liability could increase substantially and the Company's earnings and cash flows from operations could be materially adversely affected. The Company is indemnified from any tax liabilities of subsidiaries previously owned by the Seller related to the periods prior to the Acquisition.

Note 7 — Debt

Current maturities of long-term debt is comprised of the following (in thousands):

	March 31, 2018	December 31, 2017
Unsecured overdraft facility - Short-term debt (see note (i) below)	$ 2,159	$ -
Senior Secured Credit Facility, due March 31, 2020 (see note (ii) below)	12,005	-
8.625% Senior Secured Notes, due November 1, 2018 (see note (iii) below)	-	30,167
	$ 14,164	$ 30,167

Long-term debt is comprised of the following (in thousands):

	March 31, 2018	December 31, 2017
8.25% Senior Unsecured Notes, due February 15, 2025 (see note (iv) below)	$ 589,487	$ -
9.5% Senior Secured Notes, due November 2, 2020 (see note (v) below)	-	496,503
Revolving Credit Facility, due April 30, 2020 (see note (vi) below)	-	-
Senior Secured Credit Facility, due March 31, 2020 (see note (ii) below)	12,274	-
	$ 601,761	$ 496,503

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

For the twelve months ending March 31,	
2019	$ 12,500
2020	12,500
2021	-
2022	-
2023 and thereafter	600,000
Total debt	$ 625,000

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

	March 31, 2018		
	Principal Amount	Unamortized Debt Issuance Costs	Carrying Value
8.25% Senior Unsecured Notes, due February 15, 2025	$ 600,000	$ (10,513)	$ 589,487
Senior Secured Credit Facility, due March 31, 2020	25,000	(721)	24,279
Total	$ 625,000	$ (11,234)	$ 613,766

	December 31, 2017		
	Principal Amount	Unamortized Debt Issuance Costs	Carrying Value
9.5% Senior Secured Notes, due November 2, 2020	$ 502,835	$ (6,332)	$ 496,503
8.625% Senior Secured Notes, due November 1, 2018	30,415	(248)	30,167
Total	$ 533,250	$ (6,580)	$ 526,670

The effective interest rates on the 8.25% Senior Unsecured Notes due February 15, 2025, 9.5% Senior Secured Notes due November 2, 2020 and 8.625% Senior Secured Notes due November 1, 2018 are 8.59%, 10.02% and 9.79%, respectively.

(i) Unsecured overdraft facility

On April 26, 2017, Shelf Drilling Egypt Limited, a wholly owned subsidiary of the Company, entered into a $5 million equivalent of foreign currency unsecured and uncommitted credit facility. The facility is available in foreign currency to finance the subsidiary's running expenses, overheads and payments to suppliers. Interest is paid monthly on the drawn balance and is calculated using the Central Bank of Egypt Mid Corridor rate plus 3% per annum. Further, an additional stamp duty of 0.2% per annum is to be paid quarterly on actual utilization.

(ii) Senior Secured Credit Facility, due March 2020

On December 21, 2017, Shelf Drilling Asset III, Ltd (the "SDAIII"), a wholly owned subsidiary of the Company, entered into a $75 million senior secured credit facility (the "SDA Facility"). The SDA Facility includes a $50 million guarantee facility, which can be used for issuing bank guarantees, and a $25 million term loan facility, which can be used to fund the upgrade and capital expenditure costs for two of the recently acquired premium jackup drilling rigs. On March 27, 2018, the Company drew $25 million under the SDA Facility, which amount was outstanding as of March 31, 2018. As of December 31, 2017, there was no utilization under this facility. The outstanding bank guarantees under the uncommitted guarantee facility was $8.1 million and nil as of March 31, 2018 and December 31, 2017, respectively. The SDA Facility matures on March 31, 2020.

The term loan facility of $25 million is due for repayment in four equal semi-annual instalments beginning on September 28, 2018. Cash borrowings under the term loan facility bear interest at LIBOR plus 5% per annum and a 1.75% per annum commitment fee was payable quarterly on the unused amount of such term loan facility. The guarantee facility fee accrues on issued bank guarantees at 2.75% per annum (or 1.375% per annum if the bank guarantee is cash collateralized). Interest and relevant fees are payable quarterly in arrears.

The SDA Facility further requires a total net leverage ratio (consolidated net debt to consolidated EBITDA, as defined in the SDA Facility) not to exceed 4:1 and is tested semi-annually. In addition, the fair market value of the two acquired rigs shall be tested annually and such valuation must exceed 140% of the total outstanding amount under the SDA Facility. The Company was in compliance with both of these financial covenants as of December 31, 2017.

The Company incurred total debt issuance costs of $1.3 million for the term loan facility and guarantee facility. As of March 31, 2018, the unamortized debt issue costs for the term loan facility of $0.7 million (current: $0.4 million; long-term: $0.3 million) were presented in the balance sheet as a direct deduction from the carrying value of the debt. As of March 31, 2018, the unamortized debt issuance costs for the guarantee facility of $0.5 million were reported as other assets on the condensed consolidated interim balance sheet. As of December 31, 2017, the unamortized debt issuance costs for the term loan and guarantee facility of $1.3 million was reported as other assets.

The total amortization of debt issue costs during the three months ended March 31, 2018 was $60 thousand.

As of March 31, 2018, SDAIII provides guarantee for the SDA Facility. As a result of the issuance of the $600 million of new 8.25% Senior Unsecured Notes due 2025 (the "8.25% Senior Unsecured Notes"), the Company has agreed for SDAIII to guarantee the 8.25% Senior Unsecured Notes by February 2019. In order for this to occur, the Company believes it may need to pay the SDA Facility in full by February 2019.

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

On January 12, 2017, the Company cancelled $444.585 million aggregate principal amount of 8.625% Senior Secured Notes (the "8.625% Senior Secured Notes") in exchange for $416.09 million aggregate principal amount of 9.5% Senior Secured Notes and a principal payment of $28.5 million in cash. As of December 31, 2017, the Company recognized a loss of $13.7 million associated with this debt extinguishment which included the $7.5 million write-off of the original unamortized debt issuance cost, an incentive fee of $5.7 million paid to the lenders and legal fees of $0.6 million ($55 thousand was incurred in December 2016). These transactions were recorded as an expense in interest expense and financing charges.

SDHL's obligations under the outstanding 8.625% Senior Secured Notes were guaranteed by a majority of SDHL's subsidiaries, subject to certain exceptions. The indenture governing the 8.625% Senior Secured Notes were amended to eliminate or waive substantially all of the restrictive covenants and to eliminate certain events of default.

In February 2018, the Company fully settled the outstanding $30.4 million of 8.625% Senior Secured Notes. The Company recognized a loss of $0.2 million associated with this debt extinguishment which included the write-off of unamortized debt issuance costs, premium to tender and professional fees. These transactions were recorded as an expense in interest expense and financing charges during the three months ended March 31, 2018. The total amortization of debt issue costs during the three months ended March 31, 2018 was $44 thousand.

(iv) 8.25% Senior Unsecured Notes, due February 2025

On February 7, 2018, SDHL completed the issuance of $600.0 million of new 8.25% Senior Unsecured Notes due 2025 issued at par. SDHL received net proceeds of $589.3 million, after deduction of the $10.7 million of fees and expenses which are capitalized and amortized over the life of the debt.

The Company used the net proceeds to purchase and cancel or redeem $502.8 million of 9.5% Senior Secured Notes and $30.4 million of 8.625% Senior Secured Notes, or such notes redemption provisions. Interest on the 8.25 % Senior Unsecured Notes accrues from February 7, 2018 at a rate of 8.25% per year and is payable semi-annually in arrears on February 15 and August 15 of each year, beginning August 15, 2018.

SDHL's obligations under the 8.25% Senior Unsecured Notes are guaranteed by a majority of SDHL's subsidiaries (collectively, the "Note Guarantors"), subject to certain exceptions. The notes and the note guarantees will be SDHL's and the Note Guarantors' senior unsecured obligations and will:

- rank senior in right of payment to any of SDHL's and the Note Guarantors' existing and future subordinated indebtedness, if any;
- rank pari passu in right of payment with all existing and future senior unsecured indebtedness of SDHL and the Note Guarantors;
- be effectively subordinated to all existing and future secured indebtedness of SDHL and the Note Guarantors, to the extent of the value of the assets securing such indebtedness; and
- be structurally subordinated to all existing and future indebtedness, including the SDA Facility and the sale and leaseback transaction, preferred stock and other liabilities, including trade payables, of any non-guarantor subsidiaries of SDHL.

At any time prior to February 15, 2021, SDHL is entitled to redeem the notes, in whole or in part at a price equal to 100% of the principal amount plus accrued and unpaid interest and the Applicable Premium (as defined in the indenture). SDHL may also redeem the notes of up to 35% of the aggregate principal amount at a redemption price of 108.25% plus accrued and unpaid interest from the net cash proceeds from one or more qualified equity offerings.

On or after February 15, 2021, SDHL may redeem the 8.25% Senior Unsecured Notes, in whole or part, at the redemption prices set forth below, together with accrued and unpaid interest up to and including the redemption date.

Period	Redemption Price
Between February 15, 2021 and February 14, 2022	106.188%
Between February 15, 2022 and February 14, 2023	104.125%
Between February 15, 2023 and February 14, 2024	102.063%
On or after February 15, 2024	100.000%

If SDHL experiences a change of control, as defined in the indenture governing the 8.25 % Senior Unsecured Notes and a decrease in the rating of the 8.25 % Senior Unsecured Notes by both Moody's Investors Services and Standard & Poor's Financial Services LLC by one or more gradations, it must offer to repurchase the 8.25% Senior Unsecured Notes at an offer price in cash equal to 101% of their principal amount, plus accrued and unpaid interest.

As of March 31, 2018, the unamortized debt issuance costs of $10.5 million were reported as a component of long-term debt on the condensed consolidated interim balance sheet. The total amortization of debt issue costs during the three months ended March 31, 2018 was $0.2 million.

(v) 9.5% Senior Secured Notes, due November 2020

On January 12, 2017, SDHL completed the issuance and sale of $502.835 million aggregate principal amount of 9.5% Senior Secured Notes (the "9.5% Senior Secured Notes"). The 9.5% Senior Secured Notes were sold in exchange and cancellation of $444.585 million aggregate principal amount of 8.625% Senior Secured Notes (of which $28.5 million was a principal payment in cash), and $86.75 million in exchange for partial settlement of the $350 million term loan entered into on October 8, 2013 (the "Midco Term Loan"). As a result of this transaction, SDHL incurred $8.1 million of debt issuance cost as a direct deduction from the carrying value of the debt and is amortized over the term using the effective interest rate. Interest on these notes accrues from January 12, 2017 at a rate of 9.5% per year and was payable semi-annually on May 1 and November 1 of each year, beginning May 1, 2017.

SDHL's obligations under the 9.5% Senior Secured Notes were guaranteed by a majority of SDHL's subsidiaries (collectively, the "9.5% Senior Secured Notes Guarantors"), subject to certain exceptions. The obligations of the 9.5% Senior Secured Notes Guarantors were secured by liens on the rigs and other assets owned by the Note Guarantors. These liens were subordinated to the liens securing the obligations of the revolving credit facility Guarantors.

SDHL could have redeemed the 9.5% Senior Secured Notes, in whole or part, at the redemption prices set forth below, together with accrued and unpaid interest up to and including the redemption date.

Period	Redemption Price
On or after January 12, 2017	104.313%
On or after the first anniversary of January 12, 2017	102.156%
On or after the second anniversary of January 12, 2017	100.000%

If SDHL had experienced a change of control, as defined in the indenture governing the 9.5% Senior Secured Notes (the "9.5% Senior Secured Notes Indenture"), it would have had to offer to repurchase the 9.5% 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 have been required to use the proceeds to offer to repurchase the 9.5% Senior Secured Notes at an offer price in cash equal to 100% of their principal amount, plus accrued and unpaid interest.

In February 2018, the Company fully settled the outstanding $502.8 million of 9.5% Senior Secured Notes. The Company recognized a loss of $18.8 million associated with this debt extinguishment which included a $6.1 million write-off of unamortized debt issuance costs, premium of $12.2 million and professional fees of $0.5 million. These transactions were recorded as an expense in interest expense and financing charges during the three months ended March 31, 2018. The total amortization of debt issue costs during the three months ended March 31, 2018 was $0.2 million.

(vi) Revolving Credit Facility, due April 2020

On February 24, 2014, SDHL entered into a $150 million revolving credit facility ("SDHL Revolver") which was available for utilization on February 28, 2014. This facility amount was increased to $200 million on June 11, 2014 in accordance with the terms of the SDHL Revolver. 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.

On January 12, 2017, the Company successfully amended the SDHL Revolver to extend the maturity date from April 30, 2018 to April 30, 2020 and to permanently reduce the facility from $200 million to $160 million with certain other terms of this agreement amended. All borrowings under the SDHL Revolver mature on April 30, 2020, and letters of credit and bank guarantees issued under the SDHL Revolver expire no later than five business days prior to April 30, 2020.

The Company issued bank guarantees and performance bonds totaling $3.5 million and $12.3 million as of March 31, 2018 and December 31, 2017, respectively, against the SDHL Revolver. As of March 31, 2018 and December 31, 2017, the Company had no outstanding borrowings under the SDHL Revolver. There are certain limitations which restrict the Company's ability to draw down the available balance of the SDHL Revolver.

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 (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.

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 or SDHL by Standard and Poor's and Moody's; currently the Applicable Margin is 5.0% per year for borrowings at the Adjusted LIBOR Rate.

The Applicable Margin can range from a maximum of 6.5% per year to a minimum of 3.75% per year for borrowings at the Adjusted LIBOR Rate and from a maximum of 5.5% per annum to a minimum of 2.75% 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 35% 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, 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) not greater than 3.5:1 and tested quarterly. The Company was in compliance with this ratio as of March 31, 2018 and December 31, 2017.

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 pari-passu liens securing the outstanding 8.625% Senior Secured Notes and 9.5% Senior Secured Notes.

The debt issuance costs associated with this new arrangement as well as the unamortized balance of the original debt issuance cost are deferred and amortized over the new terms of the SDHL Revolver.

The unamortized debt issuance costs which were carried as both current and long-term assets on the condensed consolidated interim balance sheets were as follows:

	March 31, 2018	December 31, 2017
Current	$ 1,343	$ 1,333
Non-current	1,457	1,797
Total	$ 2,800	$ 3,130

The amortization of debt issuance costs on the SDHL Revolver amounted to $0.3 million each during the three months ended March 31, 2018 and 2017.

Terms Common to All Indebtedness

The 8.25% Senior Unsecured Notes Indenture, SDA Facility and the SDHL Revolver contain customary restrictive covenants. These agreements also contain a provision under which an event of default by SDHL or by any restricted subsidiary on any other indebtedness exceeding $25 million would be triggered 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 8.25% Senior Unsecured Notes Indenture, SDA Facility and the SDHL Revolver contain covenants that, among other things, limit SDHL's ability and the ability of their restricted subsidiaries in connection with:

- Incurrence of new indebtedness or equivalent;
- Restricted payments;
- Disposal of assets;
- Incurrence of new liens;
- Certain transactions with affiliates;
- Consolidation, merger and transfer of assets; and
- Impairment of security interest.

The 8.25% Senior Unsecured Notes Indenture, SDA Facility and the SDHL Revolver also contain standard events of default.

Term Loan Facility, due October 2018

On January 12, 2017, the Company fully settled the outstanding $350 million Midco Term Loan for an aggregate consideration of $339.17 million, which included the issuance of $166.67 million of SDL Preferred Shares to certain equity Sponsors (see Note 12 – Mezzanine Equity), issuance of $86.75 million aggregate principal amount of 9.5% Senior Secured Notes and $85.75 million in cash.

The Company recognized a total loss on debt extinguishment of $2.0 million, of which $0.5 million was recorded during the first quarter of 2017 under interest expense and financing charges. This included $5.1 million for legal fees (of which $1.5 million was incurred in December 2016), $4.3 million for the write-off of the unamortized original issue discount and $3.4 million for the write-off of the unamortized debt issuance cost, partly offset by the $10.8 million settlement gain.

Note 8 — 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 consisted solely of the two "fit-for-purpose" new build jackup rigs under construction 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"), wholly owned subsidiaries of Industrial and Commercial Bank of China Limited. In connection with these transactions, the Lessee executed bareboat charter agreements (the "Bareboat Charter Agreements") with the Lessor to operate the newbuild rigs and to execute two drilling service contracts with Chevron for a period of 5 years. See Note 5 – Property and Equipment.

The Company incurred a commitment fee of 1.20% per annum to the Lessor calculated on the undrawn amount of the Purchase Price calculated from October 10, 2015 until the Purchase Price was paid in full for each rig. The commitment fee was 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 was capitalized at intervals of three months from the date of payment of each installment until the charter hire accrual date, as defined in the lease contract.

The Bareboat Charter Agreements require rent with variable and fixed payment components from the charter hire accrual dates, as defined in the lease contract, through its expiry dates of December 28, 2021 and July 5, 2022 at which time the Lessee will have the obligation to acquire the Newbuild rigs from the Lessor for $82.5 million each ("Purchase Obligation Price"). The fixed monthly 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 Price) over the lease term. The average variable payments over the lease term for each rig are calculated on each payment date using a projected three month LIBOR rate plus applicable margin of 4.0% annually on the Notional Rent Outstanding (Prepaid Purchase Price reduced by fixed payments). The charter payments are made on every fifth day of the month.

The first and second Newbuild rigs commenced five-year contracts with Chevron after completion of the final customer acceptance requirements on December 1, 2016 and June 1, 2017, respectively. The Company accounted for these Sale and Leaseback Transactions as capital leases and transferred $228.6 million for the first Newbuild rig and $227.0 million for the second Newbuild rig from construction in progress to drilling rigs and equipment reported in property and equipment. See Note 5 – Property and Equipment. The capital lease contracts have an estimated average interest rate of 6.71% and 6.72% after taking into account the effect of the interest rate swap (see Note 15- Derivative Financial Instrument), and require scheduled monthly average principal payments and average interest payments of approximately $1.5 million and $0.7 million for each rig through December 5, 2021 and June 5, 2022, respectively.

As of March 31, 2018, the following is a summary of the estimated future rental payments on capital leases including the Purchase Obligation Price (in thousands):

For the twelve months ending March 31,		
2019	$	53,960
2020		52,703
2021		50,276
2022		124,119
2023		88,374
Total future rental payments	$	369,432

The Company made rental payments of $13.2 million and $4.2 million, including interest of $4.6 million and $1.4 million, during the three months ended March 31, 2018 and 2017, respectively.

The total outstanding balance of obligations under the Sale and Leaseback Transactions is $305.3 million and $313.9 million as of March 31, 2018 and December 31, 2017, respectively, of which $35.1 million and $35.1 million were classified as current on the condensed consolidated interim balance sheets.

There were no payments made by the Lessor directly to the Builder during the three months ended March 31, 2018 and 2017. In addition, the Company recorded nil and $1.0 million for interest in kind on the obligations under the Sale and Leaseback Transactions during the three months ended March 31, 2018 and 2017, respectively.

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 Market Value of the rig plus additional cash collateral or any additional security provided by the Company to the lessor divided by the Notional Rent Outstanding); and (3) a Consolidated Net Debt to Consolidated EBITDA Ratio at or below 4:1, as defined in the Bareboat Charter Agreement and tested semi-annually. As of December 31, 2017, the Company was in compliance with all above mentioned requirements.

Note 9 — Employee Benefit Plans

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.

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.

The contribution expense related to this plan is $80 thousand and $62 thousand during the three months ended March 31, 2018 and 2017, respectively.

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 $1.2 million and $1.8 million in expense related to employee end of service plans during the three months ended March 31, 2018 and 2017, respectively.

Retention Plans —The Company has recorded approximately $0.8 million and $0.9 million in expense related to its employee retention plans for the three months ended March 31, 2018 and 2017, respectively. The estimated total cash payments under the retention plans for 2019 are $2.8 million.

Note 10 — Commitments and Contingencies

Operating Leases and Other Commitments – The Company has operating leases and other commitments expiring at various dates, principally for office and yard space, expatriate employee accommodation and office equipment.

Sale and Leaseback Obligations – This represents minimum annual rental payments and a Purchase Obligation Price assuming average estimated interest rates pursuant to the sale and leaseback transactions as of March 31, 2018. See Note 8 - Sale and Leaseback.

As of March 31, 2018, contractual payments related to those matters were as follows (in thousands):

	Operating leases and other commitments	Sale and leaseback obligations	Total commitments
For the twelve months ending March 31,			
2019	$ 7,785	$ 53,960	$ 61,745
2020	3,322	52,703	56,025
2021	1,905	50,276	52,181
2022	820	124,119	124,939
2023	-	88,374	88,374
Total	$ 13,832	$ 369,432	$ 383,264

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 March 31, 2018, 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.

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 $102.8 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 $48.2 million and $53.6 million as of March 31, 2018 and December 31, 2017, respectively.

The Company also has a $50.0 million uncommitted guarantee facility included in the SDA Facility. The outstanding bank guarantees under the uncommitted guarantee facility was $8.1 million and nil as of March 31, 2018 and December 31, 2017, respectively.

In addition, the Company had outstanding bank guarantees and performance bonds amounting to $3.5 million and $12.3 million as of March 31, 2018 and December 31, 2017, respectively, issued against the SDHL Revolver.

Therefore, the total outstanding bank guarantees and surety bonds issued by the Company were $59.8 million and $65.9 million as of March 31, 2018 and December 31, 2017, respectively.

Note 11 — Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash and cash equivalents, accounts receivable, current restricted cash, accounts payable, accrued liabilities and short-term debt, approximate their fair market values due to the short-term nature of the instruments (except for non-current portion of restricted cash with carrying value of $14.0 million and $14.6 million and an estimated fair value of $12.6 million and $13.2 million as of March 31, 2018 and December 31, 2017, respectively). We measured the estimated fair value of the non-current portion of restricted cash using significant other observable inputs, representative of a Level 3 fair value measurement, including the terms of the instruments.

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

	March 31, 2018		December 31 , 2017	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
8.25% Senior Unsecured Notes, due February 15, 2025	$ 589,487	$ 602,016	$ -	$ -
Senior Secured Credit Facility, due March 31, 2020	24,279	$ 25,000	-	-
9.5% Senior Secured Notes, due November 2, 2020	-	-	496,503	512,721
8.625% Senior Secured Notes, due November 1, 2018	-	-	30,167	31,022
Total debt	$ 613,766	$ 627,016	$ 526,670	$ 543,743

The estimated fair value of the Company's long-term debt, except the SDA Facility, 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). The Company believes the SDA Facility carrying value of $25.0 million approximates the fair value due to its recent issuance, variable interest and relative short-term maturity.

The estimated fair value of the 8.25% Senior Unsecured Notes and the SDA Facility exclude unamortized debt issuance costs as of March 31, 2018 of $10.5 million and $0.7 million, respectively. The estimated fair value of the 9.5% Senior Secured Notes and the 8.625% Senior Secured Notes exclude unamortized debt issuance costs as of December 31, 2017 of $6.3 million and $0.2 million, respectively. See Note 7 – Debt.

Derivative financial instruments were measured at fair value on a recurring basis using Level 2 inputs. See Note 15 – Derivative Financial Instrument.

Note 12 — Mezzanine Equity

On January 12, 2017, SDL issued 1,000,000 preferred shares at $166.67 per share for a value of $166.67 million to certain equity Sponsors as part of the retirement of the Midco Term Loan. The Company incurred $0.7 million of incremental direct costs to issue the preferred shares. These costs were netted against the issue value of the preferred shares.

The preferred shares are redeemable at the option of the Company at the Liquidation Preference (which corresponds to the preferred shares purchase price plus dividend paid in kind and, without duplication, accrued but unpaid dividends) paid in cash out of the legally available funds at any time with 30 days prior notice.

The preferred shares are mandatorily redeemable upon the occurrence of a change of control, exit event or initial public offering. While circumstances requiring mandatory redemption are generally within the control of the Company, there are certain external factors beyond the Company's control that may lead to an earlier redemption. In such events, the Company would be required to redeem the preferred shares. Although there is only a remote likelihood of this mandatory redemption due to factors beyond the Company's control, the Company has classified the preferred shares as mezzanine equity rather than equity.

The preferred shares are entitled to a dividend rate equal to LIBOR plus 9% per annum paid semi-annually on January 31 and July 31. If the preferred dividend is not paid in cash on each due date, the dividend amount is added to the Liquidation Preference of the preferred shares at a rate of LIBOR plus 9.75% per annum. The total dividend recognized for the three months ended March 31, 2018 and 2017 were $4.5 million and 3.8 million, of which $3.0 million and $2.8 million, respectively, were accrued and to be paid in the next semi-annual payment. Total dividends paid in cash on the due date during the three months ended March 31, 2018 and 2017 were $8.9 million and $1.0 million, respectively.

In the event of the occurrence of any liquidation, dissolution or winding up of the Company, preferred shareholders have the first right over the assets available for distribution amongst SDL shareholders up to the Liquidation Preference.

Note 13 — Shareholders' Equity

During the three months ended March 31, 2018, there were no issuance of common shares. During the first quarter of 2017, a new ordinary share class (Class D) was approved with an authorized share capital of 1,020 shares. Class D shares had no dividend rights. The Company also amended its Articles of Association (the "Articles") to increase the authorized capital to 5,001,020 ordinary shares with a par value of $0.01 per share for a total amount of $50 thousand.

During the first quarter of 2017, the Company granted 243 ordinary shares (228 Class B shares and 15 Class C shares) under the time-based and performance-based share compensation plan to members of the Company's management. These shares were issued to a Voting Trust, managed under the voting trust agreement by one of the Sponsors, for further issuance to the employees upon fulfilling the vesting conditions. See Note 14 – Share-based Compensation.

During the three months ended March 31, 2018, 9,606 common shares issued under share-based compensation plans (4,428 time-based restricted shares and 5,178 performance restricted shares) were forfeited for nil consideration. There were no repurchase or retirement of ordinary shares during the three months ended March 31, 2017.

Recapitalization and Common Share Issuance

On April 28, 2017, the Company executed a recapitalization to simplify its capital structure. The Company repurchased and retired all the ordinary shares in Classes A, B, C, and D from the Shareholders and replaced these with a new single class of common shares (the "Recapitalization"). The Company also increased its authorized capital from 5,001,020 ordinary shares to 200,000,000 single class new common shares with a par value of $0.01 per share for a total par value of $2 million.

The Company issued 55,000,000 of new common shares to replace the existing A, B, C, and D ordinary share classes as follows:

	Outstanding ordinary shares before Recapitalization	Equivalent new common shares at the Recapitalization date
Class A	444,594	51,970,740
Class B	25,653	1,893,513
Class C	6,130	-
Class D	1,020	1,135,747
Total	477,397	55,000,000

In order to determine the number of new common shares to be allocated against each ordinary share repurchased, the Company determined the fair value of each ordinary share class by allocating the estimated equity value before the Recapitalization to the ordinary share classes in accordance with the Waterfall provisions within the Articles in effect at that date. Accordingly, it was determined that Class C shares have no value, resulting in allocation of no new common shares to the Class C shareholders. The 1,020 Class D shares were only in existence briefly before being exchanged into common shares and were only used for performance-based restricted share awards, which were unvested at the Recapitalization date. Accordingly, Class D had no consequence on the Waterfall considerations for the Recapitalization. However, pursuant to the Articles, a value was allocated from Class A to Class D shares.

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The Recapitalization has been accounted for as a repurchase of ordinary shares for new common shares. Therefore, the numbers for previously presented Class A, Class B and Class C ordinary shares, for all share count references and per-share information, have been retained for periods prior to the Recapitalization. The Recapitalization did not result in a change in total shareholder equity as there were no cash proceeds. The par values of the ordinary shares and the new common shares are identical at $0.01 per share.

Private Placement

On April 28, 2017, the Company successfully completed an offering of 28,125,000 new common shares at a price of $8.00 per share for total gross proceeds of $225.0 million (the "Private Placement"). The incremental direct costs of the Private Placement were $7.8 million, resulting in approximately $217.2 million of net proceeds.

On May 5, 2017, the new common shares issued in the Private Placement began trading on the Norwegian over-the-counter (OTC) market under the symbol SHLF.

Following is the summary of all classes of ordinary shares / common shares issued and outstanding during the three months ended March 31, 2018 and 2017 (in thousands, except share data):

	Three months ended March 31, 2018	
	Number of shares issued and outstanding	Amount of shares issued and outstanding (at par value)
	Common shares	
Balance, beginning of period	83,125,000	$ 831
Shares issued to trust	-	-
Repurchase and retirement of shares	(9,606)	-
Balance, end of period	83,115,394	$ 831

	Three months ended March 31, 2017			
	Number of ordinary shares issued and outstanding			
	Class A	Class B	Class C	Total
Balance, beginning of period	444,594	25,099	6,075	475,768
Shares issued to trust	-	228	15	243
Repurchase and retirement of shares	-	-	-	-
Balance, end of period	444,594	25,327	6,090	476,011

	Three months ended March 31, 2017			
	Amount of ordinary shares issued and outstanding (at par value)			
	Class A	Class B	Class C	Total
Balance, beginning of period	$ 5	$ -	$ -	$ 5
Shares issued to trust	-	-	-	-
Repurchase and retirement of shares	-	-	-	-
Balance, end of period	$ 5	$ -	$ -	$ 5

The total shares issued to trust for share-based compensation were 2,265,254 common shares and 16,087 ordinary shares as of March 31, 2018 and 2017, respectively.

All common shares have pari passu rights to participate in any common share dividends declared and represent the residual claim on the Company's assets. The Company did not pay any ordinary or common dividend during the three months ended March 31, 2018 and 2017. The Company is restricted in declaring and paying dividends to its new common shareholders until the preferred shares are fully redeemed. See Note 12 – Mezzanine Equity.

In connection with the Private Placement, the Sponsors and the Company amended and restated a sponsor shareholders agreement. Under the amended agreement, a Sponsor has preferential governance rights if it maintains a minimum level of ownership of 7% in the Company. Subject to certain exceptions and conditions, these preferential governance rights include, but are not limited to, the right to appoint and remove directors, a veto right on the approval of significant corporate transactions and certain corporate actions, pre-emptive rights, a consent right to any articles' amendment and the right to require the Company to file a registration statement for a public offering of common shares. Investors participating in the Private Placement were not provided these equivalent rights. The sponsor shareholders agreement and the preferential governance rights provided therein terminate upon (i) the consummation of an initial public offering, (ii) when only one sponsor continues to hold common shares or all sponsors become affiliates or (iii) an exit event, including a sale of the Company or substantially all of its assets.

Note 14 — Share-based Compensation

The Company has a share-based compensation plan under which it had issued time-based Class B and performance-based Class C and Class D restricted shares prior to the Recapitalization (See Note 13 – Shareholder's Equity). These Class B, C and D shares were awarded to certain members of the Company's management as remuneration for future services of employment and were held in a voting trust on the employees' behalf.

Time-based restricted Class B shares typically vest in equal proportion over a five-year required service period from the date of grant. In the event of an initial public offering ("IPO") or other exit event, all time-based unvested shares would vest immediately, regardless of grant date. In the event of an IPO, the shares are non-transferable and are required to remain in the voting trust pursuant to the terms of a management shareholder agreement. These transfer restrictions would lapse ratably over three years, at one year intervals beginning twelve months after an IPO. Compensation cost is being 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 restricted Class C shares had rights to dividends or distributions while Class D shares had none of these rights. Upon an exit event or IPO, Class C and Class D shares would vest immediately. Class C and Class D shares were subject to the same transferability restrictions as described above regarding Class B shares upon an IPO. Compensation expense related to the grant date fair value of the performance-based shares were to be recognized upon vesting.

There were no new grants during the three months ended March 31, 2018. During the three months ended March 31, 2017, the Company had granted 243 additional ordinary shares (228 Class B shares and 15 Class C shares) to members of the Company's management.

The grant date fair values for the Class B and Class C grants during the first quarter of 2017 were estimated using standard quantitative modeling techniques performed by an independent third party. The estimates were 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 during the periods presented:

	Three months ended March 31, 2017	
	Class B	**Class C**
Valuation assumptions:		
Expected term	2 years	2 years
Risk free interest rate	1.20% p.a.	1.20% p.a.
Expected volatility	65.0%	65.0%

Expected Term: The expected term represented 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 had not historically issued any dividends on these classes of shares and did not expect to in the future nor were the unvested shares entitled to dividends at the time of the grant.

Effects of Recapitalization

As part of the Recapitalization, the employee share-based compensation awards in ordinary share Classes B and D were replaced with new common shares on a relative value basis consistent with the overall allocation of shareholder equity value. No other changes were made to the terms of the awards. The new common shares associated with the employee share-based compensation awards continue to be held in a voting trust on employees' behalf.

The table below summarizes the replacement of the Class B, C and D shares with new common shares at the Recapitalization date:

	Ordinary Shares Prior to Recapitalization			Equivalent new common shares at the Recapitalization date		
	Vested	Unvested	Total	Vested	Unvested	Total
Class B	9,600	5,833	15,433	708,558	430,555	1,139,113
Class C	-	1,020	1,020	-	-	-
Class D	-	1,020	1,020	-	1,135,747	1,135,747
Total	9,600	7,873	17,473	708,558	1,566,302	2,274,860

At the Recapitalization date, the unamortized cumulative compensation cost for the former Class B, Class C and Class D shares amounted to $2.9 million, $5.8 million and $9.1 million, respectively.

The $2.9 million unamortized compensation cost for the former Class B time based awards will continue to be recognized over the remaining applicable vesting period subject to acceleration in the event of an IPO or other exit event.

As no value was allocated to the former Class C performance based shares on Recapitalization due to the application of the Waterfall provisions within the Articles, and therefore Class C awards had no applicable exchange ratio and were effectively cancelled pursuant to the Recapitalization, the Company will not recognize the previously measured and unrecognized cumulative compensation cost of $5.8 million relating to Class C awards.

The unamortized compensation cost of $9.1 million relating to the former Class D performance based awards will be recognized in a future period upon IPO or other exit event.

The Company has recorded a share-based compensation expense related to the share-based compensation plan of $0.2 million each during the three months ended March 31, 2018 and 2017. No income tax benefit was recognized for these plans.

The following table summarizes the total unrecognized compensation expense and the expected weighted average period for the shares to be recognized:

	Three months ended March 31,			
	2018		2017	
	Time based restricted shares	Performance based shares	Time based restricted shares	Performance based shares
	Common shares		Class B	Class C
Total unrecognized compensation expense (in thousands)	$ 2,076	$ 9,045	$ 2,819	$ 5,768
Weighted-average period unvested compensation expense	2.40 years	N/A	2.95 years	N/A

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

	Number of shares		Weighted average grant date fair value per share	
	Time based restricted shares	Performance based shares	Time based restricted shares	Performance based shares
Non-vested shares at January 1, 2018	393,760	1,135,747	$ 5.89	$ 8.00
Granted	-	-	-	-
Vested	(181,944)	-	1.21	-
Forfeited	(4,428)	(5,178)	8.00	8.00
Non-vested shares at March 31, 2018	207,388	1,130,569	$ 10.01	$ 8.00

	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, 2017	7,704	965	$ 357.05	$ 5,808.48
Granted	228	15	672.00	11,088.00
Vested	(2,145)	-	39.60	-
Forfeited	-	-	-	-
Non-vested shares at March 31, 2017	5,787	980	$ 487.11	$ 5,889.71

The total grant date fair value of the time based restricted vested ordinary shares was $0.2 million and $85 thousand during the three months ended March 31, 2018 and 2017, respectively.

Note 15 — Derivative Financial Instrument

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 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 three months ended March 31, 2018, the Company settled forex contracts with aggregate notional values of approximately $3.7 million, of which the aggregate amounts were designated as an accounting hedge. There were no such transactions during the three months ended March 31, 2017.

As of March 31, 2018, the estimated amount of net unrealized losses associated with the forex contracts that will be reclassified to earnings during the next nine months was $0.2 million. The net unrealized gains / (losses) associated with this derivative financial instrument will be reclassified to operating and maintenance expense, to the extent fully effective.

Interest Rate Swaps

The Company may enter into interest rate swaps to manage exposures arising from business activities that result in the payment of future known and uncertain cash amounts, the value of which are determined by interest rates. The Company's derivative financial instruments are used to manage differences in the amount, timing, and duration of the Company's known or expected cash payments principally related to the Company's borrowings.

The Company's objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of fixed-rate amounts from a counterparty in exchange for the Company making variable-rate payments over the life of the agreements without exchange of the underlying notional amount.

During the three months ended March 31, 2018, the Company entered into an interest rate swaps with aggregate notional values of approximately $215.8 million, of which the aggregate amounts were designated as an accounting hedge. As of March 31, 2018, the estimated amount of net unrealized losses associated with the interest rate swaps that will be reclassified to earnings was $0.2 million. There were no such transactions during the three months ended March 31, 2017.

The following table presents the amounts recognized in the Company's condensed consolidated interim balance sheets and condensed consolidated interim statements of operations related to the derivative financial instruments designated as cash flow hedges for the three months ended March 31, 2018 and 2017 (in thousands). The effective portion of gain / (loss) reclassified from AOCIL is recorded under operating and maintenance expense for forex contracts and under interest expense and financing charges for interest rate swaps.

	Unrealized loss recognized through AOCIL	
	Three months ended March 31,	
	2018	2017
Cash flow hedges		
Foreign currency forward contracts	$ (268)	$ -
Interest rate swaps	(300)	-
	$ (568)	$ -

	Loss reclassified from AOCIL to		
		Three months ended March 31,	
	Statement of operation classification	2018	2017
Cash flow hedges			
Foreign currency forward contracts	Operating and maintenance	$ 27	$ -
Interest rate swaps	Interest expense and financing charges	71	-
		$ 98	$ -

	Gain / (loss) recognized through "Other, net"	
	Three months ended March 31,	
	2018	2017
Cash flow hedges		
Foreign currency forward contracts	$ -	$ -
Interest rate swaps	-	-
	$ -	$ -

The following table presents the fair values of the derivative forex contracts and interest rate swaps designated as hedging instruments (in thousands):

	Balance sheet classification	March 31, 2018	December 31, 2017
Liability derivatives			
Short-term foreign currency forward contracts	Other current liabilities	$ 241	$ -
Short-term interest rate swaps	Other current liabilities	62	-
Long-term interest rate swaps	Other long-term liabilities	167	-

Note 16 — Supplemental Cash Flow Information

As part of the sale and leaseback agreements for the Newbuilds, interest in kind of $1.0 million was recorded as obligations under sale and leaseback during the three months ended March 31, 2017. This non-cash transaction was not reflected on the condensed consolidated interim statements of cash flows for the three months ended March 31, 2017. There were no such transactions during the three months ended March 31, 2018.

In relation to the refinancing of the Company's debt in January 2017, $166.67 million of preferred shares were issued to certain equity Sponsors and $86.75 million 9.5% Senior Secured Notes were issued for the full settlement of the Midco Term Loan, and $416.09 million 8.625% Senior Secured Notes were cancelled in exchange for 9.5% Senior Secured Notes. These non-cash transactions were not reflected on the condensed consolidated interim statements of cash flows for the three months ended March 31, 2017.

Capital expenditures and deferred costs

Capital expenditures and deferred costs include rig acquisition and other fixed asset purchases, construction expenditures on the Newbuilds and certain expenditures associated with regulatory inspections, major equipment overhauls, contract preparation, including rig upgrades, mobilization and stacked rig reactivations.

The following table sets out the Company's capital expenditures and deferred costs (in thousands):

	Three months ended March 31,	
	2018	**2017**
Regulatory and capital maintenance	$ 5,682	$ 4,990
Contract preparation	3,100	1,928
Fleet spares and others	1,600	(743)
	$ 10,382	$ 6,175
Rig acquisitions	6,788	-
Newbuilds	-	9,811
Total capital expenditures and deferred costs	$ 17,170	$ 15,986

The following table reconciles the cash payment for additions to property and equipment and changes in deferred costs, net to total capital expenditures and deferred costs (in thousands):

	Three months ended March 31,	
	2018	**2017**
Cash payments for additions to property and equipment	$ 9,309	$ 7,423
Net change in accrued but unpaid additions to property and equipment	(4,424)	2,308
	$ 4,885	$ 9,731
Add: Asset addition related to sale and leaseback transactions	-	965
Total capital expenditures	$ 4,885	$ 10,696
Changes in deferred costs, net	$ (6,723)	$ (11,554)
Add: Amortization of deferred costs	19,008	16,844
Total deferred costs	$ 12,285	$ 5,290
Total capital expenditures and deferred costs	$ 17,170	$ 15,986

The total cash and cash equivalents excludes restricted cash amounting to $14.7 million and $15.3 million as of March 31, 2018 and December 31, 2017, respectively. These amounts were included under other assets, except for the current portion of $0.7 million and $0.6 million as of March 31, 2018 and December 31, 2017, respectively, which was included under other current assets. Restricted cash is primarily used for the reserve requirements for the sale and leaseback transactions as well as for collateral for bid tenders and performance bonds.

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported in the condensed consolidated interim balance sheets to the total of such amounts reported in the condensed consolidated interim statements of cash flows (in thousands):

	Three months ended March 31, 2018	Three months ended March 31, 2017
Cash and cash equivalents	$ 120,598	$ 81,105
Restricted cash included in other current assets	690	-
Restricted cash included in other assets	13,993	8,675
Total cash, cash equivalents and restricted cash	$ 135,281	$ 89,780

Note 17 — Loss Per Share

The net loss is allocated to the three classes of common stock under the provisions of the Waterfall distribution set forth in the Articles until Recapitalization date. See Note 13 – Shareholders' Equity.

The loss per share during the three months ended March 31, 2017 is calculated based on information prior to the recapitalization for the ordinary Class A, B, C and D shares.

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

	Three months ended March 31, 2018	Three months ended March 31, 2017		
	Common Shares	Class A	Class B	Class C
Numerator for loss per share				
Net loss	$ (38,517)	$ (1,534)	$ -	$ -
Less: Preferred shares dividend	4,495	3,805	-	-
Net loss attributable to common and ordinary shares	$ (43,012)	$ (5,339)	$ -	$ -
Denominator for loss per share				
Weighted average shares:				
Basic outstanding per Class	81,651,566	444,594	18,147	5,110
Effect of stock options and other share-based awards	-	-	-	-
Diluted per Class	81,651,566	444,594	18,147	5,110
Basic loss per share per Class	$ (0.53)	$ (12.01)	$ -	$ -
Diluted loss per share per Class	$ (0.53)	$ (12.01)	$ -	$ -

For the three months ended March 31, 2018 and 2017, there were 130,656 dilutive common shares and 2,661 dilutive class B and class C shares, respectively, which were not included in the computation of diluted loss per share as the effect of including these shares in the calculation would have been anti-dilutive.

Note 18 — Segment and Related Information

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 Company evaluates the performance of the operating segment based on revenues from external customers.

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

	Three months ended March 31,	
	2018	2017
Saudi Arabia	$ 44,775	$ 44,208
Thailand	29,134	13,542
India	25,336	44,167
United Arab Emirates	20,213	11,897
Nigeria	15,303	17,233
Other countries	12,749	15,206
As Reported Revenue	$ 147,510	$ 146,253

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 any impairment, by location based on the country in which the assets were located at the balance sheet date were as follows (in thousands):

	March 31,	December 31,
	2018	2017
Thailand	$ 439,494	$ 443,090
United Arab Emirates	248,000	244,882
Saudi Arabia	200,073	207,125
Nigeria	184,623	183,959
India	106,856	110,752
Other countries	203,016	216,086
Total long-lived assets	$ 1,382,062	$ 1,405,894

The total long-lived assets are comprised of property and equipment and short-term and long-term deferred costs. A substantial portion of the Company's assets are mobile. Asset locations at the end of the period are not necessarily indicative of the geographic distribution of the revenue generated by such assets during the period.

Note 19 — 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 $1.0 million and $0.8 million during the three months ended March 31, 2018 and 2017, respectively. The total liability recorded under accounts payable for such transactions were $0.6 million and $0.6 million as of March 31, 2018 and December 31, 2017, respectively.

The Company recorded $1.4 million and $1.4 million for the three months ended March 31, 2018 and 2017, respectively, of Sponsors' costs related to the $0.4 million 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. The total liability recorded under accounts payable for such transactions were $42 thousand and $52 thousand as of March 31, 2018 and December 31, 2017, respectively.

Note 20 — Subsequent Events

The Company has evaluated subsequent events through May 15, 2018, the date of issuance of the condensed consolidated interim financial statements. The Company determined that no subsequent events had occurred that would require recognition in these financial statements.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in conjunction with the accompanying unaudited condensed consolidated interim financial statements contained in this Quarterly Report on Form 10-Q ("Interim Report") equivalent and the audited consolidated financial statements included in our Annual Report for the year ended December 31, 2017. Unless otherwise indicated, references to "we", "us", "our" and the "Company" refer collectively to the Company.

This Interim Report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts included in this report regarding any of the matters in the list immediately below are forward-looking statements. Forward-looking statements in this report include, but are not limited to, statements about the following subjects:

- our ability to renew or extend contracts, enter into new contracts when such contracts expire, and negotiate the dayrates and other terms of such contracts;
- the demand for our rigs, including the preferences of some of our customers for newer and/or higher specification rigs;
- changes in worldwide rig supply and demand, competition or technology, including as a result of delivery of newbuild rigs;
- the expectations of our customers relating to future energy prices and ability to obtain drilling permits;
- the impact of variations in oil and gas production and prices and demand in hydrocarbons;
- the impact of variations in demand for our products and services;
- sufficiency and availability of funds and adequate liquidity for required capital expenditures and deferred costs, working capital and debt service;
- our levels of indebtedness, covenant compliance and access to future capital;
- the level of reserves for accounts receivables;
- the disproportionate changes in operating and maintenance costs compared to changes in operating revenues;
- downtime and other risks associated with offshore rig operations or rig relocations, including rig or equipment failure, damage and other unplanned repairs;
- the expected completion of shipyard projects including the timing of newbuild rigs construction and delivery and the return of idle rigs to operations;
- future capital expenditures and deferred costs, refurbishment, reactivation, transportation, repair and upgrade costs;
- the cost and timing of acquisitions and integration of additional rigs;
- our ability to reactivate rigs;
- the proceeds and timing of asset dispositions;
- the effects and results of our strategies;
- complex laws and regulations, including environmental, anti-corruption and tax laws and regulations, that can adversely affect the cost, manner or feasibility of doing business;
- litigation, investigations, claims and disputes and their effects on our financial condition and results of operations;
- effects of accounting changes and adoption of accounting policies;
- expectations, trends and outlook regarding offshore drilling activity and dayrates, industry and market conditions, operating revenues, operating and maintenance expense, insurance coverage, insurance expense and deductibles, interest expense and other matters with regard to outlook and future earnings;
- potential asset impairment as a result of future decline in demand for shallow water drilling rigs;
- the market value of our rigs and of any rigs we acquire in the future may decrease;
- effects of customer interest or inquiries;
- the global number of contracted rigs, and our ability to benefit from any increased activity;
- our ability to attract and retain skilled personnel on commercially reasonable terms, whether due to labor regulations, unionization or otherwise;
- the security and reliability of our technology systems and service providers;
- adverse changes in foreign currency exchange rates;
- changes in general economic, fiscal and business conditions in jurisdictions in which we operate and elsewhere;
- our ability to obtain financing and pursue other business opportunities may be limited by our debt levels, debt agreement restrictions and the credit ratings assigned to our debt by independent credit rating agencies; and
- our incorporation under the laws of the Cayman Islands and the limited rights to relief that may be available compared to U.S. laws.

This Interim Report should be read in its entirety as it pertains to Shelf Drilling, Ltd. ("SDL") except where indicated, the Condensed Consolidated Interim Financial Statements and the Notes to the Condensed Consolidated Interim Financial Statements are combined. References in this report to "Shelf,", "SDL", the "Company," "Group," "we," "us," "our" and words of similar meaning refer collectively to Shelf Drilling Ltd. and its consolidated subsidiaries, unless the context requires otherwise. When used in this Interim Report, the words "could," "believe," "anticipate," "intend," "estimate," "expect," "project" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain such identifying words. These forward-looking statements are based on the Company's current expectations and assumptions about future events and are based on currently available information as to the outcome and timing of future events.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the Company's actual results, performance or achievements to be materially different from the anticipated future results, performance or achievements expressed or implied by the forward-looking statements. The statements under Item 1A. Risk Factors included in our Annual Report for the year ended December 31, 2017 should be read carefully in addition to the above uncertainties and assumptions. These risks and uncertainties are beyond the Company's ability to control, and in many cases, the Company cannot predict such risks and uncertainties which could cause its actual results to differ materially from those indicated by the forward-looking statements. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those indicated.

All subsequent written and oral forward-looking statements attributable to the Company or to persons acting on the Company's behalf are expressly qualified in their entirety by reference to these risks and uncertainties. Undue reliance should not be placed on forward-looking statements. Each forward-looking statement is applicable only as of the date of the particular statement, and the Company undertakes no obligation to update or revise any forward-looking statements, except as required by law.

Business

The Company provides shallow-water drilling services to the oil and natural gas industry. We are a leading international shallow water offshore drilling contractor providing equipment and services for the drilling, completion and well maintenance of shallow water offshore oil and natural gas wells. We are solely focused on shallow water operations in depths of up to 400 feet and own 38 independent-leg cantilever ("ILC") jack-up rigs, two of which are stacked, and one stacked swamp barge, making us the world's largest owner and operator of jack-up rigs by number of active rigs. All operations are conducted through Shelf Drilling Holdings, Ltd. ("SDHL"), an indirect wholly owned subsidiary of SDL.

The Company's corporate offices are in Dubai, United Arab Emirates ("UAE"), geographically close to its operations in the Middle East (we include Egypt and the Mediterranean 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 listed on the Norwegian over-the-counter market ("OTC") in May 2017. Our website address is www.shelfdrilling.com.

Recent events

In February 2018, SDHL completed the issuance of $600.0 million of new 8.25% Senior Unsecured Notes due 2025 (the "8.25% Senior Unsecured Notes") issued at par. The net proceeds were used to purchase and cancel or redeem $502.8 million of 9.5% Senior Secured Notes due November 2020 (the "9.5% Senior Secured Notes") and $30.4 million of 8.625% Senior Secured Notes due November 2018 (the "8.625% Senior Secured Notes"), or such notes redemption provision, with the remaining cash retained for general corporate purposes. See *Note 7 – Debt* in "Item 1. Financial Statements" of "Part I. Financial Information".

Drilling fleet

The following table summarizes the Company's offshore drilling rigs as of March 31, 2018 and 2017:

	As of March 31,	
	2018	**2017**
Jackups	38	35
Swamp barge	1	1
Under construction	-	1
Total	39	37

Subsequent to March 31, 2017, the Company added three premium jack-up drilling rigs and one Newbuild rig to its active fleet, and sold one rig for non-drilling purposes which was stacked and not being marketed for contract drilling.

Two of the acquired premium jack-up rigs, Shelf Drilling Resourceful and Shelf Drilling Tenacious were delivered to us in May 2017, and the third rig, the Shelf Drilling Mentor, was delivered in September 2017. These rigs started their respective contracts during the quarter ended March 31, 2018.

In addition, the second Newbuild rig, the Shelf Drilling Krathong was delivered and started its drilling contract during the second quarter of 2017.

Outlook

The business environment for offshore drilling contractors remains challenging with continued pressure on market dayrates, but there are indications of a recovery in the jack-up rig market. Brent crude oil, which declined from a high of $115.06 per barrel on June 19, 2014 to a low of $27.88 per barrel on January 20, 2016 and was $75.92 per barrel on April 30, 2018, is a key driver of exploration, development and production activity by our customers. Brent crude oil prices have traded above $60 per barrel for the past 6 months.

The shallow water market has been more resilient than the deepwater market due to the relatively low breakeven prices and short cycles. However, dayrates and utilization for all offshore rigs have been significantly impacted. In general, recent contract awards have often been short-term in nature and subject to an extremely competitive bidding process. The intense pressure on operating day rates has resulted in rates that approximate direct operating expenses. In addition, we are seeing increased pressure to accept other less favorable contractual and commercial terms, including reduced or no mobilization and/or demobilization fees, reduced early termination fees and/or termination notice periods.

While price competition among offshore drilling contractors remains intense, the global number of contracted jack-up rigs has begun to increase, growing by 4% from January 2017 to March 2018. We believe there will be several multi-rig tenders to be awarded soon in the Middle East for long-term contracts, which would further increase the contracted rig count by approximately 5%. We continue to see a strong level of market and tender inquiries from our customers, particularly in the Middle East, West Africa and other key markets. Oil and gas companies have expressed a high interest in 2018 in increasing their drilling activity in our core operating regions. We believe that we will be positioned to benefit from a continued increase in demand for jack-up rig services due to our operating track record and competitive low cost structure.

We remain focused on delivering safe and cost efficient operations, as well as realizing efficiency gains across all levels of the organization.

Operational measures

Contract backlog: Contract backlog is the maximum contract drilling dayrate revenue that can be earned from a drilling contract based on the contracted operating dayrate less any planned out-of-service periods during the firm contract period for regulatory inspections and surveys or other work. Contract backlog excludes revenue resulting from mobilization and demobilization fees, capital or upgrade reimbursement, recharges, bonuses and other revenue sources. Our contract backlog includes only firm commitments for contract drilling services represented by definitive agreements. Contract backlog also includes revenues under non-drilling contracts for the use of our rigs such as bareboat charters and contracts for accommodation units. For these contracts, contract backlog includes the maximum contract amount of revenue. The contract period excludes additional periods resulting from the future exercise of extension options under our contracts, and such extension periods are included only when such options are exercised. The contract operating dayrate may temporarily change due to mobilization, weather and repairs, among other factors. Contract backlog is a key indicator of our potential future revenue generation.

Contract backlog was $1.2 billion across 27 contracted rigs with a weighted average backlog dayrate of $78.3 thousand per day and average contracted days of 549 per rig as of March 31, 2018, compared with $1.5 billion across 26 contracted rigs with a weighted average dayrate of $95.0 thousand per day and average contracted days of 621 per rig as of March 31, 2017.

Marketable rigs: We define marketable rigs as all of our rigs that are operating or are available to operate, which excludes stacked rigs, rigs undergoing reactivation projects, rigs under non-drilling contracts and newbuild rigs under construction.

As of March 31, 2018, 35 rigs were marketable (of which 26 were under contract and nine were actively being marketed), one rig was under non-drilling contract and three rigs were stacked compared to 31 marketable rigs, two rigs under non-drilling contract and three stacked rigs as of March 31, 2017. The increase in the marketable rigs is a result of the delivery of the second Newbuild and acquisition of three premium jack-up rigs in 2017.

Average dayrate: Average dayrate is the average contract dayrate earned by marketable rigs over the reporting period excluding amortization of lump sum mobilization fees, contract preparation and capital expenditure reimbursements, recharges, bonuses and other revenue.

The average dayrate realized for the three months ended March 31, 2018 was $70.3 thousand, an increase of 1.1% from the average dayrate of $68.5 thousand realized for the three months ended March 31, 2017. The increase in the average dayrate was primarily due to the contract for the second Newbuild which started in June 2017, partly offset by the contract completions of four rigs in India in 2017.

Marketed Utilization: Marketed utilization measures the dayrate revenue efficiency of our marketable rigs. This is the number of days during which marketable rigs generate dayrate revenue divided by the maximum number of days during which those rigs could have generated dayrate revenue. Marketed utilization varies due to changes in operational uptime, planned downtime for periodic surveys, timing of underwater inspections, contract preparation and upgrades, time between contracts and the use of alternative dayrates for waiting-on-weather periods, repairs, standby, force majeure, mobilization or other rates that apply under certain circumstances. We exclude all other types of revenue from marketed utilization.

Marketed utilization in Q1 2018 of 63% was lower than the marketed utilization in Q1 2017 of 70%. The decrease was primarily driven by the contract completions of four rigs in India in 2017. There were nine rigs idle awaiting marketing opportunities at the end of Q1 2018 compared to eight rigs at the end of Q1 2017.

Financial measures

In addition to the operational measures discussed above, we also use certain generally accepted accounting principles ("GAAP") and non-GAAP financial measures to evaluate the performance of our business. We believe the non-GAAP financial measures we use are useful in assessing our historical and future performance throughout the commodity price cycles that have characterized our industry since our inception.

Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA")

Adjusted EBITDA and Adjusted EBITDA margin: Adjusted EBITDA excludes certain items included in net income (loss), the most directly comparable GAAP financial measure. We believe that Adjusted EBITDA and Adjusted EBITDA margin are useful non-GAAP financial measures because they are widely used in our industry to measure a company's operating performance without regard to items such as interest expense, income tax expense, depreciation and amortization and other specific expenses, which can vary substantially from company to company, and are also useful to an investor in evaluating the performance of the business over time. In addition, our management uses Adjusted EBITDA and Adjusted EBITDA margin in presentations to our board of directors to provide a consistent basis to measure operating performance of our business, as a measure for planning and forecasting overall expectations, for evaluation of actual results against such expectations and in communications with our shareholders, lenders, noteholders, rating agencies and others concerning our financial performance. Adjusted EBITDA reflects adjustments for certain items and expenses set forth below that we believe affect the comparability of financial results from period to period. Adjusted EBITDA margin is defined as Adjusted EBITDA divided by Revenue. Adjusted EBITDA and Adjusted EBITDA margin may not be comparable to similarly titled measures employed by other companies. These financial measures should not be considered in isolation or as a substitute for net income, operating income, other income or cash flow statements data prepared in accordance with GAAP. Adjusted EBITDA and Adjusted EBITDA margin have significant limitations, including not reflecting our cash requirements for capital or deferred costs, acquired rig reactivation costs, contractual commitments, taxes, working capital or debt service.

Our financial measures for the three months ended March 31, 2018 and 2017 were as follows (in thousands):

	Three months ended March 31,	
	2018	**2017**
Net loss	$ (38,517)	$ (1,534)
Add back:		
Interest expense and financing charges, net of interest income (1)	38,777	30,213
Income tax expense	4,658	4,550
Depreciation	21,868	18,369
Amortization of deferred costs	19,008	16,844
Gain on disposal of assets	(120)	(138)
EBITDA	$ 45,674	$ 68,304
Sponsors' fee (2)	1,125	1,125
Share-based compensation expense, net of forfeitures	202	220
Acquired rig reactivation costs (3)	1,970	-
Adjusted EBITDA	$ 48,971	$ 69,649
Adjusted EBITDA margin	33.2%	47.6%

(1) Represent interest expenses incurred and accrued on our debt and the amortization of debt issuance fees and costs over the term of the debt net of capitalized interest and interest income. This also includes the losses on debt extinguishments in relation to our debt refinancing in Q1 2017 and Q1 2018.

(2) Represent the fee to the sponsors in respect of their role as advisors to us.

(3) Represent the expenditures accounted for as operating expenses in accordance with GAAP, which were incurred in connection with the reactivation of stacked or idle rigs acquired with the specific intention to reactivate and deploy.

For the three months ended March 31, 2018 and 2017, the Company's unrestricted subsidiaries accounted for $15.3 million (31.2%) and $7.7 million (11.1%), respectively, of the Company's Adjusted EBITDA. As of March 31, 2018 and December 31, 2017, the Company's unrestricted subsidiaries had assets of $646.7 million, representing 38.3%, and $654.5 million, representing 38.9%, of the Company's total assets, respectively. SDHL has agreed to cause its subsidiary, Shelf Drilling Asset III, Ltd. ("SDAIII"), which holds two newly acquired rigs, to guarantee the 8.25% Senior Unsecured Notes due 2025 by February 2019. Assuming that SDAIII's guarantee was in effect, as of March 31, 2018 and December 31, 2017, the unrestricted subsidiaries would have accounted for $482.3 million, or 28.5% of our total assets and $487.4 million, or 29.0%, of our total assets, respectively.

Operating Results

Three months ended March 31, 2018 ("Q1 2018") compared to three months ended March 31, 2017 ("Q1 2017")

Revenues

Total revenue for Q1 2018 was $147.5 million compared to $146.3 million for Q1 2017. Revenue for Q1 2018 consisted of $144.6 million (98.0%) of operating revenue and $2.9 million (2.0%) of other revenue. In Q1 2017, these same revenues were $142.4 million (97.3%) and $3.9 million (2.7%), respectively.

Revenue in Q1 2018 increased by $1.2 million compared to Q1 2017 primarily due to $25.0 million of higher operating revenue related to the operations of the two newbuilds and the three premium jack-up rigs acquired in 2017 and $1.1 million of higher other revenue in Q1 2018. This was mostly offset by $19.4 million related to lower marketed utilization (63% in Q1 2018 compared to 70% in Q1 2017), $3.6 million related to lower average earned dayrates excluding the two newbuilds and the three acquired rigs, and $1.9 million lower revenue related to non-drilling activities in Q1 2018.

Operating and maintenance expenses

Total operating and maintenance expenses for Q1 2018 were $90.3 million, or 61.2% of total revenue, compared to $68.5 million, or 46.8% of total revenue, for Q1 2017. Operating and maintenance expenses in Q1 2018 consisted of $81.7 million rig-related expenses and $8.6 million shore-based expenses. In Q1 2017, these same expenses were $60.4 million and $8.1 million, respectively.

In Q1 2018, rig-related expenses included $47.5 million for personnel expenses, $21.7 million for rig maintenance expenses and $12.5 million for other rig-related expenses. This compares to $38.9 million, $13.3 million and $8.2 million for those respective categories during Q1 2017. Compared to Q1 2017, the increase in rig-related expenses of $21.3 million was due to $8.8 million of costs for the three premium jack-up drilling rigs acquired in May and September 2017, $8.4 million of contract preparation and operating expenses for rigs that were idle in Q1 2017 but operating or preparing for new contract in Q1 2018, $4.9 million of higher rig mobilization costs, $3.1 million of increased costs related to the two newbuild rigs and $1.7 million higher maintenance and shipyard expenses. This was partly offset by $2.8 million lower expenses for stacked and idle rigs awaiting marketing opportunities and $2.4 million of cost savings across rigs, primarily due to lower personnel related expenditures and insurance.

There were $0.5 million of higher shore-based expenses (a 6.2% increase from Q1 2017), primarily attributable to the new shore-based office supporting the operations of the two acquired premium jack-up rigs operating in United Arab Emirates.

Depreciation expense

Depreciation expense in Q1 2018 was $21.9 million compared to $18.4 million in Q1 2017. The increase of $3.5 million primarily related to $2.8 million of depreciation for the three recently acquired premium jack-up rigs and $1.8 million depreciation for the second newbuild which was placed into service in June 2017.

Amortization of deferred costs

The amortization of deferred costs in Q1 2018 was $19.0 million compared to $16.8 million in Q1 2017. The $2.2 million increase primarily related to the amortization of contract preparation costs of the three acquired premium jack-up rigs which all started their respective contract in Q1 2018.

General and administrative expenses

General and administrative expenses in Q1 2018 were $12.6 million compared to $9.1 million in Q1 2017. The $3.5 million increase resulted from $2.3 million of net releases of provision for doubtful accounts in Q1 2017 compared to a provision of $0.1 million in Q1 2018 and $1.1 million of higher other costs.

Gain on disposal of assets

Gain on disposal of assets was $0.1 million and $0.1 million in Q1 2018 and Q1 2017, respectively.

Other (expense) / income, net

Other (expense) / income, net was an expense of $37.7 million in Q1 2018 and $30.5 million in Q1 2017. Other expense consisted primarily of interest expense and financing charges of $39.0 million and $30.4 million during Q1 2018 and Q1 2017, respectively. Interest expense and financing charges in Q1 2018 were $8.6 million higher compared to Q1 2017 primarily due to the $4.8 million higher loss on debt extinguishment associated with the refinancing of our debt and $3.8 million of higher interest expense primarily related to the sale and leaseback financing facility.

The loss on debt extinguishment for Q1 2018 was $19.0 million compared to $14.2 million for the same period in Q1 2017.

Also included in the Other (expense) / income, net is Other, net which was an income of $1.0 million in Q1 2018 compared to an expense of $0.3 million in Q1 2017. The difference of $1.3 million was mainly due to increased foreign currency exchange gains in Q1 2018.

Income tax expense

Income tax expense in Q1 2018 was $4.7 million compared to $4.6 million in Q1 2017. While we are exempt from all income taxation in the Cayman Islands, a provision for income taxes is recorded based on the tax laws and rates applicable in the jurisdictions in which we operate and earn income or are considered a 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, (i) the overall level of income before income taxes, (ii) changes in the blend of income that is taxed based on gross revenues rather than income or loss before taxes, (iii) rig movements between taxing jurisdictions and changes in our rig operating structures.

Income tax expense in Q1 2018 is higher than in Q1 2017 despite having a loss before income taxes in Q1 2018 as compared to income before income taxes in Q1 2017, primarily due to an increased proportion of expenses in 2018 for which there will be no tax benefit as such expenses are either incurred in jurisdictions which impose tax based on gross revenue rather than on net income or are incurred in jurisdictions in which the Company does not pay tax or which do not allow for a tax deduction for such expenses.

Liquidity and Capital Resources

Sources and uses of liquidity

Historically, we have met our liquidity needs principally from cash balances in banks, cash generated from operations, availability under our revolver and the sale and leaseback financing of the Newbuild rigs. Our primary uses of cash were capital expenditures and deferred costs payments, repayment of long term debt, debt issuance costs payments, and interest and income tax payments.

We had $120.6 million and $84.6 million in cash and cash equivalents as of March 31, 2018 and December 31, 2017, respectively. Under the SDHL Revolver, we had $3.5 million and $12.3 million of surety bonds issued as of March 31, 2018 and December 31, 2017, respectively. In addition, there were no cash borrowings under the SDHL Revolver during the same periods. There are certain limitations which restrict the Company's ability to draw down the available balance of the SDHL Revolver.

As of March 31, 2018 and December 31, 2017, the Company had $25 million and nil borrowings under the SDA facility. The outstanding bank guarantees under the uncommitted guarantee facility were $8.1 million and nil as of March 31, 2018 and December 31, 2017, respectively.

We may consider establishing additional financing arrangements with banks or other capital providers. Subject in each case to then existing market conditions and to our then-expected liquidity needs, among other factors, we may use a portion of our internally generated cash flows to reduce debt prior to scheduled maturities through debt repurchases, either in the open market or in privately negotiated transactions or through debt redemptions or tender offers.

At any given time, we may require a significant portion of cash on hand and amounts available under the SDHL Revolver for working capital and other needs related to the operation of our business. We believe we will have adequate liquidity to fund our operations over the next twelve months.

Detailed explanations of our liquidity and capital resources for the three months ended March 31, 2018 and 2017 are given below.

Discussion of Cash flows

The following table sets out certain information regarding our cash flow statements for the three months ended March 31, 2018 and 2017 (in thousands):

	Three months ended March 31,	
	2018	**2017**
Net cash (used in) / provided by operating activities	$ (9,627)	$ 2,963
Net cash used in investing activities	(9,018)	(7,225)
Net cash provided by / (used in) financing activities	54,100	(128,353)
Net increase / (decrease) in cash, cash equivalents and restricted cash	$ 35,455	$ (132,615)

Net cash provided by operating activities

Net cash (used in) / provided by operating activities totaled $(9.6) million in Q1 2018 compared to $3.0 million in Q1 2017. The decrease of $12.6 million was primarily due to the overall decline in our drilling business activity and cash payments associated with our debt refinancing. See discussion of operating costs in "—Results of operations."

During the three months ended March 31, 2018 and 2017, we made cash payments of $20.0 million and $24.3 million in interest and financing charges, respectively, net of interest amounts capitalized of nil and $1.6 million in relation to our Newbuilds rig construction, respectively, included under "other operating assets and liabilities, net". The amounts for capitalized interest are included in cash used in investing activities as capital expenditures.

We also made cash payments of $3.7 million and $3.0 million in income taxes included under "other operating assets and liabilities, net" during the three months ended March 31, 2018 and 2017, respectively.

Net cash used in investing activities

Net cash used in investing activities in Q1 2018 totaled $9.1 million compared to $7.2 million in Q1 2017.

Cash used for capital expenditures, including capitalized interest, totaled $9.3 million in Q1 2018 and $7.4 million in Q1 2017.

As part of the sale and leaseback transactions, interest in kind of $1.0 million was recorded as capitalized interest and obligation under sale and leaseback in Q1 2017. This non-cash transaction was not reflected on the condensed consolidated interim statements of cash flows for the three months ended March 31, 2017. There were no such transactions during the three months ended March 31, 2018.

Net cash provided by / (used in) in financing activities

Net cash provided by (used in) financing activities totaled $54.1 million in Q1 2018 compared to $(128.4) million in Q1 2017.

In February 2018, we completed the issuance of $600.0 million principal amount of the 8.25% Senior Unsecured Notes issued at par. We used the net proceeds of $589.3 million to fully settle the $502.8 million of 9.5% Senior Secured Notes and $30.4 million of 8.625% Senior Secured Notes, or such notes redemption provisions. As a result of the debt extinguishment, we recognized a loss of $19.0 million which includes the premiums of $12.2 million, $6.3 million write-off of unamortized debt issuance costs, and professional fees of $0.5 million. The write-off of unamortized debt issuance costs was reflected as non-cash transaction and included in cash provided by operating activities.

On March 27, 2018, the Company drew $25 million under the SDA Facility, used to fund the upgrade and capital expenditure costs for two of the recently acquired premium jackup drilling rigs, and is due in four equal installments with a maturity date of March 31, 2020.

During Q1 2017, in connection with the refinancing of certain of our debt, we used $28.5 million of cash to partially pay for the exchange and cancellation of the $444.6 million 8.625% SDHL Senior Secured Notes due November 2018 and $85.8 million in cash for the partial settlement of the $350 million Midco Term Loan, which was fully settled and cancelled. This resulted in total payments of long-term debt of $114.3 million, partially offset by the original discount of $10.5 million of cash provided by operating activities. In addition to the 2017 refinancing of certain of our debt, $166.7 million of preferred shares were issued to certain equity sponsors and $86.8 million 9.5% Notes (as defined herein) were issued for the full settlement of the Midco term loan, and $416.1

million 8.625% Notes were cancelled in exchange for 9.5% Notes. As a result, we issued a total of $502.8 million 9.5% Notes during 2017. These non-cash transactions were not reflected on the condensed consolidated interim statement of cash flows in Q1 2017.

During Q1 2018, we paid a total of $9.7 million of debt issuance costs and of $12.5 million of debt extinguishments costs compared to $10.4 million and $9.8 million in Q1 2017. Further, in Q1 2017, we paid $0.7 million shares issuance costs for the issuance of preferred shares.

We paid $8.9 million and $1.0 million of preferred dividends during the three months ended March 31, 2018 and 2017, respectively.

We made rental payments to the Lessor of $13.2 million and $4.2 million, of which $8.7 million and $2.8 million were related to principal payments during the three months ended March 31, 2018 and 2017, respectively, for the Newbuild rigs which entered into capital leases in December 2016 and June 2017, respectively.

Capital expenditures and deferred costs

Capital expenditures and deferred costs include fixed asset purchases, investments associated with the construction of newbuild rigs and certain expenditures associated with regulatory inspections, major equipment overhauls, contract preparation, including rig upgrades, mobilization and stacked rig reactivations. Capital expenditures and deferred costs can vary from quarter to quarter and year to year depending upon the requirements of existing and new customers, the number and scope of out-of-service projects, the timing of regulatory surveys and inspections, and the number of rig reactivations. Capital additions are included in property and equipment and are depreciated over the estimated remaining useful life of the assets. Deferred costs are included in other current assets and other assets on the condensed consolidated interim balance sheet and are amortized over the relevant periods covering: (i) the underlying firm contract period to which the expenditures relate, or; (ii) the period until the next planned similar expenditure is to be made.

The table below sets out our capital expenditures and deferred costs for the three months ended March 31, 2018 and 2017 (in thousands):

	Three months ended March 31,	
	2018	**2017**
Regulatory and capital maintenance (1)	$ 5,682	$ 4,990
Contract preparation (2)	3,100	1,928
Fleet spares and other (3)	1,600	(743)
	$ 10,382	$ 6,175
Rig acquisitions (4)	6,788	-
Newbuilds (5)	-	9,811
Total capital expenditures and deferred costs	$ 17,170	$ 15,986

(1) Includes major overhauls, regulatory costs, general upgrades and sustaining capital expenditures on rigs in operation.

(2) Includes specific upgrade, mobilization and preparation costs associated with a customer contract. It excludes, if any, contract preparation costs associated with reactivation projects, which are included under “Reactivation projects.”

(3) Includes (i) acquisition and certification costs for the rig fleet spares pool which is allocated to specific rig expenditure as and when required by that rig which will result in an expenditure charge to that rig and a credit to fleet spares and (ii) office and infrastructure expenditure.

(4) Includes capital expenditures and deferred costs associated with the acquisition of three premium jack-up drilling rigs in 2017.

(5) Includes all payments made under the construction contracts for two newbuild rigs, internal costs associated with project management, machinery and equipment provided to the project by us and capitalized interest.

Capital expenditures and deferred costs totaled $17.2 million in Q1 2018 compared to $16.0 million Q1 2017. This included $6.8 million in Q1 2018 relating to the reactivation and contract preparation of the three premium jackup rigs acquired in 2017, compared to $9.8 million for the construction of the newbuilds in Q1 2017.

Capital expenditures and deferred costs excluding newbuilds and acquisitions increased from $6.2 million in Q1 2017 to $10.4 million in Q1 2018 mainly due to a $3.6 million increase in regulatory and capital maintenance and fleet spares and a $0.6 million increase in contract preparation expenditure.

The following table reconciles the cash payments related to additions to property and equipment and changes in deferred costs, net to the total capital expenditures and deferred costs for the three months ended March 31, 2018 and 2017 (in thousands):

	Three months ended March 31, 2018	Three months ended March 31, 2017
Cash payments for additions to property and equipment	$ 9,309	$ 7,423
Net change in accrued but unpaid additions to property and equipment	(4,424)	2,308
	$ 4,885	$ 9,731
Asset addition related to sale and leaseback transactions	-	965
Total capital expenditures	$ 4,885	$ 10,696
Changes in deferred costs, net	$ (6,723)	$ (11,554)
Amortization of deferred costs	19,008	16,844
Total deferred costs	$ 12,285	$ 5,290
Total capital expenditures and deferred costs	$ 17,170	$ 15,986

Certain financial information of SDL and SDHL

The following tables present certain financial information for SDL and SDHL for the three months ended March 31, 2018 and certain adjustments to show the differences in this financial information between SDL and SDHL for these periods. These adjustments primarily reflect the existence of preferred shares at SDL and general and administrative costs relating to certain professional expenses that are recorded at SDL and not at SDHL.

March 31, 2018

Condensed Consolidated Interim Statements of Operations for the three months ended March 31, 2018

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
Revenues			
Operating revenues	$ 144,604	$ -	$ 144,604
Other revenue	2,906	-	2,906
	147,510	**-**	**147,510**
Operating costs and expenses			
Operating and maintenance	90,269	-	90,269
Depreciation	21,868	-	21,868
Amortization of deferred costs	19,008	-	19,008
General and administrative	12,607	(137)	12,470
Gain on disposal of assets	(120)	-	(120)
	143,632	**(137)**	**143,495**
Operating income	**3,878**	**137**	**4,015**
Other (expense) / income, net			
Interest income	183	-	183
Interest expense and financing charges	(38,960)	-	(38,960)
Other, net	1,040	-	1,040
	(37,737)	**-**	**(37,737)**
Loss before income taxes	**(33,859)**	**137**	**(33,722)**
Income tax expense	4,658	-	4,658
Net loss	**$ (38,517)**	**$ 137**	**$ (38,380)**
Preferred dividend (1)	(4,495)	4,495	-
Net loss attributable to common shares	**$ (43,012)**	**$ 4,632**	**$ (38,380)**

(1) In January 2017, we refinanced our long-term debt (the "2017 refinancing"). In connection with the 2017 refinancing, SDL's wholly owned subsidiary, Shelf Drilling Midco, Ltd ("Midco"), fully retired its outstanding $350 million term loan (the "Midco term loan") for an aggregate consideration of $339.17 million which included the issuance of $166.67 million of SDL preferred shares (the "preferred shares") to certain equity sponsors. This adjustment relates to the dividend on the preferred shares recorded at SDL for the three months ended March 31, 2018. The total dividend recognized for the three months ended March 31, 2018 was $4.5 million, of which $3.0 million was accrued and to be paid in the next semi-annual payment. Total dividends paid in cash on the due date during the three months ended March 31, 2018 was $8.9 million.

Condensed Consolidated Interim Balance Sheets as of March 31, 2018

	Shelf Drilling, Ltd.	Adjustments	Shelf Drilling Holdings, Ltd.
		(In thousands)	
Assets			
Cash and cash equivalents	$ 120,598	$ (10)	$ 120,588
Accounts and other receivables, net[(1)]	128,035	5,525	133,560
Other current assets[(2)]	98,903	(3,778)	95,125
Total current assets	347,536	1,737	349,273
Property and equipment	1,625,456	-	1,625,456
Less accumulated depreciation	392,574	-	392,574
Property and equipment, net	1,232,882	-	1,232,882
Deferred tax assets	690	-	690
Other assets	107,194	-	107,194
Total assets	**$ 1,688,302**	**$ 1,737**	**$ 1,690,039**
Liabilities and equity			
Accounts payable[(3)]	$ 76,465	$ (406)	$ 76,059
Interest payable	7,446	-	7,446
Obligations under sale and leaseback	35,115	-	35,115
Current maturities of long-term debt	14,164	-	14,164
Accrued income taxes	5,878	-	5,878
Other current liabilities[(4)]	22,536	(2,995)	19,541
Total current liabilities	161,604	(3,401)	158,203
Long-term debt	601,761	-	601,761
Obligations under sale and leaseback	270,156	-	270,156
Deferred tax liabilities	4,257	-	4,257
Other long-term liabilities	18,580	-	18,580
Total long-term liabilities	894,754	-	894,754
Mezzanine equity, net of issuance costs[(5)]	165,978	(165,978)	-
Commitments and contingencies			
Common shares[(6)]	831	(831)	-
Additional paid-in capital[(7)]	658,797	84,279	743,076
Accumulated other comprehensive income	(470)	-	(470)
Accumulated losses[(8)]	(193,192)	87,668	(105,524)
Total equity	465,966	171,116	637,082
Total liabilities and equity	**$ 1,688,302**	**$ 1,737**	**$ 1,690,039**

(1) This adjustment primarily relates to legal and accounting fees paid by SDHL on behalf of SDL.

(2) This adjustment primarily relates to deferred third party professional services recorded at the SDL level for certain corporate activities.

(3) This adjustment primarily relates to the accrual of third party professional services recorded at the SDL level for certain legal activities.

(4) In connection with the 2017 refinancing, SDL issued $166.67 million of SDL preferred shares to certain equity sponsors. This adjustment relates to the preferred dividend at SDL that has been accrued but not yet paid.

(5) This adjustment relates to the issuance of preferred shares, net of the issuance costs of $0.7 million. Refer to footnote 1 of the Condensed Consolidated Interim Statements of Operations for the three months ended March 31, 2018 regarding the issuance of the preferred shares.

(6) In April 2017, SDL completed an offering of 28,125,000 new common shares at a price of $8.00 per share (the "Private Placement"). In connection with the Private Placement, the current classes of A, B, C and D ordinary shares were converted into a single class of new common shares, pursuant to which 55,000,000 new common shares were issued to the existing holders of SDL. This adjustment reflects the total number of outstanding shares of 83,125,000, with par value of $0.01 per share.

(7) This adjustment primarily reflects a capital contribution from Shelf Drilling Intermediate, Ltd. ("SDIL") to SDHL in 2012 and preferred shares dividends at SDL, partially offset by ordinary shares dividend at SDHL. SDIL is 100% owned by Shelf Drilling Midco, Ltd ("Midco") which is 100% directly owned by SDL.

(8) This adjustment primarily relates to the Midco term loan interest expense and financing charges, preferred shares dividends at SDL, ordinary shares dividend at SDHL and certain general and administrative costs incurred at SDL.

Condensed Consolidated Interim Statements of Cash flows for the three months ended March 31, 2018

	Shelf Drilling, Ltd.	Adjustments	Shelf Drilling Holdings, Ltd.
		(In thousands)	
Cash flows from operating activities			
Net loss	$ (38,517)	$ 137	$ (38,380)
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation	21,868	-	21,868
Loss on derivative financial instruments, net	98	-	98
Provision for doubtful accounts, net	85	-	85
Amortization of deferred revenue	(3,426)	-	(3,426)
Share-based compensation expense, net of forfeitures / Capital contribution by Parent share-based compensation	202	-	202
Non-cash portion of loss on debt extinguishment [1]	6,320	-	6,320
Debt extinguishment costs	12,505	-	12,505
Amortization of debt issue costs	822	-	822
Gain on disposal of assets	(120)	-	(120)
Deferred tax expense, net	481	-	481
Payments for settlement of derivative financial instruments, net	(98)	-	(98)
Changes in deferred costs, net	6,723	-	6,723
Changes in operating assets and liabilities			
Intercompany receivables	-	(137)	(137)
Other operating assets and liabilities, net	(16,570)	39	(16,531)
Net cash used in operating activities	(9,627)	39	(9,588)
Cash flows from investing activities			
Additions to property and equipment	(9,309)	-	(9,309)
Proceeds from disposal of property and equipment	291	-	291
Net cash used in investing activities	(9,018)	-	(9,018)
Cash flows from financing activities			
Short-term debt	2,159	-	2,159
Proceeds from issuance of long-term debt	625,000	-	625,000
Payments for obligations under sale and leaseback	(8,659)	-	(8,659)
Payments to retire long-term debt	(533,250)	-	(533,250)
Payments of debt issuance costs	(9,739)	-	(9,739)
Payments of debt extinguishment costs	(12,505)	-	(12,505)
Preferred shares dividend paid [1]	(8,906)	8,906	-
Ordinary shares dividend paid [2]	-	(8,900)	(8,900)
Net cash provided by financing activities	54,100	6	54,106
Net increase in cash, cash equivalents and restricted cash	35,455	45	35,500
Cash, cash equivalents and restricted cash at beginning of period [3]	99,826	(55)	99,771
Cash, cash equivalents and restricted cash at end of period	**$ 135,281**	**$ (10)**	**$ 135,271**

(1) This adjustment primarily relates to the payment of SDL's preferred dividends.

(2) This adjustment reflects the ordinary shares dividend paid by SDHL to fund SDL's preferred shares dividend payment.

(3) As a result of the adoption of Accounting Standards Update 2016-15 as discussed in *Note 2 – Recently Adopted and Issued Accounting Pronouncements* in "Item 1, Financial Statements" of "Part I, Financial Information", the change in restricted cash of $0.6 million during the three months ended March 31, 2017 previously reported as cash flows from investing activities has been presented as part of cash and cash equivalents and restricted cash.

Contractual Obligations

In the normal course of business, we enter into various contractual obligations that impact or could impact our liquidity. The table below contains our estimated contractual obligations stated at face value as of March 31, 2018 (in thousands):

	Years ended March 31,						
	2019	2020	2021	2022	2023	Thereafter	Total
Debt repayment (1)	$ 12,500	$ 12,500	$ -	$ -	$ -	$600,000	$ 625,000
Interest on debt (2)	53,905	52,963	49,728	49,500	49,500	92,897	348,493
Sale and lease back obligations (3)	53,960	52,703	50,276	124,119	88,374	-	369,432
Operating leases and other commitments	7,785	3,322	1,905	820	-	-	13,832
Total	$ 128,150	$ 121,488	$ 101,909	$ 174,439	$137,874	$692,897	$1,356,757

(1) Debt includes 8.25% Senior Unsecured Notes and SDA Facility.

(2) Assumes no change in the current variable interest rate applied, where applicable. Includes commitment fees on our revolver assuming no change in the undrawn balance.

(3) This represents minimum annual rental payments and Purchase Obligation Price assuming estimated average interest rates (including impact of the recent interest rate hedge) under the sale and leaseback transactions as of March 31, 2018.

Other Commercial Commitments

We have other commercial commitments which contractually obligate us to settle with cash under certain circumstances. Surety bonds and parent company guarantees entered into between certain customers and governmental bodies guarantee our performance regarding certain drilling contracts, customs import duties and other obligations in various jurisdictions.

We have surety bond facilities in either U.S. dollars or local currencies of approximately $102.8 million provided by several banks to guarantee various contractual, performance, and customs obligations. We entered into these facilities in India, Egypt, UAE and Nigeria. The outstanding surety bonds were $48.2 million and $53.6 million at March 31, 2018 and December 31, 2017, respectively.

The Company also has a $50.0 million uncommitted guarantee facility included in the SDA facility. The outstanding bank guarantees under the uncommitted guarantee facility was $8.1 million and nil as of March 31, 2018 and December 31, 2017, respectively.

In addition, we had outstanding bank guarantees and performance bonds amounting to $3.5 million and $12.3 million as of March 31, 2018 and December 31, 2017, respectively, against the SDHL Revolver.

Therefore, the total outstanding bank guarantees and surety bonds issued by the Company were $59.8 million and $65.9 million as of March 31, 2018 and December 31, 2017, respectively.

Contingencies

As of March 31, 2018, we are not exposed to any contingent liabilities that will result in a material adverse effect on the current consolidated financial position, results of operations or cash flows. The majority of the contingent liabilities that we are exposed to, relate to legal and tax cases, which are fully indemnified by Transocean Inc.. See *Note 6 - Income Taxes and Note 10 - Commitments and Contingencies* in “Item 1. Financial Statements” of “Part I. Financial Information”.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our financial statements, which have been prepared in accordance with GAAP. The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. Certain accounting policies involve judgments and uncertainties to such an extent that there is a reasonable likelihood that materially different amounts could have been reported under different conditions, or if different assumptions had been used. We evaluate our estimates and assumptions on a regular basis. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and assumptions used in preparation of our financial statements. We believe that most of these accounting policies reflect our more significant estimates and assumptions used in preparation of our financial statements.

For a discussion of the critical accounting policies and estimates that we use in the preparation of our Condensed Consolidated Interim Financial Statements, see "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies, Key Judgements and Estimates" in Part II of our Annual Report on Form 10-K Equivalent for the year ended December 31, 2017. During the three months ended March 31, 2018, there were no material changes to the judgments, assumptions or policies upon which our critical accounting estimates are based, except for the impact of the adoption of the new accounting standard on revenue from contracts with customers. *See Note 1 – Summary of Significant Accounting Policies in "Item 1. Financial Statements" of "Part I. Financial Information".*

New Accounting Pronouncements

See *Note 2 – Recently Adopted and Issued Accounting Pronouncements* in the accompanying condensed consolidated interim financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks, including liquidity risk, interest rate risk, foreign currency risk and credit risk.

Liquidity risk

We manage our liquidity risk by maintaining adequate cash reserves at banking facilities, and by continuously monitoring our cash forecasts, our actual cash flows and by matching the maturity profiles of financial assets and liabilities.

Interest Rate Risk

We are exposed to interest rate risk related to the fixed rate debt under the 8.25% Senior Unsecured Notes and variable rate debts under our revolver, the SDA facility, preferred shares and the obligations under our sale and leaseback transactions. 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, expose us to changes in market interest rates if and when maturing debt is refinanced with new debt. The variable rate debt, where the interest rate may be adjusted frequently over the life of the debt, expose us to short-term changes in market interest rates.

Based upon variable-rate obligations outstanding as of March 31, 2018, a hypothetical one percentage point change in annual interest rates could result in a corresponding change in annual interest expense of approximately $1.2 million, including the impact of the recent interest rate hedge.

We maintain documented policy and procedures to monitor and control the use of the derivative instruments. We are not engaged in derivative transactions for speculative or trading purposes.

Foreign Currency Risk

Our international operations expose us to currency exchange rate risk. This risk is primarily associated with compensation costs of employees and purchasing costs from non-U.S. suppliers, which are denominated in currencies other than the U.S. dollar. We do not have any material non-U.S. dollar debt and thus are not exposed to currency risk related to debt.

Our primary currency exchange rate risk management strategy involves structuring certain customer contracts to provide for payment from the customer in both 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 our international operations has not historically had a material impact on our operating results.

Further, we utilize forex contracts to manage a portion of foreign exchange risk, for which we maintain documented policy and procedures to monitor and control the use of the derivative instruments. We are not engaged in derivative transactions for speculative or trading purposes. Our forex contracts generally require us to net settle the spread between the contracted foreign currency exchange rate and the spot rate on the contract fixing date.

Credit Risk

Our financial instruments that potentially subject us to concentrations of credit risk are cash and cash equivalents and accounts receivables. We generally maintain cash and cash equivalents at commercial banks with high credit ratings.

Our trade receivables are with a variety of government owned or controlled energy companies, publicly listed integrated oil companies or independent exploration and production companies. We perform ongoing credit evaluations of our customers, and generally do not require material collateral. We may from time to time require our customers to issue bank guarantee in our favor to cover non-payment under drilling contracts.

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. Our allowance for doubtful accounts was $2.6 million and $2.5 million as of March 31, 2018 and December 31, 2017, respectively.

Item 4. Controls and Procedures

We are not required to report this Item.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company may be involved in litigations, claims and disputes incidental to our business, which may involve claims for significant monetary amounts, some of which would not be covered by insurance. In the opinion of management, none of the existing disputes to which we are a party will have a material adverse effect on our financial position, results of operations or cash flows.

See *Note 10 – Commitments and Contingencies* to the condensed consolidated interim financial statements included in "Item 1. Financial Statements".

Item 1A. Risk Factors

The information set forth under the caption "Forward-looking Information" of Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 of Part I of this report is incorporated by reference in response to this Item and there have been no material changes from the risk factors previously disclosed in the Company's Annual Report for the year ended December 31, 2017.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

Material agreements governing indebtedness can be found on our website.