

SHELF DRILLING, LTD.
INDEX TO INTERIM REPORT
THREE MONTHS ENDED MARCH 31, 2019 AND 2018
(UNAUDITED)

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**SHELF DRILLING, LTD.
THREE MONTHS ENDED MARCH 31, 2019 AND 2018
(UNAUDITED)**

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements



Report of Independent Auditors

To the board of directors of Shelf Drilling, Ltd.

We have reviewed the accompanying condensed consolidated interim financial information of Shelf Drilling, Ltd. and its subsidiaries (the "Company"), which comprise the condensed consolidated interim balance sheet as of March 31, 2019, and the related condensed consolidated interim statements of operations, comprehensive income, equity and cashflows for the three-month periods ended March 31, 2019 and 2018.

Management's responsibility for the condensed consolidated interim financial information

The Company's management is responsible for the preparation and fair presentation of the condensed consolidated interim financial information in accordance with accounting principles generally accepted in the United States of America; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of the condensed consolidated interim financial information in accordance with accounting principles generally accepted in the United States of America.

Auditor's responsibility

Our responsibility is to conduct our review in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial information for it to be in accordance with accounting principles generally accepted in the United States of America.

Other matter

We previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of the Shelf Drilling, Ltd. and its subsidiaries as of December 31, 2018, and the related consolidated statements of operations, comprehensive income, equity and cashflows for the year then ended (not presented herein), and in our report dated March 4, 2019, we expressed an unmodified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2018, is consistent, in all material respects, with the audited consolidated balance sheet from which it has been derived.

PricewaterhouseCoopers
Dubai, United Arab Emirates
May 15, 2019

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Douglas O'Mahony, Rami Serhan, Jacques Fakhoury and Mohamed ElBorno are registered as practising auditors with the UAE Ministry of Economy

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

	Three months ended March 31,	
	2019	2018
Revenues		
Operating revenues.....	\$ 142,910	\$ 144,604
Other revenue.....	4,327	2,906
	<u>147,237</u>	<u>147,510</u>
Operating costs and expenses		
Operating and maintenance.....	92,244	90,269
Depreciation.....	20,352	21,868
Amortization of deferred costs.....	18,149	19,008
General and administrative.....	11,587	12,607
Gain on disposal of assets.....	(2,867)	(120)
	<u>139,465</u>	<u>143,632</u>
Operating income	<u>7,772</u>	<u>3,878</u>
Other (expense) / income, net		
Interest income.....	368	183
Interest expense and financing charges.....	(20,208)	(38,960)
Other, net.....	(276)	1,040
	<u>(20,116)</u>	<u>(37,737)</u>
Loss before income taxes	<u>(12,344)</u>	<u>(33,859)</u>
Income tax expense	1,256	4,658
Net loss	<u>\$ (13,600)</u>	<u>\$ (38,517)</u>
Less: Preferred shares dividend.....	-	4,495
Net loss attributable to common shares	<u>\$ (13,600)</u>	<u>\$ (43,012)</u>
Loss per share:		
Basic and Diluted - Common shares.....	\$ (0.12)	\$ (0.53)
Weighted average shares outstanding:		
Basic and Diluted - Common shares.....	111,240,394	81,651,566

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,	
	2019	2018
Net loss	\$ (13,600)	\$ (38,517)
Other comprehensive income, net of tax.....		
Change in unrealized (losses) / gains on derivative financial instruments.....		
Changes in unrealized gains / (losses).....	73	(568)
Reclassification of net (gains) / loss from other comprehensive income to net income.....	(96)	98
	<u>\$ (23)</u>	<u>\$ (470)</u>
Total comprehensive loss	<u>\$ (13,623)</u>	<u>\$ (38,987)</u>

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)
(Unaudited)

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Assets		
Cash and cash equivalents.....	\$ 69,886	\$ 91,203
Accounts and other receivables, net.....	120,918	143,439
Assets held for sale.....	2,479	5,154
Other current assets.....	80,975	81,532
Total current assets.....	274,258	321,328
Property and equipment.....	1,646,164	1,637,489
Less accumulated depreciation.....	442,421	422,609
Property and equipment, net.....	1,203,743	1,214,880
Deferred tax assets.....	2,294	2,526
Other assets.....	124,275	107,162
Total assets.....	\$ 1,604,570	\$ 1,645,896
Liabilities and equity		
Accounts payable.....	\$ 70,760	\$ 83,930
Interest payable.....	9,488	28,050
Accrued income taxes.....	5,725	4,771
Other current liabilities.....	17,733	20,143
Total current liabilities.....	103,706	136,894
Long-term debt.....	888,151	887,764
Deferred tax liabilities.....	4,475	3,939
Other long-term liabilities.....	30,583	26,042
Total long-term liabilities.....	923,209	917,745
Commitments and contingencies (Note 12)		
Common shares of \$0.01 par value; 144,063,473 shares authorized at March 31, 2019 and December 31, 2018, respectively; 111,240,394 issued and outstanding at March 31, 2019 and December 31, 2018, respectively	1,112	1,112
Additional paid-in capital.....	880,841	880,820
Accumulated other comprehensive income.....	220	243
Accumulated losses.....	(304,518)	(290,918)
Total equity.....	577,655	591,257
Total liabilities and equity.....	\$ 1,604,570	\$ 1,645,896

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

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,	
	2019	2018	2019	2018
	Shares		Amount	
Common and ordinary shares				
Balance, beginning of period.....	111,240,394	83,125,000	\$ 1,112	\$ 831
Repurchase and retirement of shares.....	-	(9,606)	-	-
Balance, end of period.....	111,240,394	83,115,394	\$ 1,112	\$ 831
Additional paid-in capital				
Balance, beginning of period.....			\$ 880,820	\$ 663,090
Preferred shares dividend.....			-	(4,495)
Share-based compensation expense, net of forfeitures.....			21	202
Balance, end of period.....			\$ 880,841	\$ 658,797
Accumulated other comprehensive income				
Balance, beginning of period.....			\$ 243	\$ -
Net unrealized loss on derivative financial instruments.....			(23)	(470)
Balance, end of period.....			\$ 220	\$ (470)
Accumulated losses				
Balance, beginning of period.....			\$ (290,918)	\$ (154,675)
Net loss.....			(13,600)	(38,517)
Balance, end of period.....			\$ (304,518)	\$ (193,192)
Total equity				
Balance, beginning of period.....			\$ 591,257	\$ 509,246
Preferred shares dividend.....			-	(4,495)
Share-based compensation expense, net of forfeitures.....			21	202
Total comprehensive loss.....			(13,623)	(38,987)
Balance, end of period.....			\$ 577,655	\$ 465,966

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,	
	2019	2018
Cash flows from operating activities		
Net loss.....	\$ (13,600)	\$ (38,517)
Adjustments to reconcile net loss to net cash (used in) / provided by operating activities		
Depreciation	20,352	21,868
(Gain) / loss on derivative financial instruments, net.....	(96)	98
(Reversal of) / provision for doubtful accounts, net.....	(31)	85
Amortization of deferred revenue.....	(1,337)	(3,426)
Share-based compensation expense, net of forfeitures.....	21	202
Non-cash portion of loss on debt extinguishment.....	-	6,320
Debt extinguishment and retirement costs.....	-	12,505
Amortization of debt issue costs and premium.....	663	822
Gain on disposal of assets.....	(2,867)	(120)
Deferred tax expense, net.....	768	481
Proceeds from / (payments of) settlement of derivative financial instruments, net.....	96	(98)
Changes in deferred costs, net *.....	610	6,723
Changes in operating assets and liabilities.....	(19,871)	(16,570)
Net cash used in operating activities.....	(15,292)	(9,627)
Cash flows from investing activities		
Additions to property and equipment *.....	(11,182)	(9,309)
Proceeds from disposal of property and equipment.....	4,960	291
Net cash used in investing activities.....	(6,222)	(9,018)
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)
Payments to retire long-term debt.....	-	(533,250)
Payments of debt financing costs.....	(147)	(9,739)
Payments of debt extinguishment and retirement costs.....	-	(12,505)
Preferred shares dividend paid.....	-	(8,906)
Net cash (used in) / provided by financing activities.....	(147)	54,100
Net (decrease) / increase in cash, cash equivalents and restricted cash.....	(21,661)	35,455
Cash, cash equivalents and restricted cash at beginning of period*.....	92,835	99,826
Cash, cash equivalents and restricted cash at end of period*.....	\$ 71,174	\$ 135,281

* See Note 17 – 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.

SHELF DRILLING, LTD.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited)

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 with principal investors from affiliates of Castle Harlan, Inc., CHAMP Private Equity and Lime Rock Partners (together, the “Sponsors”). SDL is a holding company with no significant operations or assets other than owned interests in its direct and indirect subsidiaries. SDL and its majority owned subsidiaries (together, the “Company”) provide shallow-water drilling services to the oil and natural gas industry. The Company’s corporate offices are in Dubai, United Arab Emirates (“UAE”), geographically close to its operations in the Middle East (including Egypt and the Mediterranean), South East Asia, India and West Africa. Currently, 57,665,180 SDL shares are listed on the Oslo Stock Exchange under the ticker symbol SHLF.

SDL, through its majority and wholly owned subsidiaries, provides safe and reliable fit-for-purpose independent cantilever jack-up drilling services. The Company is primarily engaged in development and workover activity on producing assets in shallow water of up to 375 feet in water depth. As of March 31, 2019, the Company owned 36 independent cantilever jack-up rigs, three of which were 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 of a normal recurring nature unless otherwise noted. Operating results for the three months ended March 31, 2019 are not necessarily indicative of the results that may be expected for the year ending December 31, 2019 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, 2018.

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, 2018.

Leases — A lease contract is a contract that conveys the right to control the use of an identified asset for a period of time in exchange for consideration. Lease classification is made at the inception of the lease whether it is an operating lease or a finance lease.

The Company determines the lease term as the non-cancellable period of a lease, including renewal or termination options that the Company is reasonably certain to exercise. The Company considers all relevant facts and circumstances that create an economic incentive for the lessee to exercise the option. The Company will reassess the lease term upon the occurrence of either a significant event or a significant change in circumstances that is within the control of the Company.

The Company as a Lessee

At the commencement date, the Company recognizes a right-of-use asset and a lease liability for all leases, whether operating or finance leases. The right-of-use asset is initially recognized at cost comprising of the amount of the initial measurement of the lease liability; any lease payments made at or before the commencement date, less any lease incentives received; and any initial direct costs incurred by the Company. Finance lease right-of-use assets and operating lease right-of-use assets are recorded in the condensed consolidated interim balance sheet. See Note 7 – Leases

Lease liability is initially recognized at the present value of the future lease payments using the interest rate implicit in the lease, if that rate can be determined, or the Company’s incremental borrowing rate. Finance lease liabilities and operating lease liabilities are recorded in the condensed consolidated interim balance sheet.

Subsequent to initial recognition, the right-of-use asset is carried at cost adjusted for amortization and impairment. The lease liability is then measured by increasing interest on the lease liability, reduced by the lease payments made and remeasured for the impact of foreign currency changes and any reassessment or lease modification or revised in-substance fixed lease payments.

For a contract that contains a lease component and non-lease components, the lease is accounted for as one single lease component in accordance with the Company’s policy. Therefore, all non-lease components in the lease contracts are included in the measurement of the right-of-use asset and operating lease liability.

SHELF DRILLING, LTD.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited)

Operating lease expenses are recognized on a straight-line basis over the lease term and included under operating and maintenance expenses and general or administrative expenses in the condensed consolidated interim statements of operations. For finance leases, the interest expense on the lease liability and amortization of the right-of-use asset are recorded separately as interest expense and operating and maintenance expenses, respectively, in the condensed consolidated interim statements of operations.

Derivative Financial Instruments — The Company’s derivative financial instruments may consist of forex contracts and interest rate swaps which the Company may designate as cash flow hedges. Each derivative contract is stated in the condensed consolidated interim balance sheets at fair value with gains and losses reflected in the condensed consolidated interim 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 derivative financial instruments to their fair value are recorded as a component of accumulated other comprehensive income / (loss) (“AOCIL”), in the condensed consolidated interim balance sheets. The entire changes in the fair value included in the assessment of hedge effectiveness 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 condensed consolidated interim statements of operations to offset the impact of foreign currency fluctuations of the expenditures in local currencies in the countries in which the Company operates. Derivatives with asset fair values and derivatives with liability fair values are reported in other current assets or other assets and other current liabilities or other long-term liabilities, respectively, on the 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 February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which generally requires to recognize a lease liability, measured on a discounted basis, and a corresponding 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. The ASU is effective for annual and interim periods for fiscal years beginning after December 15, 2018 for public business entities.

The Company has adopted various ASUs related to Leases (Topic 842) as of January 1, 2019 using a modified retrospective approach. The Company elected the package of practical expedients under the transition guidance, which allowed not to reassess: (1) whether any expired or existing contracts are or contain leases; (2) the lease classification for any expired or existing leases; and (3) initial direct costs for any existing leases; and by class of underlying asset to not separate non-lease components from associated lease components and combine them as a single lease component. In addition, as a lessee, the Company has taken the accounting policy election to not recognize an asset and liability for short term leases. The Company did not apply the hindsight practical expedient to determine the lease term for existing leases.

The adoption of Topic 842 resulted in the recording of right-of-use assets and lease liabilities of approximately \$12.6 million and \$12.3 million, respectively, as of January 1, 2019. On adoption, the lease liabilities were measured at the present value of the remaining lease payments and were discounted using a single discount rate. As most of the Company’s leases do not provide an implicit rate, the Company used the incremental borrowing rate, currently 7.5%, at the commencement date in determining the present value of lease payments. The new standard did not materially impact our condensed consolidated interim statements of operations and had no impact on our condensed consolidated interim statements of cash flows.

As a lessor, the Company’s drilling contracts contain a lease component related to the underlying drilling rig, in addition to the service component provided by crews and personnel’s expertise to operate such drilling equipment. The service component of operating the drilling rig is predominant in our drilling contracts. Accordingly, with the election of the practical expedient to present the lease and associated non-lease operations as a single component, the Company’s accounting for the drilling rigs revenue as a single performance obligation under the new revenue guidance in ASC 606 remains unchanged.

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

SHELF DRILLING, LTD.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited)

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 has adopted this standard as of January 1, 2019. While this ASU amends presentation and disclosure requirements and changes how companies assess effectiveness, the adoption did not have a material impact on the condensed consolidated interim financial statements.

In June 2018, the FASB issued ASU No. 2018-07, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share Based-Payment Accounting. This ASU intends to improve the usefulness of information provided and reducing the cost and complexity of financial reporting. A main objective of this ASU is to substantially align the accounting for share-based payments to employees and non-employees. The guidance is effective for annual reporting periods beginning after December 15, 2018 for public entities, including interim periods within that period, with early adoption permitted. The Company has adopted this standard as of January 1, 2019. The adoption of this standard did not have a material effect on the condensed consolidated interim financial statements.

Recently issued accounting standards

In August 2018, the FASB issued ASU No. 2018-14 – Compensation – Retirement Benefits – Defined Benefit Plans – General (Subtopic 715-20): Disclosure Framework – Changes to the Disclosure Requirements for Defined Benefit Plans. This amendment modifies disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The main objective of this ASU is to remove disclosures that are no longer considered cost beneficial, clarify specific requirements of disclosures and to add disclosure requirements that are identified as relevant. The amendments are effective for fiscal years ending after December 15, 2020, with early adoption permitted. The Company does not intend to early adopt this standard. The Company believes that the adoption of this standard will not have a material effect on the condensed consolidated interim financial statements.

In August 2018, the FASB issued ASU No. 2018-13 – Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement. This ASU modifies the disclosure requirements in Topic 820 by identifying a narrower set of disclosures about that topic to be required on the basis of, among other consideration, an evaluation of whether the expected benefits of entities providing the information justify the expected costs. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. The Company does not intend to early adopt this standard. The Company believes that the adoption of this standard will not have a material effect 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, 2020, 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.

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 period could vary based on the actual operations. The Company's integrated drilling service provided under each drilling contract is a single performance obligation and comprises of a series of distinct drilling services. The activities performed and the level of service provided can vary hour to hour.

The dayrate invoices billed to the customer are typically determined based on the varying rates applicable to the specific activities performed on an hourly basis. Variable consideration is only recognized as revenue to the extent that it is probable that a significant reversal will not occur during the contract term. When determining if variable consideration should be constrained, management considers whether there are factors outside the Company's control that could result in a significant reversal of revenue as well as the likelihood and magnitude of a potential reversal of revenue.

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NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited)

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. These activities are not considered to be distinct within the context of the contract therefore, the associated revenue is recorded as a contract liability and amortized on a straight-line basis over the contract term. The associated deferred contract costs are amortized on a straight-line basis over the contract term.

In addition, fees received for demobilization of the rig are included in operating revenues. In most contracts, there is uncertainty as to the amount of expected demobilization revenue due to contractual provisions that stipulate certain conditions must be present at contract completion for such revenue to be received. Therefore, the demobilization fees are recorded when it becomes probable that there will not be a material cumulative revenue reversal. 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 variable consideration related to remaining unsatisfied performance obligations. The future recognition of fixed consideration related to remaining unsatisfied performance obligations is disclosed below under contract liabilities.

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 can charge an early termination fee to the customer. In such cases, any remaining deferred revenue and costs are recorded to the condensed consolidated interim statement of operations upon such termination, when it becomes probable that there will not be a material cumulative revenue reversal. The extension options are at agreed prices and terms and are typically accounted for as contract modifications as if it were a separate contract.

The Company also provides catering, accommodation services, 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, 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 obtained by a customer.

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 material 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 19 – 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 and advance payments from customers for future services. Current contract liabilities are included in other current liabilities and noncurrent contract liabilities are included in other long-term liabilities on the condensed consolidated interim 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):

	<u>March 31,</u>	<u>December 31,</u>
	<u>2019</u>	<u>2018</u>
Current contract liabilities	\$ 3,114	\$ 3,021
Non-current contract liabilities	3,069	3,536
	<u>\$ 6,183</u>	<u>\$ 6,557</u>

SHELF DRILLING, LTD.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(Unaudited)

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

	Contract liabilities
Balance as of December 31, 2018.....	\$ 6,557
Increase due to contractual additions.....	3,150
Decrease due to amortization of contract liabilities.....	(3,524)
Balance as of March 31, 2019.....	\$ 6,183

Out of the \$3.5 million amortization of contract liabilities, \$1.4 million of revenue recognized in the current period was included in the beginning contract liabilities balance.

Expected future amortization of contract liabilities recorded as of March 31, 2019 is as follows (in thousands):

For the twelve months ending March 31,

2020.....	\$ 3,114
2021.....	1,820
2022.....	1,140
2023 and thereafter.....	109
	<u>\$ 6,183</u>

Deferred contract costs

Costs incurred for upfront rig mobilizations and certain contract preparations 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 are included in other current assets and other assets on the condensed consolidated interim balance sheets. Certain non-contractual costs such as regulatory inspections, major equipment overhauls, including rig upgrades, and stacked rig activations are not included in deferred contract costs.

Following are the details of the deferred contract costs (in thousands):

	March 31,	December 31,
	2019	2018
Current deferred contract costs.....	\$ 26,119	\$ 29,276
Non-current deferred contract costs.....	9,226	5,663
	<u>\$ 35,345</u>	<u>\$ 34,939</u>

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

	Deferred contract costs
Balance as of December 31, 2018.....	\$ 34,939
Increase due to contractual additions.....	8,630
Decrease due to amortization of deferred contract costs.....	(8,224)
Balance as of March 31, 2019.....	\$ 35,345

Note 4 — 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

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relevant third parties have contractual arrangements to convey decision-making and economic rights to the Company. These VIEs provide drilling related 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. The Nigerian third parties are not in a position to provide additional financing and do not participate in any gains or 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. The Nigerian third parties are not in a position to provide additional financing and do not participate in any gains or losses.

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, 2019									
Total assets	\$	52	\$	12,865	\$	22,075	\$	2,084	\$ 37,076
Total liabilities		357		488		10,127		1,314	12,286
Net carrying amount	\$	(305)	\$	12,377	\$	11,948	\$	770	\$ 24,790
December 31, 2018									
Total assets	\$	43	\$	11,500	\$	22,372	\$	1,901	\$ 35,816
Total liabilities		426		1,431		10,685		1,503	14,045
Net carrying amount	\$	(383)	\$	10,069	\$	11,687	\$	398	\$ 21,771

Note 5 — Property and Equipment

Property and equipment as of March 31, 2019 and December 31, 2018 consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Drilling rigs and equipment.....	\$ 1,501,197	\$ 1,497,716
Spares.....	38,326	40,755
Construction in progress.....	88,453	81,674
Land and building.....	2,178	1,354
Other	16,010	15,990
Total property and equipment.....	\$ 1,646,164	\$ 1,637,489
Less: Accumulated depreciation.....	(442,421)	(422,609)
Total property and equipment, net.....	\$ 1,203,743	\$ 1,214,880

There were no rigs added to the Company's drilling rig fleet during the three months ended March 31, 2019 and 2018.

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Total capital expenditures for the three months ended March 31, 2019 and 2018 were \$9.3 million and \$4.9 million, respectively. During the three months ended March 31, 2019, the capital expenditures included \$1.3 million related to reactivation costs for one premium jack-up drilling rig acquired in July 2018 and \$0.9 million related to the two premium newbuild jack-ups delivered in May 2019. There were no such transactions during the three months ended March 31, 2018.

During the three months ended March 31, 2019, the Company sold two rigs previously recorded as assets held for sale (see Note 6- Assets held for sale).

Disposals of other property and equipment with a net carrying amount of \$0.2 million and \$0.1 million were sold for \$0.1 million and \$0.2 million and resulted in a (loss) / gain on disposal of assets of (\$0.1) million and \$0.1 million during the three months ended March 31, 2019 and 2018, respectively.

The Company did not record an impairment charge during the three months ended March 31, 2019 and 2018.

Note 6 — Assets held for sale

As of December 31, 2018, the Company was committed to a plan to sell four stacked rigs in the next twelve months, the Key Gibraltar, Comet, Rig 124 and Adriatic X. As a result, these rigs were classified as assets held for sale and were recorded at the lower of carrying value or fair value less costs to sell.

During the three months ended March 31, 2019, the Company sold the Key Gibraltar and Adriatic X with a combined carrying value of \$2.7 million for total net proceeds of \$5.6 million and recognized a gain of \$2.9 million. The net proceeds included \$0.2 million of costs to sell and \$0.7 million deposit received in Q4 2018 for the sale of one of the rigs.

On March 25, 2019, the Company entered into agreements with a third party to sell the two stacked rigs (the Comet and Rig 124) for a total aggregate selling price of \$3.1 million. The transaction is expected to close in Q3 2019.

Note 7 — Leases

The Company has lease agreements principally for office and yard space, expatriate employee accommodation, vehicles and office equipment with either cancellable and non-cancellable lease terms. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The leases typically are for periods ranging from one to six years and are spread across multiple geographical locations where the Company operates. Most leases include extension and/or termination options, where the exercise of the lease renewal options is at the Company's sole discretion.

Certain lease agreements include payments that are adjusted periodically for inflation and based on other criteria. The Company's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

Short-term leases, with an initial term of 12 months or less are not recorded on the condensed consolidated interim balance sheet. Lease expense for short-term leases are recognized on a straight-line basis over the lease term. As of March 31, 2019, the Company does not have any finance leases.

Operating right-of-use assets and operating lease liabilities

Following are the details of the right-of-use asset and lease liability (in thousands):

Assets	Balance Sheet Classification	March 31, 2019
Operating right-of-use assets.....	Other assets	\$ 11,889

Liabilities	Balance Sheet Classification	March 31, 2019
Operating lease liabilities - current.....	Other current liabilities	\$ 4,255
Operating lease liabilities - long-term.....	Other liabilities	6,974
		\$ 11,229

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The Company signed agreements to bareboat charter two premium jack-up rigs with options to buy one or both through the initial contract term of three years as part of the Transaction, which have not commenced as of March 31, 2019, and as such, have not been recognized on the Company's condensed consolidated interim balance Sheets. These operating leases provide for fixed lease payments of approximately \$16.4 million each to be paid over the respective lease terms and are expected to commence in August 2019. See Note 21 – Subsequent Events.

Lease expense

During the three months ended March 31, 2019, the total lease expense was \$ 5.1 million, of which \$1.2 million related to the operating lease right-of-use assets and \$3.9 million for short-term leases.

As of March 31, 2019, the following is the summary of the maturity of lease liabilities (in thousands):

Year ending December 31,

2019 (excluding the three months ended March 31, 2019).....	\$	3,302
2020.....		4,304
2021.....		2,834
2022.....		1,896
2023.....		251
Thereafter.....		17
Total lease payments.....	\$	12,604
Less: Interest.....		1,375
Present value of lease liabilities.....	\$	11,229

As of December 31, 2018, the future minimum rental payments under noncancelable operating leases were as follows (in thousands):

Year ending December 31,

2019	\$	4,586
2020.....		3,829
2021.....		2,438
2022.....		1,818
2023.....		251
Thereafter.....		17
Total lease payments.....	\$	12,939

As of March 31, 2019, the weighted-average remaining lease term and weighted average discount rate for operating lease right -of -use assets are as follows:

	March 31,
<u>Lease term and discount rate</u>	<u>2019</u>
Weighted-average remaining lease term (years).....	3.33
Weighted-average discount rate.....	7.5%

During the three months ended March 31, 2019, the Company paid \$1.3 million for amounts that have been included in the measurement of operating lease liabilities and operating right-of-use assets.

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Note 8 — 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 (10.2)% and (13.8)% for the three months ended March 31, 2019 and 2018, respectively. The Company has income tax expense for the three months ended March 31, 2019 and 2018, despite having a loss before income taxes for both periods, resulting in a negative effective tax rate for both periods. The reason for which the Company has income tax expense for each of the respective periods despite having a loss before income taxes for each respective period is primarily due to the Company incurred expenses for each period in jurisdictions in which the Company does not receive a tax benefit for such expenses, as such expenses are either incurred in jurisdictions which impose tax based on gross revenue rather than based on net income or are incurred in jurisdictions which do not allow for tax deductions for such expenses or where the Company is not subject to tax.

Income Tax Expense — Income tax expense was \$1.3 million for the three months ended March 31, 2019, compared to \$4.7 million for the three months ended March 31, 2018. Income tax expense in Q1 2019 is lower than in Q1 2018 primarily due to tax benefits of approximately \$3.0 million in Q1 2019 related to the release of certain tax reserves.

Income tax expense for the three months ended March 31, 2019 and 2018 was 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, 2019 and 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 was not possible to reliably estimate an annual 2019 and 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 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 2026.

The Company's deferred tax liabilities as of March 31, 2019 and December 31, 2018 include liabilities related to differences in the carrying value of certain assets for financial reporting purposes versus the basis of such assets for income tax reporting purposes, primarily due to accelerated depreciation for income tax purposes. The Company's deferred tax liabilities as of March 31, 2019 and December 31, 2018 also 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. As of both March 31, 2019 and December 31, 2018 there were no unremitted earnings of any subsidiary that the Company considered permanently reinvested.

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. Liabilities related to uncertain tax positions recorded as other long-term liabilities, were \$8.2 million and \$10.0 million as of March 31, 2019 and December 31, 2018, respectively.

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The changes to liabilities for uncertain tax positions were as follows (in thousands):

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Balance, beginning of period.....	\$ 10,001	\$ 2,248
Reductions for prior period tax positions.....	(2,242)	-
Reductions related to statute of limitation expirations.....	-	(400)
Additions for current period tax positions.....	393	8,153
Balance, end of period.....	<u>\$ 8,152</u>	<u>\$ 10,001</u>

The Company recognizes any interest and penalties related to uncertain tax positions as a component of income tax expense.

As of March 31, 2019, and December 31, 2018, the Company has \$0.3 million and \$1.0 million, respectively, of accrued interest and penalties related to uncertain tax positions recorded as other long-term liabilities.

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, tax positions related to the tax consequences of various intercompany transactions, the taxable presence of the Company's subsidiaries in a given jurisdiction, the basis of taxation in a given jurisdiction (such as deemed profits versus actual profits), or the applicability of relevant double tax treaty benefits to certain transactions; or should the Company otherwise lose a material tax dispute in any jurisdiction, the Company's income tax liability could increase substantially and the Company's earnings and cash flows from operations could be materially adversely affected.

Note 9 — Debt

Debt is comprised of the following (in thousands):

	<u>March 31,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
8.25% Senior Unsecured Notes, due February 15, 2025 (see note (ii) below).....	\$ 888,151	\$ 887,764
Revolving Credit Facility, due April 30, 2023 (see note (iii) below).....	-	-
	<u>\$ 888,151</u>	<u>\$ 887,764</u>

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

For the twelve months ending March 31,

2020.....	\$ -
2021.....	-
2022.....	-
2023.....	-
2024 and thereafter.....	900,000
Total debt.....	<u>\$ 900,000</u>

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

March 31, 2019				
	Principal Amount	Unamortized Debt Issuance Costs	Unamortized Premium	Carrying Value
8.25% Senior Unsecured Notes, due February 15, 2025.....	\$ 900,000	\$ (14,575)	\$ 2,726	\$ 888,151

December 31, 2018				
	Principal Amount	Unamortized Debt Issuance Costs	Unamortized Premium	Carrying Value
8.25% Senior Unsecured Notes, due February 15, 2025.....	\$ 900,000	\$ (15,051)	\$ 2,815	\$ 887,764

The effective interest rates on the 8.25% Senior Unsecured Notes due February 15, 2025 is 8.54%.

(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. In addition, an additional stamp duty of 0.2% per annum is to be paid quarterly on actual utilization. As of March 31, 2019 and December 31, 2018, the Company had no outstanding borrowings under the Unsecured overdraft facility.

(ii) 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 February 15, 2025 (the "8.25% Senior Unsecured Notes") issued at par. SDHL received net proceeds of \$589.3 million, after deduction of \$10.7 million of fees and expenses which were capitalized and are being 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 due November 2, 2020 and \$30.4 million of 8.625% Senior Secured Notes due November 1, 2018, 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.

On June 19, 2018, SDHL completed the issuance of an additional \$300.0 million of 8.25% Senior Unsecured Notes at an issue price of 101% for total gross proceeds of \$303.0 million, including the \$3.0 million premium. SDHL received net proceeds of \$297.2 million, after the deduction of \$5.8 million of fees and expenses which are capitalized and amortized over the life of the debt. The Company used the net proceeds to repay the \$25.4 million aggregate principal amount of the \$75.0 million senior secured facility ("SDA Facility") including the accrued interest, and the remaining proceeds were placed in an escrow account. These funds, along with cash on hand, were used for the full repayment of the obligations under sale and leaseback on July 9, 2018 (see Note 10 – Sale and Leaseback).

There have been no changes in the covenants or obligations associated with the issuance of the additional \$300.0 million 8.25% Senior Unsecured Notes. As a result of the issuance of the additional \$300.0 million of 8.25% Senior Unsecured Notes, all subsidiaries related to the Newbuild rigs and SDL became guarantors.

SDHL's obligations under the 8.25% Senior Unsecured Notes are guaranteed by the majority of SDHL's subsidiaries (collectively, the "Note Guarantors"), subject to certain exceptions. The 8.25% Senior Unsecured Notes and the Note Guarantees (as defined in the indentures) are SDHL's and the Note Guarantors' senior unsecured obligations and:

- 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;
- are 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

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- are structurally subordinated to all existing and future indebtedness, including 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.

The total amortization of debt issue costs during the three months ended March 31, 2019 and 2018 was \$0.5 million and \$0.2 million, respectively. The total amortization of premium during the three months ended March 31, 2019 was \$89 thousand.

(iii) Revolving Credit Facility, due April 2023

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 would 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.

After initially entering into the SDHL Revolver and until the June 4, 2018 amendment, cash borrowings under the SDHL Revolver bore 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 accrued 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.

On June 4, 2018, the Company successfully amended the SDHL Revolver that, among other things effective June 19, 2018 (i) extended the maturity date from April 30, 2020 to April 30, 2023; (ii) increased the facility from \$160 million to \$225 million; (iii) changed the Applicable Margin into a range from a maximum of 5.0% per year to a minimum of 3.0% per year for borrowings at the Adjusted LIBOR Rate and from a maximum of 4.0% per annum to a minimum of 2.0% per year for borrowings at the Alternate Base Rate; (iv) changed the total net leverage ratio (as defined in the SDHL Revolver) to not greater than 4.75:1 for any test period ending on or prior to December 31, 2019, 4.5:1 for any test period after January 1, 2020 and ending on or prior to December 31, 2020 and 4.0:1 for any test period thereafter; (v) requires the collateral rig market values to equal or exceed 140% of the aggregate amount of all revolving commitments, and (vi) SDL is now a guarantor. Additionally, in accordance with the amendment, the Applicable Margin is now calculated based on the higher of either the total net leverage ratio of SDL or the total net leverage ratio of SDHL. As of March 31, 2019, the Applicable Margin was 4.5% per year for borrowings at the Adjusted LIBOR Rate.

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On February 13, 2019, the Company executed the following amendment to the SDHL Revolver which became effective upon the closing of the Transaction (as defined in Note 14- Shareholder's Equity): (i) change the total net leverage ratio (as defined in the SDHL Revolver) to not greater than 5.0:1 for any test period ending on or prior to December 31, 2019 and December 31, 2020, and 4.0:1 for any test period thereafter; and (ii) provide restriction on dividend payments through April 30, 2023 if the total net leverage ratio exceeds 4.50:1.00.

The Company was in compliance with all covenants as of March 31, 2019 and December 31, 2018.

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.

All borrowings under the SDHL Revolver mature on April 30, 2023 and letters of credit and bank guarantees issued under the SDHL Revolver expire no later than five business days prior to April 30, 2023.

The Company issued bank guarantees and performance bonds totaling \$7.1 million and \$8.6 million as of March 31, 2019 and December 31, 2018, respectively, against the SDHL Revolver. As of March 31, 2019 and December 31, 2018, 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.

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 total unamortized debt issuance costs were \$4.6 million and \$4.8 million, as of March 31, 2019 and December 31, 2018, respectively, recorded under other assets on the condensed consolidated interim balance sheets.

The amortization of debt issuance costs on the SDHL Revolver amounted to \$0.2 million and \$0.3 million during the three months ended March 31, 2019 and 2018, respectively.

Terms Common to All Indebtedness

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

Note 10 — 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 jack-up 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

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newbuild rigs and to execute two drilling service contracts with Chevron for a period of 5 years. See Note 5 – Property and Equipment.

On June 8, 2018, the Company issued a termination notice for the obligations under the Sale and Leaseback Transactions and agreed with the Lessor to reduce the notice period from 90 days to 30 days. Upon completion of the notice period on July 9, 2018, the then remaining principal balance outstanding under the obligations under the Sale and Leaseback Transactions of \$293.5 million was paid in full. The Company recorded \$6.0 million debt extinguishment costs in interest expense and financing charges in the consolidated statements of operations for the year ended December 31, 2018, primarily related to the \$5.9 million call premium. Additionally, the related requirement for a fully funded debt reserve account was released upon the termination of the Sale and Leaseback Transactions. The associated interest rate swap was terminated on June 21, 2018. See Note 16 – Derivative Financial Instrument.

The Company made rental payments of \$13.2 million, including interest of \$4.6 million, during the three months ended March 31, 2018. There were no such transactions during the three months ended March 31, 2019.

Note 11— Employee Benefit Plans

Retirement and Savings Plans — The Company contributes between 4.5% and 8.33% of certain employees’ base salaries each month into an employee’s retirement plan. The actual percentage rate contribution of certain employees is determined by the number of years of service with the Company, including, for certain employees, the number of years of service with legacy companies. The Company has no further obligations for these retirement plans and the Company’s contributions are expensed as incurred.

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

The Company has recorded approximately \$1.6 million and \$1.5 million in expense related to its retirement and savings plan for the three months ended March 31, 2019 and 2018, 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 \$0.8 million and \$1.2 million in expense related to employee end of service plans during the three months ended March 31, 2019 and 2018, respectively.

Retention Plans — The Company has recorded approximately \$0.6 million and \$0.8 million in expense related to its employee retention plans for the three months ended March 31, 2019 and 2018, respectively. The estimated total cash payments under the retention plans in 2020 are \$3.5 million.

Note 12 — Commitments and Contingencies

Purchase Commitment – As of March 31, 2019, the Company has a commitment to acquire two premium newbuild jack-up rigs from a third party as part of the Transaction as defined in Note 21- Subsequent Events. The two rigs were delivered on May 9, 2019. See Note 21- Subsequent Events.

Legal Proceedings — The Company is involved in various claims and lawsuits in the normal course of business.

In 2018, one of the subsidiaries of the Company has filed a lawsuit in relation to one of the rigs that entered into a Bareboat Charter Agreement (“Agreement”) with Offshore Drilling Solutions Ltd. (“Original Charterer”) for the intended use of the rig under a drilling contract with Furie Operating Alaska, LLC (“Furie”) to operate and drill in Alaska. Furie, Cornucopia Oil & Gas Company LLC and Corsair Oil & Gas LLC hold the ownership interests in the said drilling wells and Furie was the operator of the wells. By a Deed of Guarantee in July 2015, Deutsche Oel und Gas (“Guarantor”), the parent company of Cornucopia Oil & Gas Company, LLC, which is the sole member and owner of Furie, guaranteed the obligations of the Charterer under the Agreement for securing the payments of future chartering costs of the Company rig by Furie.

The Company entered into the agreement with Offshore Drilling Solutions Ltd. in July 2015 which was later assigned to Kadmas Limited (“Kadmas”) in November 2015.

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Kadmas has breached the terms of this agreement by failing to pay the Company amounts owed under the Agreement. An amount of \$11.0 million plus accrued interest and all reasonable expenses, costs and attorney’s fees incurred by the Company was owed as of June 2018. In addition to this, the Company is owed an additional \$23,000 per day from July 2018 through February 2019.

Based on legal advice received, the Company filed a complaint on June 4, 2018 before the Superior Court for the State of Alaska at Anchorage, against Furie, Cornucopia Oil & Gas Company, LLC, Corsair Oil & Gas LLC and Furies’ lender, Energy Capital Partners Mezzanine Opportunities Fund, LP, (collectively “Defendants”) in relation to various alleged breaches by the Defendants. On August 16, 2018, the Company exercised its right to terminate the Agreement on account of payment default by the Original Charterer. A corresponding notice has also been issued demanding Guarantor to perform the payment obligations of Original Charterer under the Agreement. An arbitration proceeding was initiated against the Guarantor in November 2018 and the parties are in the process of constituting the arbitration tribunal. Aside from the arbitration proceedings against the Guarantor, the Company reserves the right in the future to pursue legal action against the Original Charterer. In January 2019, it was intimated that an Arbitrator had to be appointed and a case management hearing fixed for July 25, 2019 where a trial date would be fixed.

The resolution of this legal case filed by the Company is not expected to have a material impact on the results of operations as the Company has ceased revenue recognition from May 2017 for this Agreement and recorded a provision against the total outstanding receivable due from Kadmas.

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 \$79.3 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 \$50.8 million and \$52.9 million as of March 31, 2019 and December 31, 2018, respectively.

In addition, the Company had outstanding bank guarantees and performance bonds amounting to \$7.1 million and \$8.6 million as of March 31, 2019 and December 31, 2018, respectively, against the SDHL Revolver.

Therefore, the total outstanding bank guarantees and surety bonds issued by the Company were \$57.9 million and \$61.5 million as of March 31, 2019 and December 31, 2018, respectively.

Note 13 — Fair Value of Financial Instruments

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

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

	March 31, 2019		December 31, 2018	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
8.25% Senior Unsecured Notes, due February 15, 2025.....	\$ 888,151	\$ 857,592	\$ 887,764	\$ 782,757

The estimated fair value of the Company’s long-term debt was determined using quoted market prices or Level 1 inputs.

As of March 31, 2019, the estimated fair value of the 8.25% Senior Unsecured Notes excludes unamortized debt issuance costs and unamortized premium of \$14.6 million and \$2.7 million, respectively, and as of December 31, 2018, \$15.1 million and \$2.8 million, respectively. See Note 9 – Debt.

Derivative financial instruments were measured at fair value on a recurring basis using Level 2 inputs. See Note 16 – Derivative Financial Instruments.

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Note 14 — Shareholders' Equity

Authorized share capital and issued and outstanding shares

In April 2017, the Company 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. In connection with the Private Placement, the previously existing classes A, B, C and D ordinary shares were repurchased and retired with a new single class of 55,000,000 common shares. On May 5, 2017, the new common shares issued in the Private Placement were quoted on the Norwegian over-the-counter ("OTC") under the symbol "SHLF". After the Private Placement, the total number of outstanding common shares was 83,125,000.

On June 25, 2018, the Company successfully completed an initial public offering of 28,125,000 new common shares at approximately \$8 per share for total gross proceeds of \$226.9 million (the "Offering" or "IPO"). The incremental direct costs of the Offering were \$10.7 million, resulting in approximately \$216.2 million of net proceeds. The Offering proceeds were used to redeem all outstanding preferred shares and the remainder was used to assist in the acquisition of one premium jack-up drilling rig from a third party. As a result of the consummation of the Offering, the Company amended the Articles of Association (the "Articles") to reduce the authorized share capital to 144,063,473 common shares with a par value of \$0.01 per share.

On June 25, 2018, following the completion of the Offering, the 28,125,000 shares issued in the Private Placement were delisted from the OTC market and together with the 28,125,000 Offering shares were registered in the Norwegian Central Securities Depository (VPS) and listed on Oslo Børs ASA under the symbol SHLF.

During the three months ended March 31, 2019, there was no issuance or forfeitures of common shares. During the three months ended March 31, 2018, there was no issuance of common shares and 9,606 common shares (4,428 time-based restricted shares and 5,178 performance-based restricted shares) issued under share-based compensation plans were forfeited for nil consideration.

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, 2019 and 2018.

During May 2019, the Company successfully issued 26,769,230 common shares for the purchase of the two premium newbuild CJ46 jack-up rigs. See Note 21 – Subsequent Events.

Note 15 — Share-based Compensation

Restricted shares

Until June 2018, the Company had a share-based compensation plan under which it had issued time-based and performance-based restricted shares. These 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 shares typically vest and are recorded as compensation expense in equal proportion over a five-year required service period from the date of grant or upon IPO. Compensation expense related to the grant date fair value of the performance-based shares would be recognized upon vesting or upon IPO. As a result of the Offering, all shares under the share-based compensation plan were vested. The shares are non-transferable and such transfer restrictions will lapse ratably over three years, at one-year intervals beginning twelve months after the IPO.

The Company has recorded share-based compensation expense related to the share-based compensation plan of \$0.2 million during the three months ended March 31, 2018. There was no such transaction during the three months ended March 31, 2019. No income tax benefit was recognized for these plans.

2017 Long term Incentive Plan

The Company has adopted the 2017 Long-Term Incentive Plan (the "2017 LTIP") effective June 25, 2018, to provide for the issuance of share options, restricted shares, deferred shares, share units, unrestricted shares and cash-based awards (the "awards"). Under the 2017 LTIP, there are 14,400,000 shares (approximately 10% of authorized share capital) reserved for issuance as awards to certain officers, non-employee directors and key employees who are in a position to contribute significantly to the Company's long-term performance and growth. As of March 31, 2019 and December 31, 2018, there were 14.4 million shares

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available for issuance as awards under the 2017 LTIP. Awards may be satisfied by newly issued shares, including shares held by a subsidiary or by delivery of shares held in an affiliated employee benefit trust at the Company's discretion.

There were no new grants under this plan during the three months ended March 31, 2019. In November 2018, the Company granted 14,611 Restricted Share Units (RSUs) to the chairman of the Board of Directors. The RSUs are accounted for as equity awards and will vest on the first anniversary of the grant date, subject to acceleration for change in control, as set forth in the terms of the grant. Fair value of restricted share units is based on the market price of the shares on the date of grant. Compensation expense is recognized on a straight-line basis over the requisite service period of one year. During the requisite service period, the restricted share units may not be sold or transferred and are subject to forfeiture. The restricted share unit holder has the right to receive dividend equivalents but does not have the rights of a shareholder until the shares are issued. The dividend equivalents will be forfeited if the RSUs are forfeited before vesting.

During the three months ended March 31, 2019, the total grant value of the restricted share units vested was nil. The Company has recorded share-based compensation expense related to the 2017 LTIP plan of \$21 thousand during the three months ended March 31, 2019. As of March 31, 2019, the total unrecognized compensation cost related to non-vested restricted share units was \$0.1 million and is expected to be recognized over a weighted average period of one year. There were no such transactions during the three months ended March 31, 2018.

Note 16 — Derivative Financial Instruments

Foreign Currency Forward Exchange Contracts

The Company may enter into forex contracts when management believes that market conditions are favorable to purchase contracts for future settlement with the expectation that such contracts, when settled, will reduce the exposure to foreign currency gains and losses on future foreign currency expenditures. The amount and duration of such contracts are based on the monthly forecast of expenditures in 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 included in the assessment of hedge effectiveness is recognized in other comprehensive income.

During the three months ended March 31, 2019 and 2018, the Company settled forex contracts with aggregate notional values of approximately \$3.5 million and \$3.7 million, respectively, of which the aggregate amounts were designated as an accounting hedge.

As of March 31, 2019, the estimated amount of net unrealized gains associated with the forex contracts that will be reclassified to earnings during the remaining term of the contracts 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.

In March 2018, the Company entered into interest rate swaps with aggregate notional values of approximately \$407.0 million, of which the aggregate amounts were designated as an accounting hedge. As a result of the full payment and termination of the obligations under the sale and leaseback transactions in July 2018, the Company terminated the interest rate swaps on June 21, 2018 and recognized a gain of \$0.3 million in Other, net in the consolidated statements of operation during the quarter ended June 30, 2018. There were no such transactions during the three months ended March 31, 2019.

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, 2019 and 2018 (in thousands). The gain / (loss) reclassified from AOCIL is recorded

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under operating and maintenance expense for forex contracts and under interest expense and financing charges for interest rate swaps.

	Unrealized gain / (loss) recognized through AOCIL	
	Three months ended March 31,	
	2019	2018
Cash flow hedges		
Foreign currency forward contracts.....	\$ 73	\$ (268)
Interest rate swaps.....	-	(300)
	<u>\$ 73</u>	<u>\$ (568)</u>

	Statement of operation classification	(Gain) / loss reclassified from AOCIL	
		Three months ended March 31,	
		2019	2018
Cash flow hedges			
Foreign currency forward contracts.....	Operating and maintenance	\$ (96)	\$ 27
Interest rate swaps.....	Interest expense and financing charges	-	71
		<u>\$ (96)</u>	<u>\$ 98</u>

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,	December 31,
		2019	2018
Asset derivatives			
Short-term foreign currency forward contracts.....	Other current assets	\$ 220	\$ 243

Note 17 — Supplemental Cash Flow Information

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,	
	2019	2018
Regulatory and capital maintenance.....	\$ 14,305	\$ 5,682
Contract preparation.....	8,630	3,100
Fleet spares and others.....	(897)	1,600
	<u>\$ 22,038</u>	<u>\$ 10,382</u>
Rig acquisitions.....	4,887	6,788
Total capital expenditures and deferred costs.....	<u>\$ 26,925</u>	<u>\$ 17,170</u>

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):

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	Three months ended March 31,	
	2019	2018
Cash payments for additions to property and equipment.....	\$ 11,182	\$ 9,309
Net change in accrued but unpaid additions to property and equipment.....	(1,796)	(4,424)
Total capital expenditures.....	\$ 9,386	\$ 4,885
Changes in deferred costs, net.....	\$ (610)	\$ (6,723)
Add: Amortization of deferred costs.....	18,149	19,008
Total deferred costs.....	\$ 17,539	\$ 12,285
Total capital expenditures and deferred costs.....	\$ 26,925	\$ 17,170

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):

	As of December	As of March 31,	
	31, 2018	2019	2018
Cash and cash equivalents.....	\$ 91,203	\$ 69,886	\$ 120,598
Restricted cash included in other current assets.....	1,598	1,253	690
Restricted cash included in other assets.....	34	35	13,993
Total cash, cash equivalents and restricted cash.....	\$ 92,835	\$ 71,174	\$ 135,281

Note 18 — Loss Per Share

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

	Three months ended March 31,	
	2019	2018
Common Shares		
Numerator for loss per share		
Net loss.....	\$ (13,600)	\$ (38,517)
Less: Preferred shares dividend.....	-	4,495
Net loss attributable to common shares.....	\$ (13,600)	\$ (43,012)
Denominator for loss per share		
Weighted average shares:		
Basic outstanding per Class.....	111,240,394	81,651,566
Diluted per Class.....	111,240,394	81,651,566
Basic loss per share per Class.....	\$ (0.12)	\$ (0.53)
Diluted loss per share per Class.....	\$ (0.12)	\$ (0.53)

The restricted share units awarded in November 2018 contain forfeitable rights to dividends, therefore would not be considered as participating securities for purposes of computing earnings per share. The restricted share units do not represent ordinary shares outstanding until they are vested and converted into ordinary shares. See Note 15 – Share-based Compensation.

For the three months ended March 31, 2019 and 2018, there were nil and 130,656 dilutive common 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.

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Note 19 — 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,	
	2019	2018
Saudi Arabia.....	\$ 42,240	\$ 44,775
Thailand	28,555	29,134
Nigeria	27,905	15,303
United Arab Emirates.....	18,144	20,213
India	15,541	25,336
Other countries	14,852	12,749
As Reported Revenue.....	\$ 147,237	\$ 147,510

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

Total long-lived assets, net of impairment, depreciation and amortization 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,
	2019	2018
Thailand.....	\$ 426,806	\$ 429,938
United Arab Emirates.....	304,987	303,068
Nigeria.....	181,588	183,883
Saudi Arabia.....	179,961	190,001
India.....	83,698	86,607
Other countries.....	166,052	161,342
Total long-lived assets	\$ 1,343,092	\$ 1,354,839

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. As of March 31, 2019 and December 31, 2018, the long-lived assets in the UAE include \$81.9 million and \$77.9 million, respectively, relating to the premium jack-up rig acquired in 2018 currently under reactivation. See Note 5 – Property and Equipment. 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 20 — 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 during the three months ended March 31, 2019 and 2018, respectively. The total liability recorded under accounts payable for such transactions were \$0.8 million and \$0.8 million as of March 31, 2019 and December 31, 2018, respectively.

The Company recorded \$0.4 million and \$1.4 million for the three months ended March 31, 2019 and 2018, respectively, of Sponsors' costs related to the \$0.4 million monthly fee which was discontinued upon the consummation of the Offering, 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 was \$0.1 million and \$0.2 million as of March 31, 2019 and December 31, 2018, respectively.

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Note 21 — Subsequent Events

The Company has evaluated subsequent events through May 15, 2019, the date of issuance of the condensed consolidated interim financial statements.

On February 21, 2019, the Company entered into agreements with affiliates of China Merchants & Great Wall Ocean Strategy & Technology Fund (“China Merchants”), to acquire two premium newbuild CJ46 jack-up rigs which will be paid through the issuance of new common shares and to bareboat charter two additional premium newbuild CJ46 jack-up rigs, including an option to buy either of the rigs during the initial term (the “Transaction”). The bareboat charters will commence in August 2019, subject to the completion of the two rig purchases and issuance of new common shares.

The Transaction closed on May 9, 2019 through the issuance of 26,769,230 new common shares, representing 19.4% of the then total outstanding common shares of the Company, and acquisition of two premium newbuild jack-up rigs. This will make China Merchants the largest shareholder.

The Company determined that no additional subsequent events had occurred that would require recognition in these financial statements and all material subsequent events that require disclosure have been disclosed.

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 equivalent and the audited consolidated financial statements included in our Annual Report for the year ended December 31, 2018. Unless otherwise indicated, references to "we", "us", "our" and the "Company" refer collectively to the Company.

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 Drilling," "SDL", the "Company", "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, 2018 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 375 feet and as of March 31, 2019, own 36 independent-leg cantilever (“ILC”) jack-up rigs, three 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 shallow water 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 and West Africa. As of March 31, 2019, our largest shareholders are affiliates of Castle Harlan, Inc., CHAMP Private Equity and Lime Rock Partners. Since June 25, 2018, SDL shares are listed on the Oslo Stock Exchange under the ticker symbol SHLF. Our website address is www.shelfdrilling.com.

Recent events

On February 21, 2019, the Company entered into agreements with affiliates of China Merchants & Great Wall Ocean Strategy & Technology Fund (“China Merchants”), to acquire two premium newbuild CJ46 jack-up rigs through the issuance of new common shares and to bareboat charter two additional premium newbuild CJ46 jack-up rigs, including an option to buy either of the rigs during the initial term (the “Transaction”). The bareboat charters will commence in August 2019, subject to the completion of the two rig purchases and issuance of new common shares. The Transaction closed on May 9, 2019 through the issuance of 26,769,230 new common shares, representing 19.4% of the then total outstanding common shares of the Company, making China Merchants the largest shareholder.

Drilling fleet

The following table summarizes the Company’s offshore drilling rigs as of March 31, 2019 and 2018:

	As of March 31,	
	2019	2018
Jack-ups.....	36	38
Swamp barge.....	1	1
Total	37	39

Subsequent to March 31, 2018, the Company added one premium jack-up drilling rig to its drilling fleet, and sold three rigs which were stacked and not being marketed for contract drilling.

The premium jack-up rig acquired in 2018 was undergoing reactivation as of March 31, 2019. Two of the rigs disposed were reported as held for sale in December 2018. See Note 6 – Assets held for sale in the condensed consolidated interim financial statements included in “Item 1. Financial Statements” of “Part I. Financial Information”.

Outlook

Following a severe, multi-year downturn in the offshore drilling industry, there are indications across our markets of significant improvement for jack-up rig services. Brent crude oil prices, a key driver of exploration, development and production activity, increased from a low of \$27.88 per barrel on January 20, 2016 to \$86.07 per barrel on October 4, 2018 but fell later in the fourth quarter of 2018 to as low as \$50.57 per barrel. However, in early 2019 the Brent crude oil prices have rallied and stabilized in the \$60 to \$70 per barrel range. We believe current price levels combined with the lack of investment in new development projects over the past four years will stimulate an increase in offshore activity. Furthermore, we expect that dayrates and utilization will recover more quickly for jack-up rigs than deepwater rigs due to the lower breakeven prices and shorter cycle times for many workover and development programs in shallow water basins.

The global number of contracted jack-up rigs has begun to increase, growing by 15% from 311 rigs in January 2017 to 357 rigs in May 2019, and there has been an acceleration of activity since early 2018, which has the potential to result in a continued increase in the global number of contracted rigs. In the past twelve months, the contracted rig count has increased in nearly every major jack-up region. The only exception is in India, where we anticipate at least ten long-term contracts will be awarded before the end of 2019. In addition, we expect multi-rig tenders will be awarded in the coming months in the Middle East and Mexico by large national oil companies and activity to further increase in West Africa and Southeast Asia.

Price competition among both international and regional jack-up rig contractors continues to be intense and market dayrates remain at low levels. However, we believe there is reason for optimism as day rates have started to increase for certain assets and in certain regions.

We believe that we are well positioned to benefit from a potential increase in demand for jack-up rig services due to our operating track record, our competitive low-cost structure and our existing geographic footprint. We remain focused on delivering safe and efficient operations, as well as realizing cost savings and efficiency gains across all levels of the organization. With the closing of the Transaction with China Merchants, we add four newbuild premium jack-up rigs to our fleet which further strengthens our competitive position and will create compelling contracting opportunities in an improving jack-up market.

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 may also include 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 \$0.9 billion across 26 contracted rigs with a weighted average backlog dayrate of \$70 thousand per day and average contracted days of 484 per rig as of March 31, 2019, compared with \$1.2 billion across 27 contracted rigs with a weighted average dayrate of \$78.3 thousand per day and average contracted days of 549 per rig as of March 31, 2018.

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

As of March 31, 2019, 33 rigs were marketable (of which 26 were under contract and seven were actively being marketed) and four rigs were stacked compared to 35 marketable rigs (of which 26 were under contract and nine were actively being marketed), one rig under non-drilling contract and three stacked rigs as of March 31, 2018.

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, 2019 was \$ 63.5 thousand, a decrease of 9.7% from the average dayrate of \$70.3 thousand realized for the three months ended March 31, 2018.

Effective utilization: Effective utilization measures the dayrate revenue efficiency of our marketable rigs. This is the number of calendar days during which marketable rigs generate dayrate revenue divided by the maximum number of calendar days during which those rigs could have generated dayrate revenue. Effective 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 effective utilization.

Effective utilization in Q1 2019 of 75% was higher than the marketed utilization in Q1 2018 of 63%. The increase was primarily driven by the effective utilization of our three acquired rigs. There were seven rigs idle awaiting marketing opportunities at the end of Q1 2019 compared to nine rigs at the end of Q1 2018.

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, 2019 and 2018 were as follows (in thousands):

	Three months ended March 31,	
	2019	2018
Net loss.....	\$ (13,600)	\$ (38,517)
Add back:		
Interest expense and financing charges, net of interest income ⁽¹⁾	19,840	38,777
Income tax expense.....	1,256	4,658
Depreciation.....	20,352	21,868
Amortization of deferred costs.....	18,149	19,008
Gain on disposal of assets.....	(2,867)	(120)
EBITDA	\$ 43,130	\$ 45,674
Acquired rig reactivation costs ⁽²⁾	6,163	1,970
One-time corporate transaction costs ⁽³⁾	99	-
Sponsors' fee ⁽⁴⁾	-	1,125
Share-based compensation expense, net of forfeitures.....	-	202
Adjusted EBITDA	\$ 49,392	\$ 48,971
Adjusted EBITDA margin	33.5%	33.2%

- (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 interest income. This also includes the losses on debt extinguishments in relation to our debt refinancing transactions in 2018.
- (2) 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.
- (3) Represent certain one-time third-party professional services.
- (4) Represents the fee to the Sponsors in respect of their role as advisors to us until the Offering date.

As a result of the termination of the SDA Facility in June 2018, Shelf Drilling Asset III, Ltd. (“SDAIII”), which owns two rigs acquired in 2017, became a restricted subsidiary and guarantor of the 8.25% Senior Unsecured Notes on June 19, 2018. Additionally, as a result of the \$300 million tack-on issuance of 8.25% Senior Unsecured Notes in June 2018 and subsequent payoff and termination of the sale and leaseback obligations, all subsidiaries related to the Newbuild Rigs (“Newbuild Subsidiaries”) also became restricted subsidiaries and guarantors of the 8.25% Senior Unsecured Notes as of July 9, 2018. Inclusive of SDAIII and the Newbuild Subsidiaries, our restricted subsidiaries accounted for 100% of our Adjusted EBITDA for the three months ended March 31, 2019. For the three months ended March 31, 2018, the Company’s unrestricted subsidiaries accounted for \$15.3 million (31.2%) of the Company’s Adjusted EBITDA.

Inclusive of SDAIII and the Newbuild Subsidiaries, our restricted subsidiaries accounted for 100% of our assets as of March 31, 2019 and December 31, 2018.

Operating Results

Three months ended March 31, 2019 (“Q1 2019”) compared to three months ended March 31, 2018 (“Q1 2018”)

Revenues

Total revenue for Q1 2019 was \$147.2 million compared to \$147.5 million for Q1 2018. Revenue for Q1 2019 consisted of \$142.9 million (97.1%) of operating revenue and \$4.3 million (2.9%) of other revenue. In Q1 2018, these same revenues were \$144.6 million (98.0%) and \$2.9 million (2.0%), respectively.

Revenue in Q1 2019 decreased by \$0.3 million compared to Q1 2018 primarily due to \$4.1 million lower revenue resulting from lower average earned dayrates for our fleet (excluding the three acquired rigs in 2017) and \$1.4 million lower recharges and amortization of mobilization revenue, partly offset by \$5.2 million of higher operating revenue due to the operations of the three premium jack-up drilling rigs acquired in 2017.

Operating and maintenance expenses

Total operating and maintenance expenses for Q1 2019 were \$92.2 million, or 62.6% of total revenue, compared to \$90.3 million, or 61.2% of total revenue, for Q1 2018. Operating and maintenance expenses in Q1 2019 consisted of \$83.7 million rig-related expenses and \$8.5 million shore-based expenses. In Q1 2018, these same expenses were \$81.7 million and \$8.6 million, respectively.

In Q1 2019, rig-related expenses included \$47.4 million for personnel expenses, \$32.0 million for rig maintenance expenses and \$4.3 million for other rig-related expenses. This compares to \$47.5 million, \$21.7 million and \$12.5 million for those respective categories during Q1 2018. Compared to Q1 2018, the increase in rig-related expenses of \$2.0 million was due to \$7.5 million of costs for the reactivation of the premium jack-up drilling rig acquired in July 2018, \$4.2 million of contract preparation and operating expenses for rigs that were idle in 2018 but preparing for contract or operating in 2019 and \$1.2 million higher maintenance and shipyard expenses. This was partly offset by \$4.1 million of cost savings in personnel and other operating costs, \$4.0 million lower expenses for stacked and idle rigs awaiting marketing opportunities and \$2.8 million of lower rig mobilization costs.

Shore-based expenses for the three months end March 31, 2019 were in line with the same period in 2018.

Depreciation expense

Depreciation expense in Q1 2019 was \$20.4 million compared to \$21.9 million in Q1 2018. The decrease of \$1.5 million primarily related to \$1.1 million lower depreciation on drilling rigs and equipment which were impaired in 2018.

Amortization of deferred costs

The amortization of deferred costs in Q1 2019 was \$18.1 million compared to \$19.0 million in Q1 2018. The \$0.9 million decrease primarily related to lower amortization on drilling rigs and equipment which were impaired in 2018.

General and administrative expenses

General and administrative expenses in Q1 2019 were \$11.6 million compared to \$12.6 million in Q1 2018. The \$1.0 million decrease resulted from the \$1.1 million decrease in Sponsor’s fee.

Gain on disposal of assets

Gain on disposal of assets was \$2.9 million and \$0.1 million in Q1 2019 and Q1 2018, respectively. The increase in gain on disposal of assets in Q1 2019 was due to sale of the two stacked rigs during Q1 2019.

Other (expense) / income, net

Other (expense) / income, net was an expense of \$20.1 million in Q1 2019 and \$37.7 million in Q1 2018. Other expense consisted primarily of interest expense and financing charges of \$20.2 million and \$39.0 million during Q1 2019 and Q1 2018, respectively. Interest expense and financing charges in Q1 2019 were \$18.8 million lower compared to Q1 2018 primarily due to \$19.0 million lower loss on debt extinguishment associated with the refinancing of our debt in Q1 2018 and \$4.6 million lower interest on the sale & leaseback financing facility due to its early termination in July 2018. This was partly offset by \$4.9 million higher interest on the Unsecured Notes mainly as a result of the \$300 million additional Notes issuance in June 2018.

Also included in the Other (expense) / income, net is Other, net which was an expense of \$0.3 million in the three months ended March 31, 2019 compared to a gain of \$1.0 million in the three months ended March 31, 2018. The difference of \$1.2 million was mainly due to foreign currency exchange losses in Q1 2019. The interest income of \$0.4 million in the three months ended March 31, 2019 increased by \$0.2 million compared to the same period in 2018 primarily due to an increase in interest rates and higher cash pool balances.

Income tax expense

Income tax expense in Q1 2019 was \$1.3 million compared to \$4.7 million in Q1 2018. 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 2019 is lower than in 2018 primarily due to tax benefits of approximately \$3.0 million in 2019 related to the release of certain tax reserves.

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, cash generated from issuance of long-term debt and equity and availability under our revolver. 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 \$69.9 million and \$91.2 million in cash and cash equivalents as of March 31, 2019 and December 31, 2018, respectively. Under the SDHL Revolver, we had \$7.1 million and \$8.6 million of surety bonds issued as of March 31, 2019 and December 31, 2018, 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.

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, 2019 and 2018 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, 2019 and 2018 (in thousands):

	Three months ended March 31,	
	2019	2018
Net cash used in operating activities.....	\$ (15,292)	\$ (9,627)
Net cash used in investing activities.....	(6,222)	(9,018)
Net cash (used in) / provided by financing activities.....	(147)	54,100
Net (decrease) / increase in cash, cash equivalents and restricted cash.....	\$ (21,661)	\$ 35,455

Net cash used in operating activities

Net cash used in operating activities totaled \$15.3 million in Q1 2019 compared to \$9.6 million in Q1 2018. The decrease of \$5.7 million was primarily due to an increase in reactivation and contract preparation costs. See discussion of operating costs in “—Results of operations.”

During the three months ended March 31, 2019 and 2018, we made cash payments of \$38.9 million and \$20.0 million in interest and financing charges, respectively, included under “other operating assets and liabilities, net”.

We also made cash payments of \$3.9 million and \$3.7 million in income taxes included under “other operating assets and liabilities, net” during the three months ended March 31, 2019 and 2018, respectively.

Net cash used in investing activities

Net cash used in investing activities in Q1 2019 totaled \$6.2 million compared to \$9.0 million in Q1 2018.

Cash used for capital expenditures totaled \$11.2 million in Q1 2019 and \$9.3 million in Q1 2018. The increase was primarily related to an increase in reactivation and shipyard costs.

The net proceeds from disposal of assets increased by \$4.7 million mainly due to the \$4.9 million net proceeds received in Q1 2019 for the sale of two stacked rigs.

Net cash (used in) / provided by financing activities

Net cash (used in) / provided by financing activities totaled \$(0.1) million in Q1 2019 compared to \$54.1 million in Q1 2018.

The decrease of \$54.2 million was primarily due to the decrease in retirement of long-term debt of \$533.2 million (retirement in 2018 of \$502.8 million 9.5% Senior Secured Notes and \$30.4 million 8.625% Senior Secured Notes), the decrease in principal payments for the sale and leaseback transactions of \$8.7 million, the decreased payments for debt financing and extinguishment costs of \$22.1 million and the decreased payment for preferred shares dividends of \$8.9 million in 2018, partly offset by the issuance of debt for \$625.0 million (resulting from the issuance of the \$600 million 8.25% Senior Unsecured Notes and \$25.0 million draws on the SDA Facility).

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, 2019 and 2018 (in thousands):

	Three months ended March 31,	
	2019	2018
Regulatory and capital maintenance ⁽¹⁾	\$ 14,305	\$ 5,682
Contract preparation ⁽²⁾	8,630	3,100
Fleet spares and other ⁽³⁾	(897)	1,600
	\$ 22,038	\$ 10,382
Rig acquisitions ⁽⁴⁾	4,887	6,788
Total capital expenditures and deferred costs	\$ 26,925	\$ 17,170

- (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.
- (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 and subsequent reactivation of premium jack-up rigs acquired in 2018 and 2017, and the acquisition of newbuild premium jack-up rigs in 2019.

Capital expenditures and deferred costs totalled \$26.9 million in Q1 2019 compared to \$17.2 million Q1 2018. The increase of \$9.7 million was primarily due a \$6.1 million increase in expenditures for regulatory and capital maintenance as well as fleet spares, a \$5.5 million increase in contract preparation expenditures and a \$0.9 million increase in newbuilds resulting from the acquisition of the two premium CJ46 jack-up rigs which were delivered in May 2019. This was partly offset by the \$2.8 million decrease in rig acquisitions resulting from the \$4.0 million reactivation costs in Q1 2019 of the premium jack-up drilling rig acquired in 2018, compared to the \$6.8 million reactivation costs in Q1 2018 for the three rigs acquired in 2017.

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, 2019 and 2018 (in thousands):

	Three months ended March 31,	
	2019	2018
Cash payments for additions to property and equipment.....	\$ 11,182	\$ 9,309
Net change in accrued but unpaid additions to property and equipment.....	(1,796)	(4,424)
Total capital expenditures	\$ 9,386	\$ 4,885
Changes in deferred costs, net.....	\$ (610)	\$ (6,723)
Amortization of deferred costs.....	18,149	19,008
Total deferred costs.....	\$ 17,539	\$ 12,285
Total capital expenditures and deferred costs.....	\$ 26,925	\$ 17,170

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, 2019 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, 2019

Condensed Consolidated Interim Statements of Operations for the three months ended March 31, 2019

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
Revenues			
Operating revenues	\$ 142,910	\$ -	\$ 142,910
Other revenue	4,327	-	4,327
	<u>147,237</u>	<u>-</u>	<u>147,237</u>
Operating costs and expenses			
Operating and maintenance	92,244	-	92,244
Depreciation	20,352	-	20,352
Amortization of deferred costs	18,149	-	18,149
General and administrative	11,587	(23)	11,564
Gain on disposal of assets	(2,867)	-	(2,867)
	<u>139,465</u>	<u>(23)</u>	<u>139,442</u>
Operating income	7,772	23	7,795
Other (expense) / income, net			
Interest income	368	-	368
Interest expense and financing charges	(20,208)	-	(20,208)
Other, net	(276)	-	(276)
	<u>(20,116)</u>	<u>-</u>	<u>(20,116)</u>
Loss before income taxes	(12,344)	23	(12,321)
Income tax expense	1,256	-	1,256
Net loss attributable to common shares	<u>\$ (13,600)</u>	<u>\$ 23</u>	<u>\$ (13,577)</u>

Condensed Consolidated Interim Balance Sheets as of March 31, 2019

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
Assets			
Cash and cash equivalents	\$ 69,886	\$ (208)	\$ 69,678
Accounts and other receivables, net ⁽¹⁾	120,918	391	121,309
Assets held for sale	2,479	-	2,479
Other current assets ⁽²⁾	80,975	(391)	80,584
Total current assets	<u>274,258</u>	<u>(208)</u>	<u>274,050</u>
Property and equipment	1,646,164	-	1,646,164
Less accumulated depreciation	442,421	-	442,421
Property and equipment, net	<u>1,203,743</u>	<u>-</u>	<u>1,203,743</u>
Deferred tax assets	2,294	-	2,294
Other assets	124,275	-	124,275
Total assets	<u>\$ 1,604,570</u>	<u>\$ (208)</u>	<u>\$ 1,604,362</u>
Liabilities and equity			
Accounts payable	\$ 70,760	\$ -	\$ 70,760
Interest payable	9,488	-	9,488
Accrued income taxes	5,725	-	5,725
Other current liabilities	17,733	-	17,733
Total current liabilities	<u>103,706</u>	<u>-</u>	<u>103,706</u>
Long-term debt	888,151	-	888,151
Deferred tax liabilities	4,475	-	4,475
Other long-term liabilities	30,583	-	30,583
Total long-term liabilities	<u>923,209</u>	<u>-</u>	<u>923,209</u>

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
Commitments and contingencies			
Common shares ⁽³⁾	1,112	(1,112)	-
Additional paid-in capital ⁽⁴⁾	880,841	(90,768)	790,073
Accumulated other comprehensive income	220	-	220
Accumulated losses ⁽⁵⁾	(304,518)	91,672	(212,846)
Total equity	<u>577,655</u>	<u>(208)</u>	<u>577,447</u>
Total liabilities and equity	\$ 1,604,570	\$ (208)	\$ 1,604,362

- (1) On February 21, 2019 we announced the signing of definitive agreements with affiliates of China Merchants to acquire two newbuild CJ46 rigs and bareboat charter a further two with options to buy one or both through the initial contract term of three years (“Transaction”). This adjustment primarily relates to legal and accounting fees paid by SDHL on behalf of SDL.
- (2) This adjustment primarily relates to the accrual of third party professional services for the Transaction recorded at the SDL level.
- (3) This adjustment reflects the total number of outstanding shares of 111,240,394 with a par value of \$0.01 per share.
- (4) 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.
- (5) This adjustment primarily relates to the Midco term loan interest expense and financing charges, 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, 2019

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
Cash flows from operating activities			
Net loss	\$ (13,600)	\$ 23	\$ (13,577)
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation.....	20,352	-	20,352
Gain on derivative financial instruments, net	(96)	-	(96)
Reversal of doubtful accounts, net	(31)	-	(31)
Amortization of deferred revenue	(1,337)	-	(1,337)
Share-based compensation expense, net of forfeitures / Capital contribution by Parent share-based compensation ⁽¹⁾	21	(21)	-
Amortization of debt issue costs and premium.....	663	-	663
Gain on disposal of assets.....	(2,867)	-	(2,867)
Deferred tax expense, net	768	-	768
Proceeds from settlement of derivative financial instruments, net	96	-	96
Changes in deferred costs, net.....	610	-	610
Changes in operating assets and liabilities			
Intercompany receivables ⁽²⁾	-	(359)	(359)
Other operating assets and liabilities, net ⁽³⁾	(19,871)	391	(19,480)
Net cash used in operating activities	<u>(15,292)</u>	<u>34</u>	<u>(15,258)</u>
Cash flows from investing activities			
Additions to property and equipment.....	(11,182)	-	(11,182)
Proceeds from disposal of property and equipment	4,960	-	4,960
Net cash used in investing activities	<u>(6,222)</u>	<u>-</u>	<u>(6,222)</u>
Cash flows from financing activities			
Payments of debt extinguishment and retirement costs	(147)	-	(147)
Net cash used in financing activities.....	<u>(147)</u>	<u>-</u>	<u>(147)</u>
Net decrease in cash, cash equivalents and restricted cash	(21,661)	34	(21,627)
Cash, cash equivalents and restricted cash at beginning of period	92,835	(242)	92,593
Cash, cash equivalents and restricted cash at end of period	\$ 71,174	\$ (208)	\$ 70,966

- (1) This adjustment primarily relates to share-based compensation expense recorded at SDL level.
- (2) This adjustment primarily relates to settlement of the intercompany receivable balance between SDL and SDHL during the three months ended March 31, 2019.
- (3) The adjustment relates to certain professional service expenses, including accounting fees incurred in connection with the preparation of SDL financial statements.

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, 2019 (in thousands):

	Years ending December 31,						
	Remaining 2019	2020	2021	2022	2023	Thereafter	Total
Debt repayment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 900,000	\$ 900,000
Interest on debt (1)	58,261	77,682	77,682	77,682	74,533	83,531	449,371
Operating lease obligations (2)	5,982	12,964	15,124	11,136	251	17	45,474
Total	\$ 64,243	\$ 90,646	\$ 92,806	\$ 88,818	\$ 74,784	\$ 983,548	\$ 1,394,845

- (1) Includes commitments fees on our revolver assuming no change in the undrawn balance.
- (2) Includes imputed interest of \$5.3 million and additional operating leases that have not yet commenced of \$28.9 million. See Note 7- Leases in the condensed consolidated interim financial statements included in “Item 1. Financial Statements” of “Part I. Financial Information”.

As of March 31, 2019, The Company has a purchase obligation to acquire two premium newbuild jack-up rigs from a third party as part of the Transaction as defined in Note 21- Subsequent Events. The two rigs were delivered on May 9, 2019. See Note 21- Subsequent Events in the condensed consolidated interim financial statements included in “Item 1. Financial Statements” of “Part I. Financial Information”.

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 \$79.3 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 \$50.8 million and \$52.9 million at March 31, 2019 and December 31, 2018, respectively.

In addition, we had outstanding bank guarantees and performance bonds amounting to \$7.1 million and \$8.6 million as of March 31, 2019 and December 31, 2018, respectively, against the SDHL Revolver.

Therefore, the total outstanding bank guarantees, and surety bonds issued by the Company were \$57.9 million and \$61.6 million as of March 31, 2019 and December 31, 2018, respectively.

Contingencies

As of March 31, 2019, 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. See Note 8 - Income Taxes and Note 12 - 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 and Estimates" in Part II of our Form 10-K Equivalent for the year ended December 31, 2018. During the three months ended March 31, 2019, 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 leases. *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 debt under our revolver. 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.

We maintain documented policy and procedures to monitor and control the use of the derivative instrument. 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 make an advance payment or issue a bank guarantee in our favor to cover the risk of non-payment under drilling contracts.

An allowance for doubtful accounts is established when receivables are outstanding for more than one year or 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 \$2.7 million as of March 31, 2019 and December 31, 2018.

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 12 – 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 Form 10-K Equivalent for the year ended December 31, 2018.

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.