

**SHELF DRILLING, LTD.**  
**INDEX TO INTERIM REPORT**  
**SIX MONTHS ENDED JUNE 30, 2019 AND 2018**  
**(UNAUDITED)**

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**SHELF DRILLING, LTD.  
SIX MONTHS ENDED JUNE 30, 2019 AND 2018  
(UNAUDITED)**

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**



## Report of Independent Auditors

To the board of directors and shareholders 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 June 30, 2019, and the related condensed consolidated interim statements of operations and comprehensive income for the three-month and six-month periods ended June 30, 2019 and 2018 and the condensed consolidated interim statements of equity and cash flows for the six-month periods ended June 30, 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 Shelf Drilling, Ltd. and its subsidiaries as of December 31, 2018, and the related consolidated statements of operations, comprehensive income, equity and cash flows 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 interim 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  
August 7, 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)

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
<b>Revenue</b>				
Operating revenues.....	\$ 133,942	\$ 149,049	\$ 276,852	\$ 293,653
Other revenues.....	3,135	3,466	7,462	6,372
	<u>137,077</u>	<u>152,515</u>	<u>284,314</u>	<u>300,025</u>
<b>Operating costs and expenses</b>				
Operating and maintenance.....	90,931	87,233	183,175	177,503
Depreciation.....	20,324	21,809	40,676	43,677
Amortization of deferred costs.....	19,101	21,428	37,250	40,435
General and administrative.....	11,989	26,827	23,576	39,434
Loss on impairment of assets.....	-	1,137	-	1,137
Loss / (gain) on disposal of assets.....	965	361	(1,902)	241
	<u>143,310</u>	<u>158,795</u>	<u>282,775</u>	<u>302,427</u>
<b>Operating (loss) / income.....</b>	<b>(6,233)</b>	<b>(6,280)</b>	<b>1,539</b>	<b>(2,402)</b>
<b>Other (expense) / income, net</b>				
Interest income.....	362	497	730	680
Interest expense and financing charges.....	(20,030)	(27,124)	(40,238)	(66,084)
Other, net.....	(196)	(138)	(472)	901
	<u>(19,864)</u>	<u>(26,765)</u>	<u>(39,980)</u>	<u>(64,503)</u>
<b>Loss before income taxes.....</b>	<b>(26,097)</b>	<b>(33,045)</b>	<b>(38,441)</b>	<b>(66,905)</b>
Income tax expense .....	3,575	4,339	4,831	8,996
<b>Net loss.....</b>	<b>\$ (29,672)</b>	<b>\$ (37,384)</b>	<b>\$ (43,272)</b>	<b>\$ (75,901)</b>
Less: Preferred shares dividend.....	-	5,055	-	9,550
<b>Net loss attributable to common shares.....</b>	<b>\$ (29,672)</b>	<b>\$ (42,439)</b>	<b>\$ (43,272)</b>	<b>\$ (85,451)</b>
<b>Loss per share:</b>				
Basic and Diluted - Common shares.....	\$ (0.23)	\$ (0.51)	\$ (0.36)	\$ (1.03)
<b>Weighted average shares outstanding:</b>				
Basic and Diluted - Common shares.....	126,831,264	83,722,547	119,078,898	82,687,056

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)

	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
<b>Net loss</b> .....	\$ (29,672)	\$ (37,384)	\$ (43,272)	\$ (75,901)
Other comprehensive income, net of tax.....				
Change in unrealized (losses) / gains on derivative financial instruments.....				
Changes in unrealized gains / (losses).....	68	(130)	141	(698)
Reclassification of net (gains) / loss from other comprehensive income to net income.....	(63)	(48)	(159)	50
	<u>\$ 5</u>	<u>\$ (178)</u>	<u>\$ (18)</u>	<u>\$ (648)</u>
<b>Total comprehensive loss</b> .....	<u>\$ (29,667)</u>	<u>\$ (37,562)</u>	<u>\$ (43,290)</u>	<u>\$ (76,549)</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>June 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
<b>Assets</b>		
Cash and cash equivalents.....	\$ 71,312	\$ 91,203
Accounts and other receivables, net.....	119,352	143,439
Assets held for sale.....	2,377	5,154
Other current assets.....	80,876	81,532
Total current assets.....	273,917	321,328
Property and equipment.....	1,787,538	1,637,489
Less: accumulated depreciation.....	461,852	422,609
Property and equipment, net.....	1,325,686	1,214,880
Deferred tax assets.....	2,034	2,526
Other assets.....	138,513	107,162
Total assets.....	\$ 1,740,150	\$ 1,645,896
<b>Liabilities and equity</b>		
Accounts payable.....	\$ 82,307	\$ 83,930
Interest payable.....	28,050	28,050
Accrued income taxes.....	3,377	4,771
Other current liabilities.....	24,248	20,143
Total current liabilities.....	137,982	136,894
Long-term debt.....	888,738	887,764
Deferred tax liabilities.....	4,891	3,939
Other liabilities.....	39,090	26,042
Total long-term liabilities.....	932,719	917,745
Commitments and contingencies (Note 12)		
Common shares of \$0.01 par value; 144,063,473 shares authorized at June 30, 2019 and December 31, 2018, respectively; Common shares issued and outstanding at June 30, 2019 and December 31, 2018, of 138,009,624 and 111,240,394, respectively	1,380	1,112
Additional paid-in capital.....	1,002,034	880,820
Accumulated other comprehensive income.....	225	243
Accumulated losses.....	(334,190)	(290,918)
Total equity.....	669,449	591,257
Total liabilities and equity.....	\$ 1,740,150	\$ 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)

	Six months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
	Shares		Amount	
<b>Common and ordinary shares</b>				
Balance, beginning of period.....	111,240,394	83,125,000	\$ 1,112	\$ 831
Repurchase and retirement of shares.....	-	(9,606)	-	-
Issuance of common shares.....	26,769,230	28,125,000	268	281
Balance, end of period.....	138,009,624	111,240,394	\$ 1,380	\$ 1,112
<b>Additional paid-in capital</b>				
Balance, beginning of period.....			\$ 880,820	\$ 663,090
Issuance of common shares.....			120,876	215,900
Preferred shares dividend.....			-	(9,550)
Share-based compensation expense, net of forfeitures.....			338	11,323
Balance, end of period.....			\$ 1,002,034	\$ 880,763
<b>Accumulated other comprehensive income / (loss)</b>				
Balance, beginning of period.....			\$ 243	\$ -
Net unrealized loss on derivative financial instruments.....			(18)	(648)
Balance, end of period.....			\$ 225	\$ (648)
<b>Accumulated losses</b>				
Balance, beginning of period.....			\$ (290,918)	\$ (154,675)
Net loss.....			(43,272)	(75,901)
Balance, end of period.....			\$ (334,190)	\$ (230,576)
<b>Total equity</b>				
Balance, beginning of period.....			\$ 591,257	\$ 509,246
Issuance of common shares.....			121,144	216,181
Share-based compensation expense, net of forfeitures.....			338	11,323
Preferred shares dividend.....			-	(9,550)
Total comprehensive loss.....			(43,290)	(76,549)
Balance, end of period.....			\$ 669,449	\$ 650,651

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)

	<b>Six months ended June 30,</b>	
	<b>2019</b>	<b>2018</b>
<b>Cash flows from operating activities</b>		
Net loss.....	\$ (43,272)	\$ (75,901)
Adjustments to reconcile net loss to net cash (used in) / provided by operating activities		
Depreciation .....	40,676	43,677
Loss on impairment of assets.....	-	1,137
(Gain) / loss on derivative financial instruments, net.....	(159)	50
(Reversal of) / provision for doubtful accounts, net.....	(100)	239
Amortization of deferred revenue.....	(2,452)	(7,109)
Share-based compensation expense, net of forfeitures.....	338	11,323
Non-cash portion of loss on debt extinguishment.....	-	7,368
Debt extinguishment and retirement costs.....	-	18,761
Amortization of debt issue costs and premium .....	1,334	1,606
(Gain) / loss on disposal of assets.....	(1,902)	241
Deferred tax expense, net.....	1,444	171
Proceeds from / (payments of) settlement of derivative financial instruments, net.....	159	(370)
Changes in deferred costs, net *.....	(248)	4,406
Changes in operating assets and liabilities.....	3,431	(21,206)
<b>Net cash used in operating activities.....</b>	<b>(751)</b>	<b>(15,607)</b>
<b>Cash flows from investing activities</b>		
Additions to property and equipment *.....	(24,224)	(14,126)
Proceeds from disposal of property and equipment.....	5,138	389
<b>Net cash used in investing activities.....</b>	<b>(19,086)</b>	<b>(13,737)</b>
<b>Cash flows from financing activities</b>		
Proceeds from short-term debt, net.....	-	1,843
Proceeds from issuance of common shares.....	-	226,908
Payments for common and preferred shares issuance cost .....	(553)	(7,679)
Payments for redemption of preferred shares.....	-	(166,667)
Proceeds from issuance of debt.....	-	928,000
Payments of debt financing costs.....	(147)	(17,710)
Payments to retire long-term debt.....	-	(558,250)
Payments of debt extinguishment and retirement costs.....	-	(12,693)
Payments for obligations under sale and leaseback.....	-	(17,413)
Preferred shares dividend paid.....	-	(16,268)
Proceeds from termination of interest rate swaps.....	-	320
<b>Net cash (used in) / provided by financing activities.....</b>	<b>(700)</b>	<b>360,391</b>
<b>Net (decrease) / increase in cash, cash equivalents and restricted cash.....</b>	<b>(20,537)</b>	<b>331,047</b>
Cash, cash equivalents and restricted cash at beginning of period*.....	92,835	99,825
<b>Cash, cash equivalents and restricted cash at end of period*.....</b>	<b>\$ 72,298</b>	<b>\$ 430,872</b>

\* 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.

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



**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”). Since June 25, 2018, SDL is listed on the Oslo Stock Exchange (“OSE”) under the ticker symbol SHLF. 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.

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 June 30, 2019, the Company owned 38 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 and six months ended June 30, 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 sheets. 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 sheets.

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 component, 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. Some agreements contain a lease component and a service

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

component. The Company accounts for these agreements based upon the predominant component.

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.

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

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This ASU refines and expands hedge accounting for both financial (e.g. interest rate) and commodity risks and creates more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes, for investors and analysts. The amendments are effective for annual periods beginning after December 15, 2018 for public entities, including interim periods within that period, with early adoption permitted. The Company 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 timely 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. In May 2019, the FASB issued ASU No. 2019-05, Financial Instruments – Credit Losses (Topic 326): Targeted Transition Relief, which eases the transition to the credit losses standard by providing the option to measure certain types of assets at fair value. 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.

**SHELF DRILLING, LTD.**  
**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 contract preparation and capital upgrade revenues are typically received at the commencement of the contract. Mobilization fees are generally billable to the customer in the initial phase of a contract and generate contract liabilities until they are recognized as revenue. 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 statements 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. Accounts receivable are recorded when the right to consideration becomes unconditional. 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 revenue by country based on the location of the service provided.

**Contract liabilities**

Contract liabilities represent fees for mobilization or capital upgrades and advance payments from customers for future services. Current contract liabilities are included in other current liabilities and non-current 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):

	<b>June 30,</b>	<b>December 31,</b>
	<b>2019</b>	<b>2018</b>
Current contract liabilities .....	\$ 4,033	\$ 3,021
Non-current contract liabilities .....	4,989	3,536
	<b>\$ 9,022</b>	<b>\$ 6,557</b>

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

	<b>Contract liabilities</b>
Balance as of December 31, 2018.....	\$ 6,557
Increase due to contractual additions.....	8,340
Decrease due to amortization of contractual liabilities.....	(5,875)
Balance as of June 30, 2019.....	\$ 9,022

Out of the \$5.9 million amortization of contract liabilities, \$1.9 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 June 30, 2019 is as follows (in thousands):

**For the twelve months ending June 30,**

2020.....	\$ 4,033
2021.....	2,960
2022.....	2,029
	<b>\$ 9,022</b>

**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):

	<b>June 30, 2019</b>	<b>December 31, 2018</b>
Current deferred contract costs.....	\$ 23,154	\$ 29,276
Non-current deferred contract costs.....	12,658	5,663
	<b>\$ 35,812</b>	<b>\$ 34,939</b>

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

	<b>Deferred contract costs</b>
Balance as of December 31, 2018.....	\$ 34,939
Increase due to contractual additions.....	17,717
Decrease due to amortization of deferred contract costs.....	(16,844)
Balance as of June 30, 2019.....	\$ 35,812

**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
<b>June 30, 2019</b>									
Total assets	\$	74	\$	12,433	\$	28,739	\$	1,619	\$ 42,865
Total liabilities		345		328		15,930		1,339	17,942
Net carrying amount	\$	(271)	\$	12,105	\$	12,809	\$	280	\$ 24,923
<b>December 31, 2018</b>									
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 June 30, 2019 and December 31, 2018 consisted of the following (in thousands):

	June 30, 2019	December 31, 2018
Drilling rigs and equipment.....	\$ 1,502,226	\$ 1,497,716
Construction in progress.....	225,678	81,674
Spares.....	41,311	40,755
Land and building.....	2,178	1,354
Other .....	16,145	15,990
Total property and equipment.....	\$ 1,787,538	\$ 1,637,489
Less: Accumulated depreciation.....	(461,852)	(422,609)
Total property and equipment, net.....	\$ 1,325,686	\$ 1,214,880



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There were two premium newbuild CJ46 jack-up rigs added to the Company's drilling rig fleet during the six months ended June 30, 2019 at a value of \$121.8 million and no rigs were added during the six months ended June 30, 2018. These rigs are currently undergoing rig readiness and therefore included as construction in progress in the above table.

On June 30, 2018, the Company had entered into an asset purchase agreement to acquire one premium jack-up drilling rig from a third party for \$68.5 million. As of June 30, 2019, the rig was under reactivation and included as construction in progress.

Total capital expenditures for the six months ended June 30, 2019 and 2018 were \$152.7 million (which includes \$121.8 million related to asset additions through share issuance – refer Note 17 – Supplemental Cash Flow Information) and \$10.1 million, respectively. During the six months ended June 30, 2019, the capital expenditures included \$137.5 million related to the two premium newbuild CJ46 jack-ups delivered in May 2019. There were no such transactions during the six months ended June 30, 2018.

During the six months ended June 30, 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 \$1.3 million and \$0.6 million were sold for \$0.3 million and \$0.4 million and resulted in a loss on disposal of assets of \$1.0 million and \$0.2 million during the six months ended June 30, 2019 and 2018, respectively.

The Company did not record an impairment charge on property and equipment during the three or six months ended June 30, 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 six months ended June 30, 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 rigs Comet and Rig 124 for a total aggregate selling price of \$3.1 million. The Company received a deposit of \$0.6 million in Q1 2019. 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 June 30, 2019, the Company does not have any finance leases.

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**Operating right-of-use assets and operating lease liabilities**

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

<b>Assets</b>	<b>Balance Sheet Classification</b>	<b>June 30, 2019</b>
Operating right of use assets.....	Other assets	\$ 19,834

  

<b>Liabilities</b>	<b>Balance Sheet Classification</b>	<b>June 30, 2019</b>
Operating lease liabilities - current.....	Other current liabilities	\$ 6,316
Operating lease liabilities - long-term.....	Other liabilities	12,866
		<b>\$ 19,182</b>

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 (as defined in Note 14 – Shareholder’s Equity), which have not commenced as of June 30, 2019, and as such, have not been recognized on the Company’s condensed consolidated interim balance sheets. These operating leases, which are expected to commence in the second half of 2019, provide for fixed lease payments of approximately \$16.4 million each to be paid over the respective lease terms.

**Lease expense**

During the three and six months ended June 30, 2019, the total lease expense was \$5.7 million and \$10.7 million, respectively, of which \$2.0 million and \$3.2 million, respectively, related to the operating lease right-of-use assets and \$3.7 million and \$7.5 million for short-term leases, respectively.

As of June 30, 2019, the following is the summary of the maturity of lease liabilities (in thousands):

<b>Years ending December 31,</b>	
2019 (excluding the six months ended June 30, 2019).....	\$ 3,477
2020.....	6,540
2021.....	5,353
2022.....	4,512
2023.....	1,888
Thereafter.....	17
<b>Total lease payments.....</b>	<b>\$ 21,787</b>
Less: Interest.....	2,605
<b>Present value of lease liabilities.....</b>	<b>\$ 19,182</b>

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

<b>Year ending December 31,</b>	
2019.....	\$ 4,586
2020.....	3,829
2021.....	2,438
2022.....	1,818
2023.....	251
Thereafter.....	17
<b>Total lease payments.....</b>	<b>\$ 12,939</b>



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As of June 30, 2019, the weighted-average remaining lease term and weighted average discount rate for operating lease right-of-use assets are as follows:

<u>Lease term and discount rate</u>	<u>June 30,</u>
	<u>2019</u>
Weighted-average remaining lease term (years).....	3.68
Weighted-average discount rate.....	7.5%

During the six months ended June 30, 2019, the Company paid \$3.2 million for amounts that have been included in the measurement of operating lease liabilities.

**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 revenue 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 (12.6) % and (13.4) % for the six months ended June 30, 2019 and 2018, respectively. The Company has income tax expense for the six months ended June 30, 2019 and 2018, despite having a loss before income taxes for both periods, resulting in negative effective tax rates for both periods. The reason the Company has income tax expense for each respective period despite having a loss before income taxes for each period is primarily due to expenses the Company incurs in jurisdictions where the Company does not receive any tax benefit for such expenses, as such expenses are incurred in jurisdictions which impose tax based on gross revenue rather than based on net income or in jurisdictions where the Company either is not subject to tax or is otherwise not allowed to deduct such expenses for tax purposes.

**Income Tax Expense** — Income tax expense was \$3.6 million and \$4.8 million for the three and six months ended June 30, 2019, respectively, compared to \$4.3 million and \$9.0 million for the three and six months ended June 30, 2018, respectively. Income tax expense for the three months ended June 30, 2019 is lower than for the three months ended June 30, 2018 primarily due to the Company earning less revenue during the 2019 period versus the 2018 period

Income tax expense for the three and six months ended June 30, 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 and six months ended June 30, 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 June 30, 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 June 30, 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 June 30, 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

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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 \$8.6 million and \$10.0 million as of June 30, 2019 and December 31, 2018, respectively.

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

	<u>June 30,</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.....	(1,865)	-
Reductions related to statute of limitation expirations.....	-	(400)
Additions for current period tax positions.....	501	8,153
Balance, end of period.....	<u>\$ 8,637</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 June 30, 2019, and December 31, 2018, the Company has \$0.5 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>June 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
8.25% Senior Unsecured Notes, due February 15, 2025 (see note (ii) below).....	\$ 888,738	\$ 887,764
Revolving Credit Facility, due April 30, 2023 (see note (iii) below).....	-	-
	<u>\$ 888,738</u>	<u>\$ 887,764</u>

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

**For the twelve months ending June 30,**

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

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

	June 30, 2019			
	Principal Amount	Unamortized Debt Issuance Costs	Unamortized Premium	Carrying Value
8.25% Senior Unsecured Notes, due February 15, 2025.....	\$ 900,000	\$ (13,897)	\$ 2,635	\$ 888,738

  

	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 June 30, 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 a \$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.

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SDHL's obligations under the 8.25% Senior Unsecured Notes are guaranteed by a majority of SDHL's subsidiaries (collectively, the "Note Guarantors"), subject to certain exceptions. The 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
- 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 and six months ended June 30, 2019 was \$0.5 million and \$1.0 million, respectively, and during the three and six months ended June 30, 2018 was \$0.3 million and \$0.5 million, respectively. The total amortization of premium during the three and six months ended June 30, 2019 was \$91 thousand and \$0.2 million, respectively, and during the three and six months ended June 30, 2018 was \$11 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.

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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) required the collateral rig market values to equal or exceed 140% of the aggregate amount of all revolving commitments, and (vi) made SDL 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 June 30, 2019, the Applicable Margin was 4.0% per year for borrowings at the Adjusted LIBOR Rate.

Upon the closing of the Transaction on May 9, 2019 (as defined in Note 14 – Shareholder’s Equity), the Company successfully implemented the following amendment to the SDHL Revolver: (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 June 30, 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 \$9.0 million and \$8.6 million as of June 30, 2019 and December 31, 2018, respectively, against the SDHL Revolver. As of June 30, 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 \$4.3 million and \$4.8 million, as of June 30, 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 \$0.3 million and \$0.5 million during the three and six months ended June 30, 2019, respectively, and \$0.3 million and \$0.6 million during the three and six months ended June 30, 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.



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**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 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 \$13.6 million and \$26.8 million, including interest of \$4.8 million and \$9.4 million, during the three and six months ended June 30, 2018. There were no such transactions during the six months ended June 30, 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 \$3.2 million in expense related to its retirement and savings plan for the three and six months ended June 30, 2019, respectively, and \$1.5 million and \$2.9 million in expense during the three and six months ended June 30, 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 \$1.6 million in expense related to employee end of service plans during the three and six months ended June 30, 2019, respectively, and \$0.8 million and \$2.5 million in expense during the three and six months ended June 30, 2018, respectively.

**Retention Plans** — The Company has recorded approximately \$0.7 million and \$1.3 million in expense related to its employee retention plans for the three and six months ended June 30, 2019, respectively, and \$0.5 million and \$1.3 million in expense during the three and six months ended June 30, 2018, respectively. The estimated total cash payments under the retention plans in 2020 are \$3.5 million.

**Note 12 — Commitments and Contingencies**

**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,

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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.

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 lawsuit 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. Aside from the arbitration proceedings against the Guarantor, the Company reserves the right in the future to pursue legal action against the Original Charterer.

With regards to the arbitration proceedings, the Company is seeking an order of payment from the Guarantor in respect of the unpaid hire charges to the end of the period. At the case management hearing held on July 25, 2019, the arbitration tribunal outlined the timetable for the arbitration process, including a hearing date tentatively set in March 2020.

The resolution of these legal proceedings by the Company is not expected to have a material adverse 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 \$76.4 million provided by several banks to guarantee various contractual, performance, and customs obligations. The Company entered into these facilities in India, Egypt, UAE and Nigeria. The outstanding surety bonds were \$48.3 million and \$52.9 million as of June 30, 2019 and December 31, 2018, respectively.

In addition, the Company had outstanding bank guarantees and performance bonds amounting to \$9.0 million and \$8.6 million as of June 30, 2019 and December 31, 2018, respectively, against the SDHL Revolver.

Therefore, the total outstanding bank guarantees and surety bonds issued by the Company were \$57.3 million and \$61.5 million as of June 30, 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.

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

	<u>June 30, 2019</u>		<u>December 31, 2018</u>	
	<u>Carrying value</u>	<u>Estimated fair value</u>	<u>Carrying value</u>	<u>Estimated fair value</u>
8.25% Senior Unsecured Notes, due February 15, 2025.....	\$ 888,738	\$ 841,365	\$ 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 June 30, 2019, the estimated fair value of the 8.25% Senior Unsecured Notes excludes unamortized debt issuance costs and unamortized premium of \$13.9 million and \$2.6 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.

## 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.

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 payable 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"). See Note 5 – Property and Equipment.

The Transaction closed on May 9, 2019 through the issuance of 26,769,230 new common shares for a value of \$121.8 million, representing 19.4% of the then total outstanding common shares of the Company, making China Merchants the largest shareholder. The Company incurred \$0.6 million of incremental direct costs to issue the common shares.

During the six months ended June 30, 2019, the Company awarded 1,559,536 restricted share units to certain members of management under the 2017 Long-Term Incentive Plan. See Note 15 — Share-based Compensation. During the six months ended June 30, 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.

As of June 30, 2019, the Company's authorized common shares were 144,063,473, of which 138,009,624 shares were outstanding and 6,053,849 common shares were reserved for the issuance pursuant to the long-term employee benefit plans. Currently, there are 87,672,334 shares listed on the OSE.

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 common dividend during the six months ended June 30, 2019 and 2018.



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**Note 15 — Share-based Compensation**

*Restricted shares*

Prior to the Offering in June 2018, the Company had a share-based compensation plan which had been established shortly after the Company's inception 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 would typically vest and be 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. Upon vesting, shares were 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 \$11.1 million and \$11.3 million during the three and six months ended June 30, 2018. As a result of the consummation of the Offering, the remaining unamortized share-based compensation of \$10.9 million was recognized in June 2018. There was no such transaction during the six months ended June 30, 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 that may be issued 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 June 30, 2019, and December 31, 2018, there were 6.1 million and 14.4 million shares 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.

*Restricted Share Units ("RSU")*

RSUs are contractual rights to receive shares in the future provided the specific vesting condition is met. During the three months ended June 30, 2019, the Company has awarded 779,768 time-based restricted share units ("TBRSU") and 779,768 performance-based restricted share units ("PBRSU") under the 2017 LTIP. All awards were accounted for as equity awards. The RSUs granted to employees may be settled in cash in lieu of shares at the Company's sole discretion. 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 equivalent but does not have the rights of a shareholder until the shares are issued. The dividend equivalent will be forfeited if the RSUs are forfeited before vesting.

The Company has recorded a total share-based compensation expense for all awards in general and administrative expenses of \$0.3 million for both the three and six months ended June 30, 2019. No income tax benefit was recognized for these awards.

*Time-based restricted share units*

The time-based restricted share units granted to key employees typically vest in one-third increments over a three-year period and to a non-employee director typically vest at the end of one year from the grant date, subject to acceleration following a change in control where the underlying award is not assumed, substituted or otherwise converted into an equivalent award. Fair value of TBRSU 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.

During the three months ended June 30, 2019, the Company granted 779,768 time-based restricted share units to key employees. There were no such awards granted to employees in the prior periods.

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The following table summarizes the TBRsUs granted as of June 30, 2019 and changes during the period:

	Time based restricted share units	Weighted average grant date fair value per share
Non-vested shares at January 1, 2019.....	14,611	\$ 5.93
Granted.....	779,768	4.29
Vested.....	-	-
Forfeited.....	-	-
Non-vested shares at June 30, 2019.....	794,379	\$ 4.32

As of June 30, 2019, the total unrecognized compensation cost related to non-vested time-based restricted share units was \$3.2 million which is expected to be recognized over a weighted average period of approximately 3 years. The total grant date fair value of the vested time-based restricted share units was nil during the six months ended June 30, 2019. There were no such transactions during the three and six months ended June 30, 2018.

*Performance-based restricted share units*

The performance-based restricted share units awarded to key employees are subject to the achievement of specified performance goals, of which 75% of the awards are based on a market condition such as the total shareholder return against a predetermined peer group (“TSR share units”) and 25% of the awards are based on a performance condition such as the return on capital employed (“ROCE share units”). All awards are conditioned on continued employment through the applicable vesting date.. The total restricted share units that may be earned could range from 0% to 200% of the granted restricted share units depending on performance.

The final number of ROCE share units vested will be determined based on the percentage of performance goals achieved using a three-year average of the performance goals for each of the calendar years 2019, 2020 and 2021. For the ROCE share units, the grant date will be established once all three years of the performance goals are determined which is expected to occur sometime in early 2021. The ROCE share units will be measured based on the stock price on the date of grant. After the grant date, compensation cost will be recognized through the vesting date based on the number of awards that are expected to vest based on the achievement of the average of the performance goals through 2021. Any subsequent changes in the estimate for the final number of ROCE share units that are expected to vest will be recorded as cumulative catch-up adjustment to compensation cost in the period in which the change in estimate occurs.

The TSR share units are measured on the grant date using the Monte-Carlo option pricing model, which was performed by an independent third party. The estimated fair value is determined based on several assumptions, including the market price of the shares on the date of grant at \$4.29 per share, risk-free interest rate, expected volatility and expected dividend yield over a period commensurate with the remaining term prior to vesting, as follows:

	June 30, 2019 TSR share units
<b>Valuation assumptions:</b>	
Expected term.....	2.76 years
Risk free interest rate.....	1.32% p.a.
Expected volatility.....	49.11%
Expected dividend yield.....	0%

Expected volatility was based on implied volatility from publicly traded peer group, historical volatility of the Company’s share price and other factors.

The total potential compensation cost for TSR share units is recognized over the service period regardless of whether the market conditions are ultimately achieved.

During the three months ended June 30, 2019, the Company granted 584,826 performance-based restricted share units (TSR share units) to key employees. There were no such awards in the prior periods.

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The following table summarizes the PBRsUs granted as of June 30, 2019 and changes during the period:

	<b>Performance- based restricted share units</b>	<b>Weighted average grant date fair value per share</b>
	<b>TSR share units</b>	<b>TSR share units</b>
Non-vested shares at January 1, 2019.....	-	\$ -
Granted.....	584,826	5.60
Vested.....	-	-
Forfeited.....	-	-
Non-vested shares at June 30, 2019.....	584,826	\$ 5.60

As of June 30, 2019, the total unrecognized compensation cost related to non-vested performance-based restricted share units was \$3.1 million and is expected to be recognized over a weighted average period of approximately 3 years.

The total grant date fair value of performance-based restricted vested share units was nil during the six months ended June 30, 2019. There were no such transactions during the six months ended June 30, 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 and six months ended June 30, 2019, the Company settled forex contracts with aggregate notional values of approximately \$3.6 million and \$7.1 million, respectively, and approximately \$6.4 million and \$10.1 million during the three and six months ended June 30, 2018, respectively, of which the aggregate amounts were designated as an accounting hedge.

As of June 30, 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) will be reclassified to operating and maintenance expense, to the extent fully effective.

*Interest Rate Swaps*

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

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

During the three months ended March 31, 2018, the Company entered into 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 and six months ended June 30, 2019.

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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 and six months ended June 30, 2019 and 2018 (in thousands). The gain / (loss) reclassified from AOCIL is recorded under operating and maintenance expense for forex contracts and under interest expense and financing charges for interest rate swaps.

	<u>Unrealized gain / (loss) recognized through AOCIL</u>		<u>Unrealized gain / (loss) recognized through AOCIL</u>		
	<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>		
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>	
<b>Cash flow hedges</b>					
Foreign currency forward contracts.....	\$ 68	\$ (643)	\$ 141	\$ (911)	
Interest rate swaps.....	-	513	-	213	
	<u>\$ 68</u>	<u>\$ (130)</u>	<u>\$ 141</u>	<u>\$ (698)</u>	
		<u>Gain / (loss) reclassified from AOCIL</u>		<u>Gain / (loss) reclassified from AOCIL</u>	
		<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>	
	<u>Statement of operation classification</u>	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
<b>Cash flow hedges</b>					
Foreign currency forward contracts.....	Operating and maintenance	\$ 63	\$ (236)	\$ 159	\$ (263)
Interest rate swaps.....	Interest expense and financing charges	-	(36)	-	(107)
		<u>\$ 63</u>	<u>\$ (272)</u>	<u>\$ 159</u>	<u>\$ (370)</u>
			<u>Gain recognized through "Other, net"</u>		<u>Gain recognized through "Other, net"</u>
			<u>Three months ended June 30,</u>		<u>Six months ended June 30,</u>
			<u>2019</u>		<u>2018</u>
Interest rate swaps, other.....		\$ -	\$ 320	\$ -	\$ 320

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

	<u>Balance sheet classification</u>	<u>June 30,</u>	<u>December 31,</u>
		<u>2019</u>	<u>2018</u>
<b>Asset derivatives</b>			
Short-term foreign currency forward contracts.....	Other current assets	\$ 225	\$ 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):

	<u>Six months ended June 30,</u>	
	<u>2019</u>	<u>2018</u>
Regulatory and capital maintenance.....	\$ 28,025	\$ 21,139
Contract preparation.....	17,717	12,360
Fleet spares and others.....	2,075	4,036
	<u>\$ 47,817</u>	<u>\$ 37,535</u>
Rig acquisitions.....	142,352	8,573
Total capital expenditures and deferred costs.....	<u>\$ 190,169</u>	<u>\$ 46,108</u>

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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):

	<b>Six months ended June 30,</b>	
	<b>2019</b>	<b>2018</b>
Cash payments for additions to property and equipment.....	\$ 24,224	\$ 14,126
Net change in accrued but unpaid additions to property and equipment.....	6,675	(4,047)
	<u>30,899</u>	<u>10,079</u>
Add: Asset additions related to share issuance .....	121,772	-
Total capital expenditures.....	<u>\$ 152,671</u>	<u>\$ 10,079</u>
Changes in deferred costs, net.....	\$ 248	\$ (4,406)
Add: Amortization of deferred costs.....	37,250	40,435
Total deferred costs.....	<u>\$ 37,498</u>	<u>\$ 36,029</u>
Total capital expenditures and deferred costs.....	<u>\$ 190,169</u>	<u>\$ 46,108</u>

In relation to the agreements entered into with China Merchants, the Company issued 26,769,230 new common shares in exchange for the two premium newbuild CJ46 jack-up rigs at an acquisition value of \$121.8 million. This non-cash transaction is not reflected on the condensed consolidated statement of cash flows for the six months ended June 30, 2019.

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):

	<b>December 31,</b>	<b>As of June 30,</b>	
	<b>2018</b>	<b>2019</b>	<b>2018</b>
Cash and cash equivalents.....	\$ 91,203	\$ 71,312	\$ 143,379
Restricted cash included in other current assets.....	1,598	952	287,472
Restricted cash included in other assets.....	34	34	21
Total cash, cash equivalents and restricted cash.....	<u>\$ 92,835</u>	<u>\$ 72,298</u>	<u>\$ 430,872</u>

### 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):

	<b>Three months ended June 30,</b>	
	<b>2019</b>	<b>2018</b>
<b>Common Shares</b>		
<b>Numerator for loss per share</b>		
Net loss.....	\$ (29,672)	\$ (37,384)
Less: Preferred shares dividend.....	-	5,055
Net loss attributable to common and ordinary shares.....	<u>\$ (29,672)</u>	<u>\$ (42,439)</u>
<b>Denominator for loss per share</b>		
Weighted average shares:		
Basic outstanding .....	<u>126,831,264</u>	<u>83,722,547</u>
Diluted .....	<u>126,831,264</u>	<u>83,722,547</u>
<b>Basic loss per share</b> .....	<u>\$ (0.23)</u>	<u>\$ (0.51)</u>
<b>Diluted loss per share</b> .....	<u>\$ (0.23)</u>	<u>\$ (0.51)</u>

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	Six months ended June 30,	
	2019	2018
Common Shares		
<b>Numerator for loss per share</b>		
Net loss .....	\$ (43,272)	\$ (75,901)
Less: Preferred shares dividend.....	-	9,550
Net loss attributable to common and ordinary shares.....	\$ (43,272)	\$ (85,451)
<b>Denominator for loss per share</b>		
Weighted average shares:		
Basic outstanding .....	119,078,898	82,687,056
Diluted .....	119,078,898	82,687,056
<b>Basic loss per share</b> .....	\$ (0.36)	\$ (1.03)
<b>Diluted loss per share</b> .....	\$ (0.36)	\$ (1.03)

The restricted share units awarded in Q4 2018 and Q2 2019 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 common shares outstanding until they are vested and converted into common shares. See Note 15 – Share-based Compensation.

For the three and six months ended June 30, 2019, there were 4,358 and 2,446 dilutive potential common shares, respectively, and for the three and six months ended June 30, 2018 there were 13,640 and 72,148 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.

### 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 revenue from external customers.

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

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Saudi Arabia.....	\$ 40,253	\$ 38,203	\$ 82,493	\$ 82,978
Thailand .....	29,712	29,444	58,267	58,578
Nigeria .....	28,151	23,564	56,056	38,867
United Arab Emirates.....	16,234	21,725	34,378	41,938
India .....	8,951	25,795	24,492	51,131
Other countries .....	13,776	13,784	28,628	26,533
<b>As Reported Revenue</b> .....	\$ 137,077	\$ 152,515	\$ 284,314	\$ 300,025

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):

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	<u>June 30,</u> <u>2019</u>	<u>December 31,</u> <u>2018</u>
Thailand.....	\$ 424,588	\$ 429,938
United Arab Emirates.....	262,678	303,068
Bahrain.....	235,021	41,753
Nigeria.....	174,932	183,883
Saudi Arabia.....	172,138	190,001
India.....	81,585	86,607
Other countries.....	114,952	119,589
<b>Total long-lived assets .....</b>	<b>\$ 1,465,894</b>	<b>\$ 1,354,839</b>

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 June 30, 2019, the long-lived assets in Bahrain include \$220.1 million relating to three premium jack-up rigs acquired in 2019 and 2018. As of December 31, 2018, the long-lived assets in the UAE included \$77.9 million relating to the premium jack-up rig acquired in 2018. 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**

Following the completion of the Transaction (as defined in Note 14 – Shareholders' Equity) in May 2019, China Merchants became the largest shareholder in the Company and is a related party to the Company. A related party provided maintenance and storage services to one of the Company's foreign subsidiaries. These services totaled \$0.6 million, which is recorded as capital expenditures, for the six months ended June 30, 2019. The total liability recorded under accounts payable was \$0.6 million and nil as of June 30, 2019 and December 31, 2018. There were no such transactions during the six months ended June 30, 2018.

The Company recorded \$0.4 million and \$0.8 million for the three and six months ended June 30, 2019, respectively, and \$1.4 million and \$2.8 million for the three and six months ended June 30, 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 \$0.3 million and \$0.2 million as of June 30, 2019 and December 31, 2018, respectively.

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 \$0.7 million and \$1.3 million during the three and six months ended June 30, 2019, respectively, and \$0.7 million and \$1.2 million for the three and six months ended June 30, 2018, respectively. The total liability recorded under accounts payable for such transactions was \$0.7 million and \$0.8 million as of June 30, 2019 and December 31, 2018, respectively.

#### **Lease with a related party**

The Company has a lease agreement related to yard space with a related party with cancellable terms. The duration of this lease is five years. The lease does not include an extension or renewal option, but a termination option is there for both parties. The lease does not include any variable payments and payments are fixed for the duration of the lease. This lease agreement does not contain any material residual value guarantees or material restrictive covenants.

The right-of-use asset recorded for the lease with related party as of June 30, 2019 was \$6.5 million. The corresponding operating lease liability as of June 30, 2019 was \$6.3 million (current: \$1.5 million; long-term: \$4.8 million).

The Company has recorded a total lease expense of \$0.4 million and \$0.8 million for both the three and six months ended June 30, 2019 and 2018, respectively.

As of June 30, 2019, following is the summary of the maturity of lease liability (in thousands) for the lease with the related party:



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**Years ending December 31,**

2019 (excluding the six months ended June 30, 2019).....	\$	818
2020.....		1,637
2021.....		1,637
2022.....		1,637
2023.....		1,637
Total lease payments.....	\$	7,366
Less: Interest.....		1,061
Present value of lease liabilities.....	\$	6,305

As of December 31, 2018, there were no future minimum rental payments pertaining to the lease with a related party.

As of June 30, 2019, the weighted-average remaining lease term and weighted average discount rate for operating lease right-of-use asset pertaining to the lease with a related party were 4.67 years and 7.5% respectively.

During the six months ended June 30, 2019, the Company paid \$0.8 million for amounts that have been included in the measurement of operating lease liabilities and operating right-of-use assets.

**Note 21 — Subsequent Events**

The Company has evaluated subsequent events through August 7, 2019, the date of issuance of the condensed consolidated interim financial statements.



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

The following discussion and analysis should be read in conjunction with the accompanying unaudited condensed consolidated interim financial statements contained in this Quarterly Report on Form 10-Q 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 June 30, 2019, own 38 independent-leg cantilever (“ILC”) jack-up rigs, three of which are stacked, and one stacked swamp barge, making us the second 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. 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](http://www.shelfdrilling.com).

### Recent events

On May 9, 2019, the Company closed a transaction 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 payments under the bareboat charter agreements are expected to commence in second half of 2019. Upon closing of the Transaction, the Company issued 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 June 30, 2019 and 2018:

	As of June 30,	
	2019	2018
Jack-ups .....	38	38
Swamp barge.....	1	1
Total .....	39	39

Subsequent to June 30, 2018, the Company added three premium jack-up drilling rigs, of which two were newbuild rigs, to its drilling fleet and three rigs were disposed. Included in the 38 jack-ups are two rigs which are reported as Assets Held for Sale in the June 30, 2019 condensed consolidated interim balance sheets.

## 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 fell in the fourth quarter of 2018 to as low as \$50.57 per barrel. However, in 2019 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 increased by 20% from 311 rigs in January 2017 to 373 rigs in August 2019, and marketed utilization for the industry is above 80% for the first time since 2015. There has been an acceleration of activity since early 2018, which we believe will continue through the remainder of 2019. In the past twelve months, the contracted rig count has increased in nearly every major jack-up region. The only exception is in India, which reached a multi-year low in May 2019, but activity has begun to recover with the recent award by ONGC of eight three-year contracts expected to commence later in 2019.

Price competition among both international and regional jack-up rig contractors has been intense for several years, and market dayrates reached historically low levels. We anticipate our results of operations for the remainder of 2019 will continue to be challenging as demand and pricing for shallow water contract drilling services recover from cyclical lows. We believe there is reason for optimism as day rates have started to rise for certain assets and in certain regions. Several of our recent awards represent an improvement in pricing relative to contracts signed in the prior one-year period.

We believe that we are well positioned to benefit from a further 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 will 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. The recent backlog additions and series of investments underway through the middle of 2019 will position the Company well heading into 2020.

## 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 \$846 million across 25 contracted rigs with a weighted average backlog dayrate of \$70.6 thousand per day and average contracted days of 479 per rig as of June 30, 2019, compared with \$1.0 billion across 28 contracted rigs with a weighted average dayrate of \$80.2 thousand per day and average contracted days of 466 per rig as of June 30, 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 June 30, 2019, 33 rigs were marketable (of which 23 were under contract and 10 were actively being marketed), excluding two premium newbuild jack-up drilling rigs acquired in May 2019 undergoing operation readiness projects, and 4 rigs were stacked, compared to 34 marketable rigs (of which 27 were under contract and seven were actively being marketed), one rig under non-drilling contract and four stacked rigs as of June 30, 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 revenues.

The average dayrate realized for the three and six months ended June 30, 2019 was \$66.2 thousand and \$64.8 thousand, respectively, a decrease of 1.9% and 5.8%, respectively, from the average dayrate of \$67.5 thousand and \$68.8 thousand for the three and six months ended June 30, 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 Q2 2019 of 66% was lower than the effective utilization in Q2 2018 of 67%. The decrease was primarily driven by the adverse impact on effective utilization of one premium jack-up drilling rig acquired in 2018 currently under reactivation and completion of contracts in India. There were 10 rigs idle awaiting marketing opportunities at the end of Q2 2019 compared to 7 rigs at the end of Q2 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 and six months ended June 30, 2019 and 2018 were as follows (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2019	2018	2019	2018
Net loss.....	\$ (29,672)	\$ (37,384)	\$ (43,272)	\$ (75,901)
<b>Add back:</b>				
Interest expense and financing charges, net of interest income (1) .....	19,668	26,627	39,508	65,404
Income tax expense.....	3,575	4,339	4,831	8,996
Depreciation.....	20,324	21,809	40,676	43,677
Amortization of deferred costs.....	19,101	21,428	37,250	40,435
Loss on impairment of assets.....	-	1,137	-	1,137
Loss on disposal of assets.....	965	361	(1,902)	241
<b>EBITDA</b> .....	\$ 33,961	\$ 38,317	\$ 77,091	\$ 83,989
Acquired rig reactivation costs (2) .....	6,403	88	12,566	2,058
One-time corporate transaction costs (3) .....	19	3,929	118	3,929
Sponsors' fee (4) .....	-	1,125	-	2,250
Share-based compensation expense, net of forfeitures .....	-	11,121	-	11,323
Other .....	-	400	-	400
<b>Adjusted EBITDA</b> .....	\$ 40,383	\$ 54,980	\$ 89,775	\$ 103,949
<b>Adjusted EBITDA margin</b> .....	29.5%	36.0%	31.6%	34.6%

(1) Represent interest expenses incurred and accrued on our debt and the amortization of debt issuance fees and costs over the term of the debt net of 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 consummation of the Offering.

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 and six months ended June 30, 2019 and 2018. For the three and six months ended June 30, 2018, the Company’s unrestricted subsidiaries accounted for \$17.3 million (31%) and \$32.4 million (31%) of the Company’s Adjusted EBITDA.

Inclusive of SDAIII and the Newbuild Subsidiaries, our restricted subsidiaries accounted for 100% of our assets as of June 30, 2019 and December 31, 2018.

## Operating Results

### *Three months ended June 30, 2019 (“Q2 2019”) compared to three months ended June 30, 2018 (“Q2 2018”)*

#### Revenue

Total revenue for Q2 2019 was \$137.1 million compared to \$152.5 million for Q2 2018. Revenue for Q2 2019 consisted of \$133.9 million (97.7%) of operating revenues and \$3.2 million (2.3%) of other revenues. In Q2 2018, these same revenues were \$149.0 million (97.7%) and \$3.5 million (2.3%), respectively.

Revenue in Q2 2019 decreased by \$15.4 million compared to Q2 2018 primarily due to \$9.8 million lower revenue resulting from lower effective utilization for our fleet in Q2 2019, \$2.9 million related to lower average earned dayrates for our fleet and \$2.7 million lower mobilization revenue amortization and recharges.

#### Operating and maintenance expenses

Total operating and maintenance expenses for Q2 2019 were \$90.9 million, or 66.3% of total revenue, compared to \$87.2 million, or 57.2% of total revenue, for Q2 2018. Operating and maintenance expenses in Q2 2019 consisted of \$82.0 million rig-related expenses and \$8.9 million shore-based expenses. In Q2 2018, these same expenses were \$78.8 million and \$8.4 million, respectively.

In Q2 2019, rig-related expenses included \$48.3 million for personnel expenses, \$30.6 million for rig maintenance expenses and \$3.1 million for other rig-related expenses. This compares to \$46.1 million, \$23.0 million and \$9.7 million for those respective categories during Q2 2018. Compared to Q2 2018, the increase in rig-related expenses of \$3.2 million was primarily due to \$6.3 million of costs for the reactivation of the premium jack-up drilling rig acquired in 2018, \$4.7 million of contract preparation and operating expenses for rigs that were idle in 2018 but preparing for new contracts or operating in 2019, \$1.5 million higher mobilization and in-between contracts standby costs and \$1.5 million higher maintenance and shipyard expenses. This was partly offset by \$6.8 million lower expenses for stacked and idle rigs awaiting marketing opportunities and \$4.0 million of costs savings in personnel and other operating costs across the fleet.

Shore-based expenses for the three months ended June 30, 2019 increased by \$0.5 million compared to the same period in 2018.

#### Depreciation expense

Depreciation expense in Q2 2019 was \$20.3 million compared to \$21.8 million in Q2 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 Q2 2019 was \$19.1 million compared to \$21.4 million in Q2 2018. The \$2.3 million decrease primarily related to lower amortization of contract preparation costs on drilling rigs that completed their contracts and lower amortization on drilling rigs which were impaired in 2018.



### **General and administrative expenses**

General and administrative expenses in Q2 2019 were \$12.0 million compared to \$26.8 million in Q2 2018. The \$14.8 million decrease primarily resulted from \$10.9 million lower share-based compensation expense due to the accelerated vesting of all unvested shares as a result of the consummation of the Offering in June 2018, \$4.0 million of lower one-time corporate transaction costs in 2018, \$1.1 million decrease in Sponsor's fee partially offset by \$1.0 million of other costs.

### **Loss on impairment of assets**

Loss on impairment of assets was nil for Q2 2019 and \$1.1 million for Q2 2018. The non-cash impairment loss in Q2 2018 represented an impairment loss on one of the Company's rigs that was classified as asset held for sale. The impairment loss was based on the carrying value of the rig being higher than the fair value less costs to sell, which led to the rig being impaired down to fair value less costs to sell.

### **Loss on disposal of assets**

Loss on disposal of assets was \$1.0 million and \$0.4 million in Q2 2019 and Q2 2018, respectively.

### **Other (expense) / income, net**

Other (expense) / income, net was an expense of \$19.9 million in Q2 2019 and \$26.8 million in Q2 2018. Other expense consisted primarily of interest expense and financing charges of \$20.0 million and \$27.1 million during Q2 2019 and Q2 2018, respectively. Interest expense and financing charges in Q2 2019 were \$7.1 million lower compared to Q2 2018 primarily due to \$10.9 million lower termination fees and interest on the sale & leaseback financing facility due to early termination in July 2018, and \$1.6 million lower interest on the SDA facility that was extinguished in June 2018. This was partly offset by \$5.3 million higher interest on the 8.25% Senior Unsecured Notes mainly resulting from 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 \$0.2 million in Q2 2019 compared to an expense of \$0.1 million in Q2 2018.

Interest income for the three months ended June 30, 2019 decreased by \$0.1 million compared to the same period in 2018.

### **Income tax expense**

Income tax expense in Q2 2019 was \$3.6 million compared to \$4.3 million in Q2 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 revenue rather than income or loss before taxes, (iii) rig movements between taxing jurisdictions and changes in our rig operating structures.

Income tax expense in Q2 2019 is lower than in Q2 2018 primarily due to the Company earning less revenue in Q2 2019 versus Q2 2018.

### ***Six months ended June 30, 2019 compared to six months ended June 30, 2018***

#### **Revenue**

Revenue for the six months ended June 30, 2019 was \$284.3 million compared to \$300.0 million for the same period in 2018. The revenue for the six months ended June 30, 2019 consisted of \$276.8 million (97.4%) of operating revenues and \$7.5 million (2.6%) of other revenues. In 2018, these corresponding figures were \$293.6 million (97.9%) and \$6.4 million (2.1%), respectively.

Revenue for the six months ended June 30, 2019 decreased by \$15.7 million compared to the same period in 2018 primarily due to \$16.9 million lower average earned day rates for our fleet and \$4.2 million lower recharges and amortization of mobilization revenue. This was partly offset by \$5.2 million higher operating revenues 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 the six months ended June 30, 2019 were \$183.2 million, or 64.4% of total revenue compared to \$177.5 million, or 59.2%, for the same period in 2018. Operating and maintenance expenses for the six months ended June 30, 2019 consisted of \$165.8 million rig-related expenses and \$17.4 million shore-based expenses. These same expenses were \$160.5 million and \$17.0 million, respectively, in 2018.

In the first half of 2019, rig-related expenses included \$95.7 million for personnel expenses, \$62.6 million for maintenance expenses and \$7.4 for other rig-related expenses. This compares to \$93.6 million, \$44.7 million and \$22.2 million for those respective categories during the same period in 2018. Compared to the six months ended June 30, 2018, the increase in rig-related expenses of \$5.3 million was primarily due to \$13.8 million of costs for the reactivation of the premium jack-up drilling rig acquired in 2018, \$8.9 million of contract preparation and operating expenses for the rigs that were idle in 2018 but preparing for contracts or operating in 2019 and \$2.7 million higher maintenance and shipyard expenses. This was partly offset by \$10.8 million lower expenses for stacked and idle rigs awaiting marketing opportunities, \$8.1 million of cost savings in personnel and other operating costs across the fleet and \$1.3 million lower rig mobilization costs.

There were \$0.4 million of higher shore-based expenses in the six months ended June 30, 2019 as compared to 2018.

#### **Depreciation expense**

Depreciation expense for the six months ended June 30, 2019 was \$40.7 million compared to \$43.7 million for the same period in 2018. The decrease of \$3.0 million primarily related to \$2.1 million lower depreciation on drilling rigs and equipment which were impaired in 2018.

#### **Amortization of deferred costs**

The amortization of deferred costs for the six months ended June 30, 2019 was \$37.2 million compared to \$40.4 million for the six months ended June 30, 2018. The \$3.2 million decrease primarily related to lower amortization of contract preparation costs on drilling rigs that completed their contracts in 2018 and lower amortization on drilling rigs which were impaired in 2018.

#### **General and administrative expenses**

General and administrative expenses for the six months ended June 30, 2019 were \$23.6 million compared to \$39.4 million for the same period in 2018. The \$15.8 million decrease in general and administrative expenses primarily resulted from \$10.9 million lower share-based compensation expense due to the accelerated vesting of all unvested shares as a result of the consummation of the Offering in June 2018, \$4.0 million of lower costs related to a one-time corporate transaction and \$2.3 million decrease in Sponsor's fee, partially offset by \$1.2 million lower other costs.

#### **Loss on impairment of assets**

Loss on impairment of assets was nil and \$1.1 million for the six months ended June 30, 2019 and 2018, respectively. The non-cash impairment loss during the six months ended June 30, 2018 represented an impairment loss on one of the Company's rigs that was classified as asset held for sale. The impairment loss was based on the carrying value of the rig being higher than the fair value less costs to sell, which led to the rig being impaired down to fair value, less costs to sell.

#### **(Gain) / Loss on disposal of assets**

Gain on disposal of assets was \$1.9 million and loss on disposal of assets was \$0.2 million for the six months ended June 30, 2019 and 2018, respectively. The increase in gain on disposals of assets was primarily due to the sale of two stacked rigs during Q1 2019.

#### **Other (expense) / income, net**

Other (expense) / income, net was an expense of \$40.0 million for the six months ended June 30, 2019 and \$64.5 million for the same period in 2018. Other expense consisted primarily of interest expense and financing charges of \$40.2 million and \$66.1 million during the six months ended June 30, 2019 and 2018, respectively. Interest expense and financing charges in 2019 period were \$25.9 million lower compared to 2018 primarily due to \$18.9 million lower loss on debt extinguishment associated with the refinancing of our debt in Q1 2018, \$15.5 million termination fees and interest on the sale & leaseback financing facility due to its early termination in July 2018 and \$1.8 million lower interest on the SDA facility that was extinguished in June 2018. This was partly offset by \$10.2 million higher interest on the 8.25% Senior Unsecured Notes mainly resulting from 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 \$0.5 million during the six months ended June 30, 2019 compared to an income of \$0.9 million during the six months ended June 30, 2018. The difference of \$1.4 million was mainly due to foreign exchange currency losses in 2019 period as compared to foreign exchange currency gains in 2018.

#### **Income tax expense**

Income tax expense for the six months ended June 30, 2019 was \$4.8 million compared to \$9.0 million for the same period in 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 revenue rather than income or loss before taxes, (iii) rig movements between taxing jurisdictions and changes in our rig operating structures.

Income tax expense for the six months ended June 30, 2019 is lower than for the same period in 2018 primarily due to tax benefits in 2019 related to a reduction in liabilities for uncertain tax positions and tax benefits in 2019 related to prior period adjustments, which include a favorable currency impact on the Company's tax receivables.

## 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 \$71.3 million and \$91.2 million in cash and cash equivalents as of June 30, 2019 and December 31, 2018, respectively. Under the SDHL Revolver, we had \$9.0 million and \$8.6 million of surety bonds issued as of June 30, 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 six months ended June 30, 2019 and 2018 are given below.

### Discussion of Cash flows

The following table sets out certain information regarding our cash flow statements for the six months ended June 30, 2019 and 2018 (in thousands):

	<b>Six months ended June 30,</b>	
	<b>2019</b>	<b>2018</b>
Net cash used in operating activities.....	\$ (751)	\$ (15,607)
Net cash used in investing activities.....	(19,086)	(13,737)
Net cash (used in) / provided by financing activities.....	(700)	360,391
Net increase in cash, cash equivalents and restricted cash.....	\$ (20,537)	\$ 331,047

#### Net cash used in operating activities

Net cash used in operating activities totaled \$0.8 million during the six months ended June 30, 2019 compared to \$15.6 million during the six months ended June 30, 2018. The increase of \$14.8 million was primarily due to a decrease in net loss. See discussion of operating costs in "—Results of operations."

During the six months ended June 30, 2019 and 2018, we made cash payments of \$39.8 million and \$29.0 million in interest and financing charges, respectively, included under "other operating assets and liabilities, net".

We also made cash payments of \$10.8 million and \$9.3 million in income taxes included under "other operating assets and liabilities, net" during the six months ended June 30, 2019 and 2018, respectively.

#### Net cash used in investing activities

Net cash used in investing activities totaled \$19.1 million during the six months ended June 30, 2019 compared to \$13.7 million during the six months ended June 30, 2018.



Cash used for capital expenditures totaled \$24.2 million and \$14.1 million during the six months ended June 30, 2019 and 2018, respectively. The increase was primarily related to the readiness projects for the two premium newbuild jack-up drilling rigs acquired in May 2019 and the reactivation costs for the premium jack-up drilling rig acquired in 2018.

The net proceeds from disposal of assets increased by \$4.7 million mainly due to the \$4.9 million net proceeds received during the six months ended June 30, 2019 for the sale of two stacked rigs.

In relation to the agreements entered into with China Merchants in 2019, the Company issued 26,769,230 new common shares in exchange for the two premium newbuild CJ46 jack-up rigs at an acquisition value of \$121.8 million. This non-cash transaction is not reflected on the condensed consolidated statement of cash flows for the six months ended June 30, 2019.

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

Net cash used in financing activities totaled \$0.7 million in the six months ended June 30, 2019 compared to net cash provided of \$360.4 million in the same period of 2018.

The decrease of \$361.1 million was primarily due to the issuance of debt of \$928.0 million in 2018 (resulting from the issuance of a total of \$900.0 million of 8.25% Senior Unsecured Notes and \$25.0 million of draws on the Senior Secured Facility) and proceeds from issuance of common shares of \$228.0 million in 2018, partly offset by the retirement of long-term debt of \$558.2 million in 2018 (retirement in 2018 of \$502.8 million 9.5% Senior Secured Notes, \$30.4 million 8.625% Senior Secured Notes and \$25.0 Senior Secured Credit Facility), the redemption of preferred shares of \$166.7 million in 2018, the payment of debt financing and extinguishment costs of \$35.0 million in 2018, the principal payments for the sale and leaseback transactions of \$17.4 million in 2018 and the payment of preferred shares dividends of \$16.3 million in 2018.

In relation to the agreements entered into with China Merchants in 2019, the Company issued 26,769,230 new common shares in exchange for the two premium newbuild CJ46 jack-up rigs at an acquisition value of \$121.8 million. This non-cash transaction is not reflected on the condensed consolidated statement of cash flows for the six months ended June 30, 2019.

#### *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 six months ended June 30, 2019 and 2018 (in thousands):

	<b>Six months ended June 30,</b>	
	<b>2019</b>	<b>2018</b>
Regulatory and capital maintenance <sup>(1)</sup> .....	\$ 28,025	\$ 21,139
Contract preparation <sup>(2)</sup> .....	17,717	12,360
Fleet spares and other <sup>(3)</sup> .....	2,075	4,036
	<b>\$ 47,817</b>	<b>\$ 37,535</b>
Rig acquisitions <sup>(4)</sup> .....	142,352	8,573
<b>Total capital expenditures and deferred costs .....</b>	<b>\$ 190,169</b>	<b>\$ 46,108</b>

- (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 with the acquisition and operation readiness costs of newbuild premium jack-up drilling rigs acquired in 2019.

Capital expenditures and deferred costs totalled \$190.2 million in the first half of 2019 compared to \$46.1 million in the first half of 2018. The increase of \$144.1 million was primarily due to the \$121.8 million acquisition of the two newbuilds premium CJ46 drilling jack-up rigs which were paid through issuance of common shares and \$20.5 million relating to the reactivation and operations readiness projects on the three recently acquired rigs, compared to \$8.6 million in the first half 2018 for the three rigs acquired in 2017. In addition, there was an increase of \$12.2 million in expenditures for regulatory and capital maintenance and contract preparation mainly due to higher level of spending associated with planned out of service projects and higher contract preparation and activation costs. This was partly offset by the \$2.0 million decrease in fleet spares.

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 six months ended June 30, 2019 and 2018 (in thousands):

	Six months ended June 30,	
	2019	2018
Cash payments for additions to property and equipment.....	\$ 24,224	\$ 14,126
Net change in accrued but unpaid additions to property and equipment.....	6,675	(4,047)
	30,899	10,079
Add: Asset additions related to share issuance .....	121,772	-
Total capital expenditures.....	\$ 152,671	\$ 10,079
Changes in deferred costs, net.....	\$ 248	\$ (4,406)
Add: Amortization of deferred costs.....	37,250	40,435
Total deferred costs.....	\$ 37,498	\$ 36,029
Total capital expenditures and deferred costs.....	\$ 190,169	\$ 46,108

#### Certain financial information of SDL and SDHL

The following tables present certain financial information for SDL and SDHL for the six months ended June 30, 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.

#### June 30, 2019

#### Condensed Consolidated Interim Statements of Operations for the six months ended June 30, 2019

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
<b>Revenue</b>			
Operating revenues.....	\$ 276,852	\$ -	\$ 276,852
Other revenues .....	7,462	-	7,462
	284,314	-	284,314
<b>Operating costs and expenses</b>			
Operating and maintenance .....	183,175	-	183,175
Depreciation .....	40,676	-	40,676
Amortization of deferred costs .....	37,250	-	37,250
General and administrative .....	23,576	(55)	23,521
Gain on disposal of assets.....	(1,902)	-	(1,902)
	282,775	(55)	282,720
<b>Operating income</b> .....	1,539	55	1,594
<b>Other (expense) / income, net</b>			
Interest income .....	730	-	730
Interest expense and financing charges .....	(40,238)	-	(40,238)
Other, net.....	(472)	-	(472)
	(39,980)	-	(39,980)
<b>Loss before income taxes</b> .....	(38,441)	55	(38,386)
Income tax expense .....	4,831	-	4,831
<b>Net loss attributable to common shares</b> .....	\$ (43,272)	\$ 55	\$ (43,217)

Condensed Consolidated Interim Balance Sheets as of June 30, 2019

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
<b>Assets</b>			
Cash and cash equivalents.....	\$ 71,312	\$ (8)	\$ 71,304
Accounts and other receivables, net <sup>(1)</sup> .....	119,352	435	119,787
Assets held for sale.....	2,377	-	2,377
Other current assets.....	80,876	-	80,876
Total current assets.....	<u>273,917</u>	<u>427</u>	<u>274,344</u>
Property and equipment.....	1,787,538	-	1,787,538
Less accumulated depreciation.....	461,852	-	461,852
Property and equipment, net.....	<u>1,325,686</u>	<u>-</u>	<u>1,325,686</u>
Deferred tax assets.....	2,034	-	2,034
Other assets.....	138,513	-	138,513
<b>Total assets</b> .....	<u>\$ 1,740,150</u>	<u>\$ 427</u>	<u>\$ 1,740,577</u>
<b>Liabilities and equity</b>			
Accounts payable.....	\$ 82,307	\$ (3)	\$ 82,304
Interest payable.....	28,050	-	28,050
Accrued income taxes.....	3,377	-	3,377
Other current liabilities.....	24,248	-	24,248
Total current liabilities.....	<u>137,982</u>	<u>(3)</u>	<u>137,979</u>
Long-term debt.....	888,738	-	888,738
Deferred tax liabilities.....	4,891	-	4,891
Other long-term liabilities.....	39,090	-	39,090
Total long-term liabilities.....	<u>932,719</u>	<u>-</u>	<u>932,719</u>
Commitments and contingencies.....			
Common shares <sup>(2)</sup> .....	1,380	(1,380)	-
Additional paid-in capital <sup>(3)</sup> .....	1,002,034	(89,894)	912,140
Accumulated other comprehensive income.....	225	-	225
Accumulated losses <sup>(4)</sup> .....	(334,190)	91,704	(242,486)
Total equity.....	<u>669,449</u>	<u>430</u>	<u>669,879</u>
<b>Total liabilities and equity</b> .....	<u>\$ 1,740,150</u>	<u>\$ 427</u>	<u>\$ 1,740,577</u>

- (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 reflects the total number of outstanding shares of 138,009,624 with a par value of \$0.01 per share.
- (3) 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.
- (4) 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 six months ended June 30, 2019

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
<b>Cash flows from operating activities</b>			
Net loss .....	\$ (43,272)	\$ 55	\$ (43,217)
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation .....	40,676	-	40,676
Gain on derivative financial instruments, net .....	(159)	-	(159)
Reversal of doubtful accounts, net .....	(100)	-	(100)
Amortization of deferred revenue.....	(2,452)	-	(2,452)
Share-based compensation expense, net of forfeitures / Capital contribution by Parent share-based compensation <sup>(1)</sup>	338	(43)	295
Amortization of debt issue costs and premium .....	1,334	-	1,334
Gain on disposal of assets .....	(1,902)	-	(1,902)
Deferred tax expense, net.....	1,444	-	1,444
Proceeds from settlement of derivative financial instruments, net	159	-	159
Changes in deferred costs, net.....	(248)	-	(248)
Changes in operating assets and liabilities			
Intercompany receivables <sup>(2)</sup> .....	-	(403)	(403)
Other operating assets and liabilities, net <sup>(3)</sup> .....	3,431	72	3,503
Net cash used in operating activities .....	<u>(751)</u>	<u>(319)</u>	<u>(1,070)</u>
<b>Cash flows from investing activities</b>			
Additions to property and equipment.....	(24,224)	-	(24,224)
Proceeds from disposal of property and equipment .....	5,138	-	5,138
Net cash used in investing activities .....	<u>(19,086)</u>	<u>-</u>	<u>(19,086)</u>
<b>Cash flows from financing activities</b>			
Payments of common shares issuance costs <sup>(4)</sup> .....	(553)	553	-
Payments of debt financing costs .....	(147)	-	(147)
Net cash used in financing activities .....	<u>(700)</u>	<u>553</u>	<u>(147)</u>
Net decrease in cash, cash equivalents and restricted cash.....	(20,537)	234	(20,303)
Cash, cash equivalents and restricted cash at beginning of period .....	92,835	(242)	92,593
<b>Cash, cash equivalents and restricted cash at end of period .....</b>	<b><u>\$ 72,298</u></b>	<b><u>\$ (8)</u></b>	<b><u>\$ 72,290</u></b>

- (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 six months ended June 30, 2019.
- (3) The adjustment relates to certain professional service expenses, including accounting fees incurred in connection with the preparation of SDL financial statements.
- (4) This adjustment relates to the issuance of common shares.

**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 June 30, 2019 (in thousands):

	Years ending December 31,						
	Remaining 2019	2020	2021	2022	2023	Thereafter	Total
Debt repayment .....	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 900,000	\$ 900,000
Interest on debt <sup>(1)</sup> .....	38,637	77,274	77,274	77,274	75,258	83,531	429,246
Operating lease obligations <sup>(2)</sup> .....	6,157	15,200	17,643	13,752	1,888	17	54,657
<b>Total .....</b>	<b>\$ 44,794</b>	<b>\$ 92,474</b>	<b>\$ 94,917</b>	<b>\$ 91,026</b>	<b>\$ 77,146</b>	<b>\$ 983,548</b>	<b>\$ 1,383,903</b>

- (1) Includes commitments fees on our revolver assuming no change in the undrawn balance.

- (2) Includes additional operating leases that have not yet commenced of \$32.9 million and a total imputed interest of \$6.5 million. See Note 7- Leases 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 \$76.4 million provided by several banks to guarantee various contractual, performance, and customs obligations. We entered into these facilities in India, Egypt, UAE and Nigeria. The outstanding surety bonds were \$48.3 million and \$52.9 million at June 30, 2019 and December 31, 2018, respectively.

In addition, we had outstanding bank guarantees and performance bonds amounting to \$9.0 million and \$8.6 million as of June 30, 2019 and December 31, 2018, respectively, against the SDHL Revolver.

Therefore, the total outstanding bank guarantees, and surety bonds issued by the Company were \$57.3 million and \$61.6 million as of June 30, 2019 and December 31, 2018, respectively.

### **Contingencies**

As of June 30, 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 six months ended June 30, 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 \$2.1 million and \$2.7 million as of June 30, 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.

## Responsibility statement

We confirm, to the best of our knowledge, that the condensed consolidated interim financial statements for the six months ended June 30, 2019 and 2018 have been prepared in accordance with accounting principles generally accepted in the United States of America, and give a true and fair view of Shelf Drilling, Ltd. and its majority owned subsidiaries' condensed consolidated interim balance sheets as of June 30, 2019 and December 31, 2018 and the related condensed consolidated interim statements of operations, comprehensive income, equity and cashflows for the six months ended June 30, 2019 and 2018.

We also confirm that, to the best of our knowledge, the interim report includes a true and fair review of important events that have occurred during the first six months of the financial year and their impact on the condensed consolidated interim financial statements, a description of the principal risks and uncertainties for the remaining six months of the financial year and major related party transactions.

7 August 2019

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Ernie Danner  
*Chairman*

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David Mullen  
*Director & Chief Executive Officer*