SHELF DRILLING, LTD.

INTERIM REPORT
NINE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018

SHELF DRILLING, LTD.
INDEX TO INTERIM REPORT
NINE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018
(UNAUDITED)

SHELF DRILLING

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(UNAUDITED)

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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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 September 30, 2019, and the related condensed consolidated interim statements of operations, comprehensive income and equity for the three-month and nine-month periods ended September 30, 2019 and 2018 and the condensed consolidated interim statements of cash flows for the nine-month periods ended September 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

PricewaterhouseCoopers
Dubai, United Arab Emirates
November 13, 2019

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

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Revenue				
Operating revenues	$ 128,958	$ 156,276	$ 405,810	$ 449,929
Other revenues	3,060	3,965	10,522	10,337
	132,018	160,241	416,332	460,266
Operating costs and expenses				
Operating and maintenance	91,446	86,069	274,621	263,572
Depreciation	20,370	21,598	61,046	65,275
Amortization of deferred costs	19,836	23,585	57,086	64,020
General and administrative	12,750	11,091	36,326	50,525
Loss on impairment of assets	-	-	-	1,137
Loss / (gain) on disposal of assets	638	(57)	(1,264)	184
	145,040	142,286	427,815	444,713
Operating (loss) / income	(13,022)	17,955	(11,483)	15,553
Other (expense) / income, net				
Interest income	317	478	1,047	1,158
Interest expense and financing charges	(20,071)	(20,600)	(60,309)	(86,684)
Other, net	86	(179)	(386)	722
	(19,668)	(20,301)	(59,648)	(84,804)
Loss before income taxes	(32,690)	(2,346)	(71,131)	(69,251)
Income tax expense	3,241	7,978	8,072	16,974
Net loss	(35,931)	(10,324)	(79,203)	(86,225)
Less: Preferred shares dividend	-	-	-	9,550
Net loss attributable to common shares	$ (35,931)	$ (10,324)	$ (79,203)	$ (95,775)
Loss per share:				
Basic and Diluted - Common shares	$ (0.26)	$ (0.09)	$ (0.63)	$ (1.04)
Weighted average shares outstanding:				
Basic and Diluted - Common shares	137,961	111,240	125,442	92,313

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

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

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Net loss	$ (35,931)	$ (10,324)	$ (79,203)	$ (86,225)
Other comprehensive income, net of tax				
Changes in unrealized (losses) / gains on derivative financial instruments				
Changes in unrealized (losses) / gains	(87)	(400)	54	(1,098)
Reclassification of net (gains) / loss from other comprehensive income to net loss	(65)	440	(224)	490
	$ (152)	$ 40	$ (170)	$ (608)
Total comprehensive loss	$ (36,083)	$ (10,284)	$ (79,373)	$ (86,833)

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 per share data)
(Unaudited)

	September 30, 2019	December 31, 2018
Assets		
Cash and cash equivalents	$ 45,723	$ 91,203
Accounts and other receivables, net	118,829	143,439
Assets held for sale	2,666	5,154
Other current assets	73,701	81,532
Total current assets	240,919	321,328
Property and equipment	1,818,709	1,637,489
Less: accumulated depreciation	479,003	422,609
Property and equipment, net	1,339,706	1,214,880
Deferred tax assets	2,691	2,526
Other assets	147,572	107,162
Total assets	$ 1,730,888	$ 1,645,896
Liabilities and equity		
Accounts payable	$ 99,262	$ 83,930
Interest payable	9,561	28,050
Accrued income taxes	4,219	4,771
Other current liabilities	30,319	20,143
Total current liabilities	143,361	136,894
Long-term debt	909,135	887,764
Deferred tax liabilities	5,016	3,939
Other long-term liabilities	40,114	26,042
Total long-term liabilities	954,265	917,745
Commitments and contingencies (Note 12)		
Common shares of $0.01 par value; 144,063 shares authorized at September 30, 2019 and December 31, 2018, respectively; Common shares issued and outstanding at September 30, 2019 and December 31, 2018, of 137,725 and 111,240, respectively	1,377	1,112
Additional paid-in capital	1,001,933	880,820
Accumulated other comprehensive income	73	243
Accumulated losses	(370,121)	(290,918)
Total equity	633,262	591,257
Total liabilities and equity	$ 1,730,888	$ 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)
(Unaudited)

	Common stock		Additional paid-in capital	Accumulated other comprehensive (loss) / income	Accumulated losses	Total equity
Three months ended September 30:	**Shares**	**Par value**				
Balance at June 30, 2019	138,010	$ 1,380	$ 1,002,034	$ 225	$ (334,190)	$ 669,449
Net loss	-	-	-	-	(35,931)	(35,931)
Net unrealized loss on derivative financial instruments	-	-	-	(152)	-	(152)
Repurchase of common shares	(285)	(3)	(697)	-	-	(700)
Share-based compensation expense, net of forfeitures	-	-	596	-	-	596
Balance at September 30, 2019	**137,725**	**$ 1,377**	**$ 1,001,933**	**$ 73**	**$ (370,121)**	**$ 633,262**
Balance at June 30, 2018	111,240	$ 1,112	$ 880,763	$ (648)	$ (230,576)	$ 650,651
Net loss	-	-	-	-	(10,324)	(10,324)
Net unrealized gain on derivative financial instruments	-	-	-	40	-	40
Isusance of common shares	-	-	46	-	-	46
Balance at September 30, 2018	**111,240**	**$ 1,112**	**$ 880,809**	**$ (608)**	**$ (240,900)**	**$ 640,413**
Nine months ended September 30:						
Balance at December 31, 2018	111,240	$ 1,112	$ 880,820	$ 243	$ (290,918)	$ 591,257
Net loss	-	-	-	-	(79,203)	(79,203)
Net unrealized loss on derivative financial instruments	-	-	-	(170)	-	(170)
Issuance of common shares	26,770	268	120,876	-	-	121,144
Repurchase of common shares	(285)	(3)	(697)	-	-	(700)
Share-based compensation expense, net of forfeitures	-	-	934	-	-	934
Balance at September 30, 2019	**137,725**	**$ 1,377**	**$ 1,001,933**	**$ 73**	**$ (370,121)**	**$ 633,262**
Balance at December 31, 2017	83,125	$ 831	$ 663,090	$ -	$ (154,675)	$ 509,246
Net loss	-	-	-	-	(86,225)	(86,225)
Net unrealized loss on derivative financial instruments	-	-	-	(608)	-	(608)
Preferred shares dividend	-	-	(9,550)	-	-	(9,550)
Issuance of common shares	28,125	281	215,946	-	-	216,227
Repurchase and retirement of ordinary shares	(10)	-	-	-	-	-
Share-based compensation expense, net of forfeitures	-	-	11,323	-	-	11,323
Balance at September 30, 2018	**111,240**	**$ 1,112**	**$ 880,809**	**$ (608)**	**$ (240,900)**	**$ 640,413**

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)

	Nine months ended September 30,	
	2019	2018
Cash flows from operating activities		
Net loss	$ (79,203)	$ (86,225)
Adjustments to reconcile net loss to net cash (used in) / provided by operating activities		
Depreciation	61,046	65,275
Loss on impairment of assets	-	1,137
Reversal of provision for doubtful accounts, net	(112)	(36)
Amortization of deferred revenue	(3,818)	(10,953)
(Gain) / loss on derivative financial instruments, net	(224)	490
Share-based compensation expense, net of forfeitures	934	11,323
Non-cash portion of loss on debt extinguishment	-	7,368
Debt extinguishment and retirement costs	-	18,799
Amortization of debt issue costs and premium	2,013	2,275
(Gain) / loss on disposal of assets	(1,264)	184
Deferred tax expense, net	912	448
Proceeds from / (payments of) settlement of derivative financial instruments, net	224	(810)
Changes in deferred costs, net *	(7,812)	13,563
Changes in operating assets and liabilities	9,229	(19,146)
Net cash (used in) / provided by operating activities	(18,075)	3,692
Cash flows from investing activities		
Additions to property and equipment *	(53,869)	(90,552)
Proceeds from disposal of property and equipment, net	6,617	2,473
Net cash used in investing activities	(47,252)	(88,079)
Cash flows from financing activities		
Proceeds from revolving credit facility	20,000	-
Proceeds from short-term debt, net	-	892
Proceeds from issuance of common shares	-	226,908
Payments for common and preferred shares issuance costs	(623)	(10,526)
Purchase of common shares	(644)	-
Payments for redemption of preferred shares	-	(166,667)
Proceeds from issuance of debt	-	928,000
Payments for obligations under sale and leaseback	-	(313,930)
Payments to retire long-term debt	-	(558,250)
Payments of debt extinguishment and retirement costs	-	(18,715)
Payments of debt financing costs	(147)	(18,996)
Preferred shares dividend paid	-	(16,268)
Proceeds from termination of interest rate swaps	-	320
Net cash provided by financing activities	18,586	52,768
Net decrease in cash, cash equivalents and restricted cash	(46,741)	(31,619)
Cash, cash equivalents and restricted cash at beginning of period *	92,835	99,825
Cash, cash equivalents and restricted cash at end of period *	$ 46,094	$ 68,206

* 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 (rebranded in September 2019 as CPE Capital) 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 September 30, 2019, the Company owned 37 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 nine months ended September 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 as an operating lease or a finance lease is made at the lease inception.

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 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 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 as needed for impairment. The lease liability is subsequently measured by increasing the lease liability for interest and reducing it by the lease payments made. The lease liability is remeasured for the impact of foreign currency changes, and certain lease modifications 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 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 and 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 foreign exchange ("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. These changes in fair value for each designated hedge 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 Company's local currency operating expenditures in certain countries. Derivatives are reported in other current assets or other assets, for derivates with asset fair values, and other current liabilities or other long-term liabilities, for derivates with liability fair values, 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 Accounting Standards Update ("ASU") No. 2016-02, Leases and related clarifying guidance, together ("Topic 842"), which generally requires to recognize a lease liability, measured on a discounted basis, and a corresponding right-of-use asset, representing the lessee's right to use, or control the use of, a specified asset for the lease term. This guidance is effective for annual and interim periods for fiscal years beginning after December 15, 2018 for public business entities.

The Company has adopted 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 made an 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 at the commencement date in determining the present value of lease payments. The new standard did not materially impact the condensed consolidated interim statements of operations and had no impact on the condensed consolidated interim statements of cash flows of the Company.

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 the Company's drilling contracts. Accordingly, with the election of the practical expedient to present the lease and associated non-lease operations as a single component, the Company's accounting for the drilling rigs revenue as a single performance obligation under the new revenue guidance in ASC 606 remains unchanged.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This ASU refines and expands hedge accounting for both financial (e.g. interest rate) and 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 were effective for annual periods beginning after December 15, 2018 for public entities, including interim periods within that period, with early adoption permitted. The Company 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 of the Company.

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 reduce 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 was 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 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 of the Company.

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 its 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 required disclosures based, in part, on an evaluation of whether the expected benefits of such disclosures 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 its condensed consolidated interim financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326) and related clarifying guidance: Measurement of Credit Losses on Financial Instruments. The main objective of this ASU is to improve financial reporting by requiring timelier recording of credit losses on financial instruments and to provide financial statement users with more information about the expected credit losses on financial instruments and other commitments with enhanced disclosures 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 of this standard by providing the option to measure certain types of assets at fair value. These standards are effective for annual reporting periods beginning after December 15, 2020, with early adoption permitted. The Company is currently evaluating the impact of their adoption on its condensed consolidated interim financial statements.

Note 3 – Revenue, Contract Liabilities and Deferred Contract Costs

Revenue

A significant portion of the Company's revenue is generated from rigs operated by the Company through dayrates charged to its 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 recognized, 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.

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. Contract liabilities for fixed consideration related to remaining unsatisfied performance obligations expected to be recognized in future periods is disclosed below.

Many drilling contracts have termination and/or extension options which can be exercised 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 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):

	September 30, 2019	December 31, 2018
Current contract liabilities	$ 6,605	$ 3,021
Non-current contract liabilities	5,896	3,536
	$ 12,501	$ 6,557

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

		Contract liabilities
Balance as of December 31, 2018	$	6,557
Increase due to contractual additions		13,185
Decrease due to amortization of contractual liabilities		(7,241)
Balance as of September 30, 2019	$	12,501

Approximately $0.6 million and $2.5 million of revenue recognized in the three and nine months ended September 30, 2019, respectively, was included in the contract liabilities balance as of December 31, 2018.

Expected future amortization of contract liabilities recorded as of September 30, 2019 is as follows (in thousands):

For the twelve months ending September 30,		
2020	$	6,605
2021		4,405
2022		1,491
	$	12,501

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 expensed or capitalized into property and equipment as appropriate and are not included in deferred contract costs.

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

		September 30, 2019		December 31, 2018
Current deferred contract costs	$	21,458	$	29,276
Non-current deferred contract costs		19,232		5,663
	$	40,690	$	34,939

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

		Deferred contract costs
Balance as of December 31, 2018	$	34,939
Increase due to contractual additions		33,281
Decrease due to amortization of deferred contract costs		(27,530)
Balance as of September 30, 2019	$	40,690

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") providing drilling related services which are Shelf Drilling Ventures Malaysia Sdn. Bhd. ("SDVM"), PT. Hitek Nusantara Offshore Drilling ("PT Hitek"), Shelf Drilling (Nigeria) Limited ("SDNL") and Shelf Drilling Offshore Services Limited ("SDOSL"), and which are included in these condensed consolidated interim financial statements. These VIEs are incorporated in jurisdictions where majority or significant foreign ownership of domestic companies is restricted or commercially incompatible with local content requirements. To comply with such foreign ownership and/or local content restrictions, the Company and the relevant local third parties, described further below, have established these VIEs and have contractual arrangements to convey decision-making and economic rights to the Company.

Following is the information about the third-party interests in the VIEs as of both September 30, 2019 and December 31, 2018:

	Third party country of incorporation	Ownership percentage
SDVM	Malaysia	60%
PT Hitek	Indonesia	20%
SDNL	Nigeria	51%
SDOSL	Nigeria	20%

Each of the third parties listed above are not in a position to provide additional financing to their respective VIEs and do not participate in any gains or losses. Additionally, 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 the Company is the primary beneficiary as it has the obligation to absorb losses and the right to receive a majority of the benefits of the VIEs. Therefore, the Company has determined that the VIEs meet the criteria to be presented as consolidated entities in the Company's condensed consolidated interim financial statements.

Following are the aggregated assets and liabilities of the VIEs (in thousands):

	September 30, 2019	December 31, 2018
Assets		
Cash and cash equivalents	$ 3,421	$ 9,449
Accounts and other receivables, net	10,572	20,530
Other current assets	1,084	1,890
Total current assets	15,077	31,869
Property and equipment, net	3,405	3,066
Other assets	10,360	881
Total non-current assets	13,765	3,947
Total assets	$ 28,842	$ 35,816
Liabilities		
Accounts payable	$ 5,335	$ 7,387
Accrued income taxes	1,083	1,825
Other current liabilities	4,296	3,872
Total current liabilities	10,714	13,084
Other long-term liabilities	7,539	961
Total long-term liabilities	7,539	961
Total liabilities	18,253	14,045
Net carrying amount	$ 10,589	$ 21,771

The Company deemed it appropriate to aggregate the disclosure of its VIEs as all of these entities have a similar operating model and perform similar revenue generating activities. There are no material restrictions on distributions of the assets disclosed above, except for certain property and equipment which is pledged as collateral as discussed in Note 9 – Debt. Liability holders typically have recourse to the general credit of the Company when seeking to enforce settlement of liabilities. See Note 20 – Related Parties for additional discussion on the Company's transactions with its VIEs.

Note 5 — Property and Equipment

Property and equipment as of September 30, 2019 and December 31, 2018 consisted of the following (in thousands):

	September 30, 2019	December 31, 2018
Drilling rigs and equipment	$ 1,580,393	$ 1,497,716
Construction in progress	174,253	81,674
Spares	45,402	40,755
Land and building	2,178	1,354
Other	16,483	15,990
Total property and equipment	$ 1,818,709	$ 1,637,489
Less: Accumulated depreciation	(479,003)	(422,609)
Total property and equipment, net	$ 1,339,706	$ 1,214,880

Total capital expenditures for the nine months ended September 30, 2019 and 2018 were $189.4 million and $88.2 million, respectively. During the nine months ended September 30, 2019 and 2018, the capital expenditures included $159.3 million related to the two premium newbuild CJ46 jack-ups delivered in May 2019 ($121.8 million of which was financed by the issuance of common shares– see Note 17 – Supplemental Cash Flow Information) and $73.6 million related to one premium jack-up rig delivered in July 2018, respectively.

The two premium newbuild CJ46 jack-up rigs acquired during 2019 are currently undergoing readiness projects and are therefore included as construction in progress in the above table. On September 26, 2019, the rig previously acquired in July 2018 completed its readiness project and the rig costs, along with the associated transaction costs, were capitalized under "Drilling rigs and equipment" for a total of $81.7 million.

During the nine months ended September 30, 2019 and 2018, the Company sold three rigs and one rig, respectively, that were previously recorded as assets held for sale (see Note 6 – Assets held for sale).

Sales and disposals of other property and equipment for assets with a net carrying amount of $2.5 million and total proceeds received of $0.6 million, resulted in a loss on disposal of assets of $1.9 million during the nine months ended September 30, 2019. Sales and disposals of other property and equipment for assets with a net carrying amount of $1.2 million and total proceeds received of $0.8 million, resulted in a loss on disposal of assets of $0.4 million, during the nine months ended September 30, 2018.

The Company did not record an impairment charge on property and equipment during the three or nine months ended September 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 each recorded at the lower of carrying value or fair value less costs to sell.

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. Rig 124 was sold in September 2019. During the third quarter of 2019, the Company committed to a plan to sell the stacked rig Hibiscus in the next twelve months. On September 30, 2019, the rigs Comet and Hibiscus were recorded as assets held for sale at the lower of carrying value or fair value less costs to sell.

During the nine months ended September 30, 2019, the Company sold the Key Gibraltar, Adriatic X, and Rig 124 with a combined carrying value of $3.6 million for total net proceeds of $6.8 million and recognized a gain of $3.2 million. The sale of the Comet was completed in October 2019. During the nine months ended September 30, 2018, the Company sold the Trident IX with a carrying value of $1.7 million for net proceeds of $1.9 million and recognized a gain of $0.2 million. During the nine months ended September 30, 2018, the Company recorded an impairment loss of $1.1 million to value the Trident IX at the lower of carrying value less costs to sell.

Note 7 — Leases

The Company has lease agreements principally for office and yard space, expatriate employee accommodation, vehicles and office equipment with either cancellable or 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. 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 September 30, 2019, the Company did not have any finance leases.

Operating right-of-use assets and operating lease liabilities

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

Right-of-use assets	September 30, 2019
Other assets	$ 20,111

Lease liabilities	September 30, 2019
Other current liabilities	$ 6,960
Other liabilities	12,243
	19,203

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 September 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 fourth quarter of 2019, provide for total lease payments of approximately $16.7 million each to be paid over the respective lease terms.

Lease expense

During the three and nine months ended September 30, 2019, total lease expense was $2.8 million and $13.5 million, respectively, of which $2.2 million and $5.4 million, respectively, related to the operating lease right-of-use assets and $0.6 million and $8.1 million for short-term leases, respectively.

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

Years ending December 31,	
Remainder of 2019	$ 1,700
2020	7,568
2021	5,784
2022	4,594
2023	1,887
Thereafter	17
Total lease payments	$ 21,550
Less: Interest	2,347
Present value of lease liabilities	$ 19,203

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

Years ending December 31,		
2019	$	4,586
2020		3,829
2021		2,438
2022		1,818
2023		251
Thereafter		17
Total lease payments	$	12,939

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

Lease term and discount rate	**September 30, 2019**
Weighted-average remaining lease term (years)	3.34
Weighted-average discount rate	7.5%

During the nine months ended September 30, 2019, the Company paid $5.5 million for amounts that have been included in the measurement of operating lease liabilities.

Note 8 — Income Taxes

Income Tax Expense

Income tax expense for the three and nine months ended September 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 nine months ended September 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.

Income tax expense was $3.2 million and $8.1 million for the three and nine months ended September 30, 2019, respectively, compared to $8.0 million and $17.0 million for the three and nine months ended September 30, 2018, respectively. Income tax expense for the three months ended September 30, 2019 is lower than for the same period in 2018 primarily due to lower revenue for the 2019 period, a greater increase in liabilities for uncertain tax positions for the 2018 period, a reduction in valuation allowance against certain deferred tax assets for the 2019 period and a reduction in the value of certain income tax receivables for the 2018 period primarily as a result of foreign currency depreciation against the U.S. dollar.

Tax Rate

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. Tax rates can vary significantly between jurisdictions. SDL is exempt from all income taxation in the Cayman Islands, its country of incorporation. 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 (11.3)% and (24.5)% for the nine months ended September 30, 2019 and 2018, respectively. The Company has income tax expense for the nine months ended September 30, 2019 and 2018, despite having a loss before income taxes for both periods, resulting in negative effective tax rates for both periods. These negative effective tax rates are 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.

Deferred Income Taxes

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 September 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 September 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 September 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 taken on the tax returns of certain subsidiaries that have resulted in a reduction in tax liabilities for those subsidiaries. In management's judgment, these tax positions are "uncertain" in that they are likely to be successfully challenged by the relevant tax authorities in the future. Liabilities related to uncertain tax positions, recorded as other long-term liabilities, were $8.7 million and $10.0 million as of September 30, 2019 and December 31, 2018, respectively.

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

	September 30, 2019	December 31, 2018
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	564	8,153
Balance, end of period	$ 8,700	$ 10,001

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

As of September 30, 2019 and December 31, 2018, the Company has $0.7 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):

	September 30, 2019	December 31, 2018
8.25% Senior Unsecured Notes, due February 15, 2025 (see note (ii) below)	$ 889,135	$ 887,764
Revolving Credit Facility, due April 30, 2023 (see note (iii) below)	20,000	-
	$ 909,135	$ 887,764

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

Years ending December 31,	
Remainder of 2019	$ -
2020	-
2021	-
2022	-
2023 and thereafter	920,000
Total debt	$ 920,000

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

	8.25% Senior Unsecured Notes, due February 2025		Revolving Credit Facility, due April 2023	
	September 30, 2019	December 31, 2018	September 30, 2019	December 31, 2018
Principal amount	$ 900,000	$ 900,000	$ 20,000	$ -
Unamortized debt issuance costs	(13,407)	(15,051)	-	-
Unamortized premium	2,542	2,815	-	-
Carrying value	$ 889,135	$ 887,764	$ 20,000	$ -

The total unamortized debt issuance costs for the Revolving Credit Facility, due April 2023 were $4.0 million and $4.8 million, as of September 30, 2019 and December 31, 2018, respectively, recorded under other assets on the condensed consolidated interim balance sheets.

(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 September 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.

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.

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

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 related guarantee of payment by SDHL and the Note Guarantors:

- 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 ("Moody's") and Standard & Poor's Financial Services LLC ("S&P's") 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 nine months ended September 30, 2019 was $0.5 million and $1.4 million, respectively, and during the three and nine months ended September 30, 2018 was $0.5 million and $0.9 million, respectively. The total amortization of premium during the three and nine months ended September 30, 2019 was $0.1 million and $0.3 million, respectively, and during both the three and nine months ended September 30, 2018 was $0.1 million.

(iii) Revolving Credit Facility, due April 2023

On February 24, 2014, SDHL entered into a revolving credit facility, which was subsequently amended on January 9, 2017, June 4, 2018 and in related side letters, including the May 9, 2019 side letter discussed further below ("SDHL Revolver"). The SDHL Revolver has a facility of $225 million, which can be drawn as cash, letters of credit or bank guarantees, or a mixture of cash, letters of credit and guarantees, subject to the satisfaction of customary conditions set forth in the underlying credit agreement. All borrowings under the SDHL Revolver mature on April 30, 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 facility is cancellable by SDHL at any time with no penalty or premium.

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.

Interest for the SDHL Revolver is based on the London inter-bank offered rate, subject to certain adjustments ("Adjusted LIBOR"), a margin based on credit ratings of the Company or its subsidiaries by S&P's and Moody's ("Applicable Margin") and/or the highest of the prime rate, the federal funds rate plus 0.5% per year, or the one-month Adjusted LIBOR rate plus 1.00% ("Alternative Base Rate") as discussed further below.

The SDHL Revolver also contains various customary restricted covenants, described further below, including limitations on the Company's leverage ratio, subject to certain specific add-backs and adjustments as outlined in the SDHL Revolver ("Total Net Leverage Ratio"). There are certain customary limitations which restrict the Company's ability to draw down the available balance of the SDHL Revolver, including but not limited to prohibiting draw down while an event of default or material adverse event is ongoing and requiring that the Company be in compliance with its financial covenant obligations both before and after the draw down.

The June 4, 2018 amendment of the SDHL Revolver, effective June 19, 2018, introduced various changes to the terms, which, among other things (i) extended the maturity date from April 30, 2020 to April 30, 2023; (ii) increased the facility amount 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 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 September 30, 2019, the Applicable Margin was 4.0% per year for borrowings at the Adjusted LIBOR Rate.

After the closing of the Transaction (as defined in Note 14 – Shareholder's Equity), the Company successfully implemented the following amendments to the SDHL Revolver as agreed in a side letter dated May 9, 2019: (i) change the Total Net Leverage Ratio requirement 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.

As of September 30, 2019, the Company owed $20.0 million and as of December 31, 2018, the Company had no outstanding borrowings under the SDHL Revolver. The Company issued bank guarantees and performance bonds totaling $8.9 million and $8.6 million as of September 30, 2019 and December 31, 2018, respectively, against the SDHL Revolver.

Interest on the borrowings of the SDHL Revolver was 5.99% per year as of September 30, 2019 and is payable quarterly. These borrowings are currently classified as a long-term liability on the Company's condensed consolidated balance sheet. Participation fees accrue on financial letters of credit and bank guarantees at the Applicable Margin for borrowings at the Adjusted LIBOR Rate and on non-financial letters of credit and bank guarantees at 50% of the Applicable Margin for borrowings at the Adjusted LIBOR Rate. 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 amortization of debt issuance costs on the SDHL Revolver were $0.3 million and $0.8 million during the three and nine months ended September 30, 2019, respectively, and $0.3 million and $0.9 million during the three and nine months ended September 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;
- Payment of dividends;
- 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. The Company was in compliance with all covenants of its debt agreements as of September 30, 2019 and December 31, 2018.

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 of 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 $3.2 million and $30.0 million, including interest of $0.2 million and $9.6 million, during the three and nine months ended September 30, 2018. There were no such transactions during the nine months ended September 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 $4.8 million in expense related to its retirement and savings plans for the three and nine months ended September 30, 2019, respectively, and $1.4 million and $4.3 million in expense during the three and nine months ended September 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 $1.2 million and $2.8 million in expense related to employee end of service plans during the three and nine months ended September 30, 2019, respectively, and $0.7 million and $3.2 million in expense during the three and nine months ended September 30, 2018, respectively.

Retention Plans

The Company sponsors medium-term cash incentive programs for certain employees. The plans generally vest over a period ranging from one to two years, and associated payouts are made upon vesting provided the participant is still employed in the Company.

The Company has recorded approximately $0.7 million and $2.0 million in expense related to its employee retention plans for the three and nine months ended September 30, 2019, respectively, and $0.5 million and $1.8 million in expense during the three and nine months ended September 30, 2018, respectively. The estimated total cash payments under the current 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 July 2015, the Company 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 (“Cornucopia”) and Corsair Oil & Gas LLC (“Corsair”) 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 and the sole member and owner of Furie, guaranteed the obligations of the Original Charterer under the Agreement for securing the payments of future chartering costs of the Company rig by Furie.

The Agreement with the Original Charterer was assigned to Kadmas Limited (“Kadmas”) in November 2015. Kadmas breached the terms of the Agreement by failing to pay the Company amounts owed. 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.

A subsidiary of the Company filed a lawsuit in June 2018 before the Superior Court for the State of Alaska in Anchorage, against Furie, Cornucopia, Corsair and Furies’ lender, Energy Capital Partners Mezzanine Opportunities Fund, LP (“ECP”), (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 was 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.

Furie, Cornucopia and Corsair, filed on August 09, 2019 for voluntary chapter 11 bankruptcy petitions (reorganization proceedings) in Delaware, USA. Due to the bankruptcy filing, there is an automatic stay on the Alaska proceedings against Furie, Cornucopia and Corsair. In the Alaska case hearing held on August 29, 2019, the Company indicated its intention to proceed with the case against ECP. The bankruptcy petitions are in their initial stages, with attempts by the debtors and their lenders (including ECP affiliates) to take all assets for the sole benefit of lenders. The Company is actively engaged with its external counsel to oppose these efforts.

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 and Other Bank Guarantees

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 $88.7 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 $54.7 million and $52.9 million as of September 30, 2019 and December 31, 2018, respectively.

In addition, the Company had outstanding bank guarantees and performance bonds amounting to $8.9 million and $8.6 million as of September 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 $63.6 million and $61.5 million as of September 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.

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

	September 30, 2019		December 31 , 2018	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
8.25% Senior Unsecured Notes, due February 15, 2025	$ 889,135	$ 805,842	$ 887,764	$ 782,757
Revolving Credit Facility, due April 2023	20,000	20,000	-	-
	$ 909,135	$ 825,842	$ 887,764	$ 782,757

The Company's long-term debt includes the outstanding balances under the 8.25% Senior Unsecured Notes and the SDHL Revolver. The estimated fair value of the 8.25% Senior Unsecured Notes was determined using quoted market prices or Level 1 inputs. The Company believes the $20.0 million carrying value of the borrowing under the SDHL Revolver approximates the fair value due to its recent issuance and variable interest rate.

As of September 30, 2019, the estimated fair value of the 8.25% Senior Unsecured Notes excludes unamortized debt issuance costs and unamortized premium of $13.4 million and $2.5 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 $8.00 per share on the OSE 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 or both 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.

As of September 30, 2019, the Company's authorized common shares were 144,063,473, of which 137,724,393 shares were outstanding. As of September 30, 2019, all authorized and unissued shares were reserved by the Company's Board of Directors for issuance pursuant to the 2017 Long-Term Incentive Plan (the "2017 LTIP"). See Note 15 – Share-based Compensation. However, the Board of Directors may amend or alter the number of shares reserved for such purposes in future periods.

As of September 30, 2019, there were 87,387,103 shares listed on the OSE, net of shares canceled by default, as discussed further below.

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 share dividends during the nine months ended Septembers 30, 2019 and 2018.

Share repurchase program

On September 1, 2019, the Board of Directors approved a share repurchase program under which the Company may repurchase shares of the Company's common stock for an aggregate of $25.0 million over a period of two years from the date of approval (the "2019 Repurchase Program"). Any repurchased shares will be canceled and will resume the status of authorized and unissued shares upon the repurchase date, as the repurchased shares are considered constructively retired on the repurchase date. These unissued shares will be available for issuance in the future. Shares will be repurchased in the open market on the OSE.

The Company repurchased approximately 285,000 shares of common stock at an average price of 22.01 NOK (or $2.45) per share during the three and nine months ended September 30, 2019 under the 2019 Repurchase Program. No amounts were repurchased during the comparable periods in 2018. As of September 30, 2019, approximately $24.3 million remains available for repurchase under the 2019 Repurchase Program.

In accordance with Cayman Islands law, the repurchased shares will be canceled by default immediately after repurchase. The SDHL Revolver limits the amount the Company can spend on common stock repurchases, including requiring the Company to maintain certain liquidity and consolidated coverage ratio targets. See Note 9 – Debt. As of September 30, 2019, the Company was in compliance with the requirements of the SDHL Revolver, the 8.25% Senior Unsecured Notes and the regulatory requirements for the Cayman Islands and the OSE related to its stock repurchases. The amount approved under the 2019 Repurchase Program was within the limitation on spending for stock repurchases in the SDHL Revolver.

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.

During the nine months ended September 30, 2018, there was no issuance of restricted common shares and 9,606 contingently forfeitable restricted 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. There were no issuances of restricted common shares during the nine months ended September 30, 2019. There were no outstanding, unvested restricted shares as of September 30, 2019 and December 31, 2018.

2017 Long-Term Incentive Plan

The Company has adopted 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, 14.4 million shares 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 September 30, 2019 and December 31, 2018, there were 12.8 million and 14.4 million shares, respectively, remaining under the 2017 LTIP. However, grants of any additional awards will be limited to the Company's authorized but unissued shares at the time of the respective award dates. 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 nine months ended September 30, 2019, the Company 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. There were no such awards granted in the prior periods.

Time-based restricted share units

The TBRSUs 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. The fair value of TBRSUs 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.

The following table summarizes the TBRSUs granted as of September 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 September 30, 2019	794,379	$ 4.32

As of September 30, 2019, the total unrecognized compensation cost related to non-vested TBRSUs was $2.9 million which is expected to be recognized over a weighted average period of approximately 2.4 years.

Performance-based restricted share units

The PBRSUs 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 valued based on the stock price on the date of grant. After the grant date, compensation cost will be recognized through the vesting date for 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 granted in June 2019 were measured on the grant date using the Monte-Carlo option pricing model, which was prepared 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:

	TSR share units
Valuation assumptions:	
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.

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

	Performance-based restricted share units	Weighted average grant date fair value per share
	TSR share units	TSR share units
Non-vested shares at January 1, 2019	-	$ -
Granted	584,826	5.60
Vested	-	-
Forfeited	-	-
Non-vested shares at September 30, 2019	584,826	$ 5.60

As of September 30, 2019, the total unrecognized compensation cost related to non-vested PBRSUs, excluding the ROCE share units, was $2.8 million and is expected to be recognized over a weighted average period of approximately 2.4 years.

Share-Based Compensation Expense

Restricted shares

The Company recorded share-based compensation expense related to restricted shares of zero and $11.3 million during the three and nine months ended September 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. No income tax benefit was recognized for these plans. There were no such transactions during the nine months ended September 30, 2019.

Restricted Share Units ("RSU")

The Company recorded total share-based compensation expense for all RSU awards in general and administrative expenses of $0.6 million and $0.9 million for the three and nine months ended September 30, 2019, respectively. No income tax benefit was recognized for these awards. There were no such transactions during the nine months ended September 30, 2018.

Note 16 — Derivative Financial Instruments

Foreign Currency Forward Exchange Contracts

The Company may enter into foreign exchange contracts when management believes that market conditions are favorable to purchase contracts for future settlement ("forex contracts") 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 nine months ended September 30, 2019, the Company settled forex contracts with aggregate notional values of approximately $3.2 million and $10.4 million, respectively, and approximately $6.3 million and $16.4 million during the three and nine months ended September 30, 2018, respectively, of which the aggregate amounts were designated as an accounting hedge.

As of September 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 $0.1 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 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 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 nine months ended September 30, 2019.

The following table presents the amounts recognized in the Company's condensed consolidated interim balance sheets and condensed consolidated interim statements of operations related to the derivative financial instruments designated as cash flow hedges for the three and nine months ended September 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.

	Unrealized (loss) / gain recognized through AOCIL			
	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Cash flow hedges				
Foreign currency forward contracts	$ (87)	$ (400)	$ 54	$ (1,311)
Interest rate swaps	-	-	-	213
	$ (87)	$ (400)	$ 54	$ (1,098)

	Gain / (loss) reclassified from AOCIL recognized through "Operating and maintenance"			
	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Cash flow hedges				
Foreign currency forward contracts	$ 65	$ (440)	$ 224	$ (703)
Interest rate swaps	-	-	-	(107)
	$ 65	$ (440)	$ 224	$ (810)

	Gain / (loss) reclassified from AOCIL recognized through "Other, net"			
	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Interest rate swaps				
Interest rate swaps, other	$ -	$ -	$ -	$ 320

The following table presents the fair values of the derivative forex contracts designated as hedging instruments included in other current assets on the Company's condensed consolidated interim balance sheets (in thousands):

	September 30, 2019	December 31, 2018
Asset derivatives		
Short-term foreign currency forward contracts	$ 73	$ 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 newbuild rigs 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):

	Nine months ended September 30,	
	2019	2018
Regulatory and capital maintenance	$ 43,190	$ 32,323
Contract preparation	28,620	15,273
Fleet spares and others	6,955	7,966
	$ 78,765	$ 55,562
Rig acquisitions	175,575	83,071
Total capital expenditures and deferred costs	$ 254,340	$ 138,633

SHELF DRILLING

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

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):

	Nine months ended September 30,	
	2019	2018
Cash payments for additions to property and equipment	$ 53,869	$ 90,552
Net change in accrued but unpaid additions to property and equipment	13,801	(2,376)
	$ 67,670	$ 88,176
Add: Asset addition related to share issuance	121,772	-
Total capital expenditures	$ 189,442	$ 88,176
Changes in deferred costs, net	$ 7,812	$ (13,563)
Add: Amortization of deferred costs	57,086	64,020
Total deferred costs	$ 64,898	$ 50,457
Total capital expenditures and deferred costs	$ 254,340	$ 138,633

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 nine months ended September 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):

	As of December 31,	As of September 30,	
	2018	2019	2018
Cash and cash equivalents	$ 91,203	$ 45,723	$ 66,622
Restricted cash included in other current assets	1,598	337	1,563
Restricted cash included in other assets	34	34	21
Total cash, cash equivalents and restricted cash	$ 92,835	$ 46,094	$ 68,206

Note 18 — Loss Per Share

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

	Three months ended September 30,	
	2019	2018
Numerator for loss per share		
Net loss	$ (35,931)	$ (10,324)
Less: Preferred shares dividend	-	-
Net loss attributable to common shares	$ (35,931)	$ (10,324)
Denominator for loss per share		
Weighted average common shares:		
Basic outstanding common shares	137,961	111,240
Diluted common shares	137,961	111,240
Basic loss per common share	$ (0.26)	$ (0.09)
Diluted loss per common share	$ (0.26)	$ (0.09)

	Nine months ended September 30,	
	2019	**2018**
Numerator for loss per share		
Net loss	$ (79,203)	$ (86,225)
Less: Preferred shares dividend	-	9,550
Net loss attributable to common shares	$ (79,203)	$ (95,775)
Denominator for loss per share		
Weighted average common shares:		
Basic outstanding common shares	125,442	92,313
Diluted common shares	125,442	92,313
Basic loss per common share	$ (0.63)	$ (1.04)
Diluted loss per common share	$ (0.63)	$ (1.04)

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 nine months ended September 30, 2019, there were 6,484 and 3,197 dilutive potential common shares, respectively, and for the three and nine months ended September 30, 2018 there were zero and 48,099 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 the drilling fleet is mobile and 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 was as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2019	**2018**	**2019**	**2018**
Saudi Arabia	$ 39,253	$ 43,106	$ 121,746	$ 126,084
Thailand	29,505	28,941	87,772	87,519
United Arab Emirates	19,498	21,989	53,876	63,927
Nigeria	18,799	27,116	74,855	65,983
India	9,653	26,372	34,145	77,503
Others	15,310	12,717	43,938	39,250
Total Revenue	$ 132,018	$ 160,241	$ 416,332	$ 460,266

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):

	September 30, 2019	December 31, 2018
Thailand	$ 421,551	$ 429,938
Bahrain	267,108	41,753
United Arab Emirates	216,700	303,068
Nigeria	168,840	183,883
Saudi Arabia	165,061	190,001
India	83,988	86,607
Others	164,230	119,589
Total long-lived assets	$ 1,487,478	$ 1,354,839

The total long-lived assets are comprised of property and equipment and short-term and long-term deferred costs. A substantial portion of the Company's assets are mobile. As of September 30, 2019, the long-lived assets in Bahrain include $253.2 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

The Company's related parties consist of the VIEs, the Sponsors and China Merchants. Following the completion of the Transaction (as defined in Note 14 – Shareholders' Equity) in May 2019, China Merchants became the largest shareholder of 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 nine months ended September 30, 2019. The total liability recorded under accounts payable was zero as of September 30, 2019 and December 31, 2018. There were no similar transactions during the nine months ended September 30, 2018.

The Company recorded $0.4 million and $1.2 million for the three and nine months ended September 30, 2019, respectively, and $0.5 million and $3.3 million for the three and nine months ended September 30, 2018, respectively, of Sponsors' costs. Sponsors' costs include directors' fees and reimbursement of costs incurred by Sponsors and directors for attendance at meetings relating to the management and governance of the Company and costs related to the $0.4 million monthly fee which was discontinued upon the consummation of the Offering. The total liability recorded under accounts payable for such transactions was $0.2 million as of both September 30, 2019 and December 31, 2018.

A VIE related party provided goods and services to drilling rigs owned by one of the Company's foreign subsidiaries. These goods and services totaled $0.5 million and $1.8 million during the three and nine months ended September 30, 2019, respectively, and $0.7 million and $1.9 million for the three and nine months ended September 30, 2018, respectively. The total liability recorded under accounts payable for such transactions was $0.6 million and $0.8 million as of September 30, 2019 and December 31, 2018, respectively.

Lease with a related party

The Company entered into a lease agreement for 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 available to either party. The lease 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 September 30, 2019 was $6.2 million. The corresponding operating lease liability as of September 30, 2019 was $6.0 million (current: $1.5 million; long-term: $4.5 million). The Company has recorded total lease expense of $0.4 million and $1.2 million for the three and nine months ended September 30, 2019, respectively and $0.4 million and $1.2 million for the three and nine months ended September 30, 2018, respectively.

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

Years ending December 31,		
Remainder of 2019	$	409
2020		1,637
2021		1,637
2022		1,637
2023		1,637
Total lease payments	$	6,957
Less: Interest		948
Present value of lease liabilities	$	6,009

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

As of September 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 4.35 years and 7.5% respectively. During the nine months ended September 30, 2019, the Company paid $1.2 million for amounts that have been included in the measurement of operating lease liabilities.

Note 21 — Subsequent Events

The Company has evaluated subsequent events through November 13, 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.

Forward Looking Statements

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, share repurchases 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 purchased or leased 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 estimated proceeds, cost to sell and timing of asset dispositions, including our assets held for sale;
- 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;
- 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 Company specific, industry specific or market factors;
- the market value of our rigs and of any rigs we acquire in the future may decrease;
- the 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" or the negative of these terms 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

Shelf Drilling, Ltd. 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 (rebranded in September 2019 as CPE Capital) and Lime Rock Partners (together, the “Sponsors”). 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 September 30, 2019, own 37 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 (“OSE”) under the ticker symbol “SHLF”. Our website address is www.shelfdrilling.com.

Recent events

During the three months ended September 30, 2019, the Company secured contracts for three of its available rigs, including a two-year contract for the Shelf Drilling Scepter for operations in the Gulf of Thailand, which is expected to commence in the fourth quarter of 2019 and three-year contracts for each of the C.E. Thornton and F.G. McClintock for operations in India, both of which are expected to commence in the fourth quarter of 2019.

During the three months ended September 30, 2019, the Company secured contract extensions for four of its rigs, including a two-year extension for each of the Shelf Drilling Tenacious and the Shelf Drilling Mentor in the Arabian Gulf, a six-month extension for the High Island VII in the Arabian Gulf and a six-month extension for the Shelf Drilling Resourceful in Nigeria.

On September 1, 2019, the Board of Directors approved a share repurchase program under which the Company may repurchase shares of the Company’s common stock for an aggregate of $25.0 million over a period of two years from the date of approval (the “2019 Repurchase Program”). Repurchased shares are considered constructively retired on the repurchase date and may be used, in part, to satisfy obligations under the Company’s long-term incentive plans. Shares will be repurchased in the open market on the OSE.

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 or both of the rigs during the initial term (the “Transaction”). The payments under the bareboat charter agreements are expected to commence in the fourth quarter 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 Company’s largest shareholder.

Drilling fleet

The following table summarizes the Company's offshore drilling rigs as of September 30, 2019 and 2018:

	As of September 30,	
	2019	**2018**
Jack-ups	37	38
Swamp barge	1	1
Total	38	39

Subsequent to September 30, 2018, the Company added two premium newbuild jack-up rigs to its drilling fleet and three rigs were disposed. Included in the 38 rigs are two rigs reported as Assets Held for Sale in the September 30, 2019 condensed consolidated interim balance sheets, of which one rig was sold to a third party in October 2019.

Outlook

Following a severe, multi-year downturn in the offshore drilling industry, we are continuing to see an improvement in demand for jack-up rig services across all of our markets. 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 the first half of 2019 Brent crude oil prices recovered, with prices in the $60 to $70 per barrel range.

We believe the current commodity price will continue to stimulate an increase in shallow water activity. Furthermore, we expect that dayrates and utilization will continue to 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 23% from 311 rigs in January 2017 to 383 rigs in November 2019. Marketed utilization for the industry went above 80% in February 2019 for the first time since 2015, and has remained above 80% into November 2019. There has been an acceleration of activity since early 2018, which we believe will continue into 2020.

We are seeing the effect of increasing demand, as previously signed contracts commence during the fourth quarter of 2019, and we anticipate our results of operations will begin to significantly improve. We believe there is reason for optimism, as dayrates have started to rise for jack-ups in all asset classes and in all regions from the cyclical lows. Several of our recent awards represent an improvement in pricing relative to contracts signed in the prior year period. These new contracts and contract extensions have increased our backlog, as discussed further below. We expect this activity will translate into increased fleet utilization in the fourth quarter of 2019 and into 2020.

We have taken steps in recent years to enhance our fleet, including our acquisition of eight premium jack-up rigs from 2016 through 2019. We remain focused on delivering safe and efficient operations and believe that we are well positioned to benefit from a further increase in demand for jack-up rig services due to our versatile fleet, operating track record, competitive low-cost structure and existing geographic footprint. The significant capital investments and backlog additions in 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 during the firm contract period less any planned out-of-service periods 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 executed 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 $977 million across 29 contracted rigs with a weighted average backlog dayrate of $65 thousand per day and average contracted days of 518 per rig as of September 30, 2019, compared with $895 million across 26 contracted rigs with a weighted average backlog dayrate of $84.0 thousand per day and average contracted days of 410 per rig as of September 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 September 30, 2019, 32 rigs were marketable (of which 28 were under contract and four were actively being marketed), one premium newbuild jack-up drilling rig acquired in May 2019 was undergoing readiness project and contract preparation, one premium newbuild jack-up drilling rig acquired in May 2019 was undergoing readiness project and four rigs were stacked, compared to 36 marketable rigs (of which 26 were under contract and 10 were actively being marketed), including one premium drilling rig acquired in July 2018, and three stacked rigs as of September 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 nine months ended September 30, 2019 was $64.7 thousand and $64.8 thousand, respectively, a decrease of 4.1% and 5.3%, respectively, from the average dayrate of $67.5 thousand and $68.4 thousand for the three and nine months ended September 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 the three months ended September 30, 2019 of 65% was lower than the effective utilization in the three months ended September 30, 2018 of 70%. The decrease was primarily driven by the adverse impact of completion of contracts in India and Nigeria. There were four rigs idle awaiting marketing opportunities at the end of the three months ended September 30, 2019 compared to 10 rigs at the end of the three months ended September 30, 2018.

Financial measures

In addition to the operational measures discussed above, we also use certain generally accepted accounting principles in the United States of America ("U.S. 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 U.S. 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 U.S. 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 nine months ended September 30, 2019 and 2018 were as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Net loss	$ (35,931)	$ (10,324)	$ (79,203)	$ (86,225)
Add back:				
Interest expense and financing charges, net of interest income (1)	19,754	20,122	59,262	85,526
Income tax expense	3,241	7,978	8,072	16,974
Depreciation	20,370	21,598	61,046	65,275
Amortization of deferred costs	19,836	23,585	57,086	64,020
Loss on impairment of assets	-	-	-	1,137
Loss / (gain) on disposal of assets	638	(57)	(1,264)	184
EBITDA	$ 27,908	$ 62,902	$ 104,999	$ 146,891
Acquired rig reactivation costs (2)	4,097	1,244	16,663	3,302
One-time corporate transaction costs (3)	14	66	132	3,995
Certain share-based compensation expense, net of forfeitures (4)	-	-	-	11,323
Sponsors' fee (5)	-	-	-	2,250
Other	-	-	-	400
Adjusted EBITDA	$ 32,019	$ 64,212	$ 121,794	$ 168,161
Adjusted EBITDA margin	24.3%	40.1%	29.3%	36.5%

(1) Represents 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 losses on debt extinguishments in relation to our debt refinancing transactions in 2018.

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

(3) Represents certain one-time third-party professional services.

(4) Represents certain share-based compensation expense, net of forfeitures, related to grants prior to the Company's June 25, 2018 initial public offering on the Oslo Stock Exchange (the "Offering" or "IPO").

(5) 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 Shelf Drilling Chaophraya and Shelf Drilling Krathong ("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 nine months ended September 30, 2019 and 2018.

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

Operating Results

Three months ended September 30, 2019 ("Q3 2019") compared to three months ended September 30, 2018 ("Q3 2018")

Revenues

Total revenue for the three months ended September 30, 2019 was $132.0 million compared to $160.2 million for the same period in 2018. Revenue for the three months ended September 30, 2019 consisted of $129.0 million (97.7%) of operating revenue and $3.0 million (2.3%) of other revenue. During the same period in 2018, the corresponding revenues were $156.3 million (97.6%) and $3.9 million (2.4%), respectively.

Revenue for the three months ended September 30, 2019 decreased by $28.2 million compared to the same period in 2018 primarily due to $20.5 million resulting from lower effective utilization across the fleet, $6.1 million from lower average earned dayrates across the fleet and $1.6 million from lower recharges and amortization of mobilization revenue.

Operating and maintenance expenses

Total operating and maintenance expenses for the three months ended September 30, 2019 were $91.4 million, or 69.2% of total revenue, compared to $86.1 million, or 53.7% of total revenue, in the three months ended September 30, 2018. Operating and maintenance expenses in the three months ended September 30, 2019 consisted of $82.1 million rig-related expenses and $9.3 million shore-based expenses. In the three months ended September 30, 2018, these same expenses were $77.7 million and $8.4 million, respectively.

During the three months ended September 30, 2019, rig-related expenses included $50.8 million for personnel expenses, $30.8 million for rig maintenance expenses and $0.5 million for other rig-related expenses. This compares to $44.8 million, $22.9 million and $10.0 million for those respective categories during the same period in 2018.

The increase in total rig-related expenses of $4.4 million was due to $4.5 million of higher rig demobilization, temporary importation and standby costs, $2.6 million of additional reactivation expense for the premium jack-up drilling rigs acquired in 2018 and 2019 and $2.5 million of contract preparation and operating expenses for rigs that were idle in 2018 but preparing for contract or operating in 2019. This was partly offset by $4.1 million lower expenses for stacked and idle rigs awaiting marketing opportunities and $0.9 million lower other personnel and operating expenses.

Shore-based expenses increased by $0.9 million for the three months ended September 30, 2019 compared to the same period in 2018.

Depreciation expense

Depreciation expense in the three months ended September 30, 2019 was $20.4 million compared to $21.6 million for the same period in 2018. The $1.2 million decrease primarily related to $1.1 million of lower depreciation on drilling rigs and equipment which were impaired in 2018.

Amortization of deferred costs

The amortization of deferred costs in the three months ended September 30, 2019 was $19.8 million compared to $23.6 million for the same period in 2018. The $3.8 million decrease primarily related to lower amortizations of contract preparation costs on drilling rigs that completed their contracts in late 2018 or 2019, partially offset by increased amortization on drilling rigs which started contracts in 2019.

General and administrative expenses

General and administrative expenses were $12.8 million in the three months ended September 30, 2019 compared to $11.1 million for the same period in 2018. The $1.7 million increase primarily resulted from $0.8 million in higher expenses to support our business, and a $0.6 million increase in share-based compensation.

(Gain) / Loss on disposal of assets

Disposal of assets was a loss of $0.6 million in the three months ended September 30, 2019 compared to a gain of $0.1 million for the same period in 2018.

Other (expense) / income, net

Other (expense) / income, net, consisting of interest expense and finance charges, interest income and other, net was an expense of ($19.7) million in the three months ended September 30, 2019 compared to ($20.3) million for the same period in 2018.

During the three months ended September 30, 2019, other expense consisted primarily of interest expense and financing charges of ($20.1) million, as well as interest income of $0.3 million and other, net of $0.1 million in income. This compares to ($20.6) million, $0.5 million and ($0.2) million in expense for those respective categories during the same period in 2018.

Interest expense and financing charges in the three months ended September 30, 2019 were $0.5 million lower compared to the same period in 2018 primarily due to $0.5 million lower interest on the sale & leaseback financing facility due to its early termination in July 2018. The change in other, net of $0.3 million was mainly due to foreign currency exchange losses during Q3 2018.

Income tax expense

Income tax expense for the three months ended September 30, 2019 was $3.2 million compared to $8.0 million for the three months ended September 30, 2018. While the Company is 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 the Company operates and earns income or is considered resident for income tax purposes. The relationship between the provision for or benefit from income taxes and the income or loss before income taxes can vary significantly from period to period considering, among other factors, (a) the overall level of income before income taxes, (b) changes in the blend of income that is taxed based on gross revenues rather than income before taxes, (c) rig movements between taxing jurisdictions and (d) changes in the Company's rig operating structures which may alter the basis on which the Company is taxed in a particular jurisdiction.

Income tax expense in Q3 2019 is lower than in Q3 2018 primarily due to lower revenue for the 2019 period, a greater increase in liabilities for uncertain tax positions for the 2018 period, a reduction in valuation allowance against certain deferred tax assets for the 2019 period and a reduction in the value of certain income tax receivables for the 2018 period primarily as a result of foreign currency depreciation against the U.S. dollar.

Nine months ended September 30, 2019 compared to nine months ended September 30, 2018

Revenues

Total revenue for the nine months ended September 30, 2019 was $416.3 million compared to $460.3 million for the same period in 2018. Revenue for the nine months ended September 30, 2019 consisted of $405.8 million (97.5%) of operating revenue and $10.5 million (2.5%) of other revenue. During the same period in 2018, the corresponding revenues were $449.9 million (97.7%) and $10.4 million (2.3%), respectively.

Revenue in the nine months ended September 30, 2019 decreased by $43.9 million compared to the same period in 2018 primarily due to $23.1 million lower average earned dayrates across the fleet, $20.3 million related to lower effective utilization across the fleet, and $5.8 million lower recharges and amortization of mobilization revenue. This was partly offset by $5.2 million of higher operating revenue due to the start of operations of the three acquired premium jack-up drilling rigs in the first quarter of 2018.

Operating and maintenance expenses

Total operating and maintenance expenses for the nine months ended September 30, 2019 were $274.6 million, or 66.0% of total revenue, compared to $263.6 million, or 57.3% of total revenue, for the same period in 2018. Operating and maintenance expenses in the nine months ended September 30, 2019 consisted of $247.9 million rig-related expenses and $26.7 million shore-based expenses. In the nine months ended September 30, 2018, these same expenses were $238.1 million and $25.5 million, respectively.

In the nine months ended September 30, 2019, rig-related expenses included $146.6 million for personnel expenses, $93.4 million for rig maintenance expenses and $7.9 million for other rig-related expenses. This compares to $138.4 million, $67.5 million and $32.2 million for those respective categories during the same period in 2018. The increase in rig-related expenses of $9.8 million was due to $16.5 million of higher costs for acquired rigs reactivation mainly for the premium jack-up drilling rig acquired in July 2018, $11.4 million of contract preparation and operating expenses for rigs that were idle in 2018 but preparing for contract or operating in 2019 and $3.1 million of higher rig mobilization and temporary importation costs. This was partly offset by $14.9 million lower expenses for stacked and idle rigs awaiting marketing opportunities, $0.5 million lower maintenance and shipyard expenses and $5.8 million lower other personnel and operating expenses.

Shore-based expenses increased by $1.2 million for the nine months ended September 30, 2019 compared to the same period in 2018.

Depreciation expense

Depreciation expense in the nine months ended September 30, 2019 was $61.0 million compared to $65.3 million for the same period in 2018. The decrease of $4.3 million primarily related to $3.2 million of lower depreciation on drilling rigs and equipment which were impaired in 2018 and $1.2 million of lower depreciation on certain of the Company's software systems, which became fully depreciated in the prior year.

Amortization of deferred costs

The amortization of deferred costs in the nine months ended September 30, 2019 was $57.1 million compared to $64.0 million during the same period in 2018. The $6.9 million decrease primarily related to lower amortizations of contract preparation costs on drilling rigs that completed their contracts in late 2018 or 2019, partially offset by increased amortization on drilling rigs which started contracts in 2019 and deferred shipyard expenditures which began amortizing in 2018.

General and administrative expenses

General and administrative expenses in the nine months ended September 30, 2019 were $36.3 million compared to $50.5 million during the same period in 2018. The $14.2 million decrease was primarily due to $10.4 million of lower share-based compensation, due to the accelerated vesting of all unvested shares in June 2018 as a result of the consummation of the Public

Offering, $3.8 million of lower transaction costs and $2.3 million due to no Sponsors' fees in 2019. This was partly offset by $2.3 million of higher expenses in 2019 to support our business.

Loss on impairment of assets

Loss on impairment of assets was zero in the nine months ended September 30, 2019 compared to $1.1 million for the nine months ended September 30, 2018. The impairment in the nine months ended September 30, 2018 is related to a non-cash impairment loss on one of the Company's rigs triggered by a rig sale agreement signed in 2018. The impairment represented the excess of the carrying amount of the rig held for sale over its fair value less costs to sell.

Gain (loss) on disposal of assets

Gain (loss) on disposal of assets was a gain of $1.2 million and a loss of ($0.2) million in the nine months ended September 30, 2019 and 2018, respectively. The gain on disposal of assets in 2019 was primarily due to the sale of two stacked rigs during the first quarter of 2019.

Other (expense) / income, net

Other (expense) / income, net, consisting of interest expense and finance charges, interest income and other, net was an expense of ($59.6) million in the nine months ended September 30, 2019 compared to ($84.8) million for the same period in 2018.

During the nine months ended September 30, 2019, other expense consisted primarily of interest expense and financing charges of ($60.3) million, as well as interest income of $1.0 million and other, net of ($0.4) million in expense. This compares to ($86.7) million, $1.2 million and $0.7 million in income for those respective categories during the same period in 2018.

Interest expense and financing charges in the nine months ended September 30, 2019 were $26.4 million lower compared to the same period in 2018 primarily due to $18.8 million higher amortization of debt issuance costs in 2018 associated with the refinancing of the Company's debt in the first quarter of 2018, $15.9 million lower early termination fees and interest on the sale & leaseback financing facility due to its early termination in July 2018 and $1.8 million lower interest and debt issuance costs on the previous debt facility that was extinguished in June 2018. This was partly offset by $10.1 million higher interest on the 8.25% Senior Unsecured Notes mainly resulting from the $300 million additional notes issuance in June 2018. The change in other, net of $1.1 million was mainly due to foreign currency exchange gains during the nine months ended September 30, 2018 as compared to losses in the nine months ended September 30, 2019.

Income tax expense

Income tax expense for the nine months ended September 30, 2019 was $8.1 million compared to $17.0 million for the nine months ended September 30, 2018. While the Company is 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 the Company operates and earns income or is considered resident for income tax purposes. The relationship between the provision for or benefit from income taxes and the income or loss before income taxes can vary significantly from period to period considering, among other factors, (a) the overall level of income before income taxes, (b) changes in the blend of income that is taxed based on gross revenues rather than income before taxes, (c) rig movements between taxing jurisdictions and (d) changes in the Company's rig operating structures which may alter the basis on which the Company is taxed in a particular jurisdiction.

Income tax expense for the nine months ended September 30, 2019 is lower than for the same period in 2018 primarily due to a reduction in valuation allowance against certain deferred tax assets for the 2019 period, lower revenue for the 2019 period, a reduction in liabilities for uncertain tax positions for the 2019 period versus an increase in such liabilities for the 2018 period, and a reduction in the value of certain income tax receivables for the 2018 period as a result of foreign currency depreciation against the U.S. dollar.

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 Feb 24, 2014 revolving credit facility as subsequently amended ("SDHL Revolver"). Our primary uses of cash were capital expenditures and deferred cost payments, repayment of long-term debt, debt issuance cost payments, and interest and income tax payments.

We had $45.7 million and $91.2 million in cash and cash equivalents as of September 30, 2019 and December 31, 2018, respectively. As of September 30, 2019, the Company owed $20.0 million and as of December 31, 2018, the Company had no outstanding borrowings under the SDHL Revolver. The Company issued bank guarantees and performance bonds totaling $8.9 million and $8.6 million as of September 30, 2019 and December 31, 2018, respectively, against the SDHL Revolver. There are certain customary limitations which restrict the Company's ability to draw down the available balance of the SDHL Revolver, including but not limited to prohibiting draw down while an event of default or material adverse event is ongoing and requiring that the Company be in compliance with its financial covenant obligations both before and after the draw down.

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, capital expenditures, deferred cost payments, share repurchases 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 nine months ended September 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 nine months ended September 30, 2019 and 2018 (in thousands):

	Nine months ended September 30,	
	2019	**2018**
Net cash (used in) / provided by operating activities	$ (18,075)	$ 3,692
Net cash used in investing activities	(47,252)	(88,079)
Net cash provided by financing activities	18,586	52,768
Net decrease in cash, cash equivalents and restricted cash	$ (46,741)	$ (31,619)

Net cash (used in) / provided by operating activities

Net cash used in operating activities totaled $18.1 million during the nine months ended September 30, 2019 compared to net cash provided by operating activities of $3.7 million during the nine months ended September 30, 2018. The decrease of $21.8 million in cash from operations was primarily due to a decrease in operating income when compared to the prior year period. See discussion of revenues and operating costs in "—Results of operations."

During the nine months ended September 30, 2019 and 2018, we made cash payments of $77.7 million and $59.1 million in interest and financing charges, respectively, included under "other operating assets and liabilities, net".

We also made cash payments of $14.3 million and $14.0 million in income taxes included under "other operating assets and liabilities, net" during the nine months ended September 30, 2019 and 2018, respectively.

Net cash used in investing activities

Net cash used in investing activities totaled $47.3 million during the nine months ended September 30, 2019 compared to $88.1 million during the nine months ended September 30, 2018.

Cash used for capital expenditures totaled $53.9 million and $90.6 million during the nine months ended September 30, 2019 and 2018, respectively. The decrease was primarily related to the readiness projects for the two premium newbuild jack-up rigs acquired in May 2019 compared to $68.5 million paid for the acquisition of one premium jack-up drilling rig in 2018.

The net proceeds from disposal of assets increased to $6.6 million during the nine months ended September 30, 2019 compared to $2.5 million during the nine months ended September 30, 2018, primarily due to the net proceeds received during the nine months ended September 30, 2019 for the sale of three 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 nine months ended September 30, 2019.

Net cash provided by financing activities

Net cash provided by financing activities totaled $18.6 million in the nine months ended September 30, 2019 compared to $52.8 million in the same period of 2018.

The decrease of $34.2 million was primarily due to significant debt and preferred stock financing activities which took place during the nine months ended September 30, 2018 compared to $20.0 million in drawdowns from the revolving credit facility during the nine months ended September 30, 2019. The 2018 financing activities included the issuance of debt of $928.0 million (resulting from the issuance of a total of $900.0 million of 8.25% Senior Unsecured Notes and $25.0 million of drawdowns on the Senior Secured Facility) and proceeds from issuance of common shares of $226.9 million, partly offset by the retirement of long-term debt of $558.2 million (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, the payment of debt financing and extinguishment costs of $37.7 million, the repayments for the sale and leaseback transactions of $313.9 million and the payment of preferred shares dividends of $16.3 million.

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 nine months ended September 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 nine months ended September 30, 2019 and 2018 (in thousands):

	Nine months ended September 30,			
	2019		2018	
Regulatory and capital maintenance (1)	$	43,190	$	32,323
Contract preparation (2)		28,620		15,273
Fleet spares and other (3)		6,955		7,966
	$	78,765	$	55,562
Rig acquisitions (4)		175,575		83,071
Total capital expenditures and deferred costs	$	254,340	$	138,633

(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 operation readiness costs of newbuild premium jack-up drilling rigs acquired in 2019 and with the acquisition and subsequent reactivation of premium jack-up rigs acquired in 2018 and 2017.

Capital expenditures and deferred costs totalled $254.3 million and $138.6 million in the nine months ended September 30, 2019 and 2018, respectively. The increase of $115.7 million was primarily due to the increase in rig acquisition of $53.3 million ($121.8 million acquisition of the two newbuilds premium CJ46 drilling jack -up rigs which were paid through issuance of common shares in 2019 compared to $68.5 million for one rig acquired in 2018) and $53.8 million relating to the reactivation and operations readiness projects on the three recently acquired rigs, compared to $14.6 million in the nine months ended September 30, 2018 for the rigs acquired in 2017. In addition, there were increases of $10.9 million in expenditures for regulatory and capital maintenance and $13.3 million in contract preparation expenditures mainly due to higher level of spending associated with planned out of service projects and rig contract preparation and activation costs.

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 nine months ended September 30, 2019 and 2018 (in thousands):

	Nine months ended September 30,	
	2019	2018
Cash payments for additions to property and equipment	$ 53,869	$ 90,552
Net change in accrued but unpaid additions to property and equipment	13,801	(2,376)
	$ 67,670	$ 88,176
Add: Asset additions related to share issuance	121,772	-
Total capital expenditures	$ 189,442	$ 88,176
Changes in deferred costs, net	$ 7,812	$ (13,563)
Amortization of deferred costs	57,086	64,020
Total deferred costs	$ 64,898	$ 50,457
Total capital expenditures and deferred costs	$ 254,340	$ 138,633

Certain financial information of SDL and SDHL

The following tables present certain financial information for SDL and SDHL for the nine months ended September 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.

Condensed Consolidated Interim Statements of Operations for the nine months ended September 30, 2019

	Shelf Drilling, Ltd.	Adjustments	Shelf Drilling Holdings, Ltd.
		(In thousands)	
Revenue			
Operating revenues	$ 405,810	$ -	$ 405,810
Other revenues	10,522	-	10,522
	416,332	-	416,332
Operating costs and expenses			
Operating and maintenance	274,621	-	274,621
Depreciation	61,046	-	61,046
Amortization of deferred costs	57,086	-	57,086
General and administrative	36,326	(90)	36,236
Gain on disposal of assets	(1,264)	-	(1,264)
	427,815	(90)	427,725
Operating loss	(11,483)	90	(11,393)
Other (expense) / income, net			
Interest income	1,047	-	1,047
Interest expense and financing charges	(60,309)	-	(60,309)
Other, net	(386)	(2)	(388)
	(59,648)	(2)	(59,650)
Loss before income taxes	(71,131)	88	(71,043)
Income tax expense	8,072	-	8,072
Net loss attributable to common shares	$ (79,203)	$ 88	$ (79,115)

Condensed Consolidated Interim Balance Sheets as of September 30, 2019

	Shelf Drilling, Ltd.	Adjustments (In thousands)	Shelf Drilling Holdings, Ltd.
Assets			
Cash and cash equivalents	$ 45,723	$ (2,364)	$ 43,359
Accounts and other receivables, net [(1)]	118,829	448	119,277
Assets held for sale	2,666	-	2,666
Other current assets	73,701	-	73,701
Total current assets	240,919	(1,916)	239,003
Property and equipment	1,818,709	-	1,818,709
Less accumulated depreciation	479,003	-	479,003
Property and equipment, net	1,339,706	-	1,339,706
Deferred tax assets	2,691	-	2,691
Other assets	147,572	-	147,572
Total assets	$ 1,730,888	$(1,916)	$ 1,728,972
Liabilities and equity			
Accounts payable	$ 99,262	$ (58)	$ 99,204
Interest payable	9,561	-	9,561
Accrued income taxes	4,219	-	4,219
Other current liabilities	30,319	-	30,319
Total current liabilities	143,361	(58)	143,303
Long-term debt	909,135	-	909,135
Deferred tax liabilities	5,016	-	5,016
Other long-term liabilities	40,114	-	40,114
Total long-term liabilities	954,265	-	954,265
Commitments and contingencies			
Common shares [(2)]	1,377	(1,377)	-
Additional paid-in capital [(3)]	1,001,933	(92,218)	909,715
Accumulated other comprehensive income	73	-	73
Accumulated losses [(4)]	(370,121)	91,737	(278,384)
Total equity	633,262	(1,858)	631,404
Total liabilities and equity	$ 1,730,888	$ (1,916)	$ 1,728,972

(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 137,724,393 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 nine months ended September 30, 2019

	Shelf Drilling, Ltd.	Adjustments	Shelf Drilling Holdings, Ltd.
		(In thousands)	
Cash flows from operating activities			
Net loss	$ (79,203)	$ 88	$ (79,115)
Adjustments to reconcile net loss to net cash used in operating activities			
Depreciation	61,046	-	61,046
Gain on derivative financial instruments, net	(224)	-	(224)
Reversal of doubtful accounts, net	(112)	-	(112)
Amortization of deferred revenue	(3,818)	-	(3,818)
Share-based compensation expense, net of forfeitures / Capital contribution by Parent share-based compensation (1)	934	(65)	869
Amortization of debt issue costs and premium	2,013	-	2,013
Gain on disposal of assets	(1,264)	-	(1,264)
Deferred tax expense, net	912	-	912
Proceeds from settlement of derivative financial instruments, net	224	-	224
Changes in deferred costs, net	(7,812)	-	(7,812)
Changes in operating assets and liabilities			
Intercompany receivables (2)	-	417	417
Other operating assets and liabilities, net (3)	9,229	(829)	8,400
Net cash used in operating activities	(18,075)	(389)	(18,464)
Cash flows from investing activities			
Additions to property and equipment	(53,869)	-	(53,869)
Proceeds from disposal of property and equipment	6,617	-	6,617
Net cash used in investing activities	(47,252)	-	(47,252)
Cash flows from financing activities			
Proceeds from revolving credit facility	20,000	-	20,000
Purchase of common shares (4)	(644)	644	-
Payments of common shares issuance costs (5)	(623)	623	-
Ordinary shares dividend paid (6)	-	(3,000)	(3,000)
Payments of debt financing costs	(147)	-	(147)
Net cash used in financing activities	18,586	(1,733)	16,853
Net decrease in cash, cash equivalents and restricted cash	(46,741)	(2,122)	(48,863)
Cash, cash equivalents and restricted cash at beginning of period	92,835	(242)	92,593
Cash, cash equivalents and restricted cash at end of period	**$ 46,094**	**$ (2,364)**	**$ 43,730**

(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 nine months ended September 30, 2019.

(3) This 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 repurchase of common shares recorded at SDL level.

(5) This adjustment relates to the issuance of common shares.

(6) This adjustment reflects the ordinary shares dividend paid by SDHL to fund SDL's repurchase 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 September 30, 2019 (in thousands):

	Years ending December 31,						
	Remainder of 2019	2020	2021	2022	2023	Thereafter	Total
Debt repayment	$ -	$ -	$ -	$ -	$ 20,000	$ 900,000	$ 920,000
Interest on debt (1)	1,065	78,213	78,209	78,209	75,564	83,531	394,791
Operating lease obligations (2)	3,211	15,348	17,194	17,354	1,887	17	55,011
Total	$ 4,276	$ 93,561	$ 95,403	$ 95,563	$ 97,451	$ 983,548	$ 1,369,802

(1) Assumes no change in the current variable interest applied on our revolver. Includes commitment fees and interest on our revolver assuming no change in the undrawn balance from September 30, 2019.

(2) Includes additional operating leases that have not yet commenced of $33.5 million and a total imputed interest of $6.3 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 $88.7 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 $54.7 million and $52.9 million at September 30, 2019 and December 31, 2018, respectively.

In addition, we had outstanding bank guarantees and performance bonds amounting to $8.9 million and $8.6 million as of September 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 $63.6 million and $61.5 million as of September 30, 2019 and December 31, 2018, respectively.

Contingencies

As of September 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 proceedings and uncertain tax positions. 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 U.S. 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 nine months ended September 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 revolving credit facility. Fixed rate debt, where the interest rate is fixed over the life of the instrument and the instrument's maturity is greater than one year, exposes 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, exposes us to short-term changes in market interest rates.

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

Foreign Currency Risk

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

Our primary currency exchange rate risk management strategy involves structuring certain customer contracts to provide for payment from the customer in both U.S. dollars and local currency. The payment portion denominated in local currency is based on anticipated local currency requirements over the contract term. Due to various factors, including customer acceptance, local banking laws, other statutory requirements, local currency convertibility and the impact of inflation on local costs, actual local currency needs may vary from those anticipated in the customer contracts, resulting in partial exposure to currency exchange rate risk. The currency exchange effect resulting from our international operations has not historically had a material impact on our operating results.

Further, we utilize foreign currency forward exchange contracts ("forex contracts") to manage a portion of foreign exchange risk, for which we maintain documented policies and procedures to monitor and control the use of 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 $1.7 million and $2.7 million as of September 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

The following table presents information related to our repurchases of the Company's equity securities during the three months ended September 30, 2019:

Period	Total number of shares purchased (1)	Weighted average price paid per share	Total number of shares purchased as part of publically announced program	Maximum number of shares that may yet be purchased under the program (2)
Common stock				
July 1 - 31, 2019	-	$ -	-	-
August 1 - 31, 2019	-	$ -	-	-
September 1 - 30, 2019	285,231	$ 2.45	285,231	-
	285,231	$ 2.45	285,231	-

(1) On September 1, 2019, the Board of Directors approved a share repurchase program under which the Company may repurchase shares of the Company's common stock on the open market for an aggregate of $25.0 million over a period of two years from the date of approval, subject to certain conditions.

(2) The Company's share repurchase program does not contain a limitation on the number of shares that may be repurchased.

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.