

SHELF DRILLING, LTD.

**QUARTERLY REPORT
NINE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019**

SHELF DRILLING, LTD.
INDEX TO QUARTERLY REPORT
NINE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019
(UNAUDITED)

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**SHELF DRILLING, LTD.
NINE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019
(UNAUDITED)**

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

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

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,	
	2020	2019	2020	2019
Revenues				
Operating revenues.....	\$ 125,106	\$ 128,958	\$ 452,645	\$ 405,810
Other revenues.....	2,339	3,060	11,185	10,522
	<u>127,445</u>	<u>132,018</u>	<u>463,830</u>	<u>416,332</u>
Operating costs and expenses				
Operating and maintenance.....	78,956	91,446	262,863	274,621
Depreciation.....	16,681	20,370	53,175	61,046
Amortization of deferred costs.....	9,495	19,836	34,237	57,086
General and administrative.....	9,386	12,750	34,782	36,326
Loss on impairment of assets.....	-	-	188,017	-
(Gain) / loss on disposal of assets.....	(5,680)	638	(5,613)	(1,264)
	<u>108,838</u>	<u>145,040</u>	<u>567,461</u>	<u>427,815</u>
Operating income / (loss).....	<u>18,607</u>	<u>(13,022)</u>	<u>(103,631)</u>	<u>(11,483)</u>
Other (expense) / income, net.....				
Interest income.....	18	317	162	1,047
Interest expense and financing charges...	(22,560)	(20,071)	(66,867)	(60,309)
Other, net.....	(179)	86	(54)	(386)
	<u>(22,721)</u>	<u>(19,668)</u>	<u>(66,759)</u>	<u>(59,648)</u>
Loss before income taxes.....	<u>(4,114)</u>	<u>(32,690)</u>	<u>(170,390)</u>	<u>(71,131)</u>
Income tax expense.....	3,565	3,241	14,083	8,072
Net loss.....	<u>\$ (7,679)</u>	<u>\$ (35,931)</u>	<u>\$ (184,473)</u>	<u>\$ (79,203)</u>
Loss per share:				
Basic and Diluted - Common shares.....	\$ (0.06)	\$ (0.26)	\$ (1.36)	\$ (0.63)
Weighted average shares outstanding:				
Basic and Diluted - Common shares.....	136,182	137,961	136,142	125,442

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,	
	2020	2019	2020	2019
Net loss	\$ (7,679)	\$ (35,931)	\$ (184,473)	\$ (79,203)
Other comprehensive income, net of tax...				
Change in unrealized gains / (losses) on derivative financial instruments.....				
Changes in unrealized gains / (losses).....	356	(87)	(617)	54
Reclassification of net losses / (gains) from other comprehensive income to net income.....	85	(65)	405	(224)
	\$ 441	\$ (152)	\$ (212)	\$ (170)
Total comprehensive loss	\$ (7,238)	\$ (36,083)	\$ (184,685)	\$ (79,373)

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, 2020	December 31, 2019
Assets		
Cash and cash equivalents.....	\$ 69,240	\$ 26,055
Accounts and other receivables, net.....	134,727	154,834
Assets held for sale.....	2,514	1,583
Other current assets.....	49,044	68,787
Total current assets.....	255,525	251,259
Property and equipment.....	1,687,081	1,775,678
Less: accumulated depreciation.....	496,194	478,694
Property and equipment, net.....	1,190,887	1,296,984
Deferred tax assets.....	1,380	2,732
Other long-term assets.....	121,060	149,070
Total assets.....	\$ 1,568,852	\$ 1,700,045
Liabilities and equity		
Accounts payable.....	\$ 66,980	\$ 79,236
Interest payable.....	12,504	28,245
Accrued income taxes.....	4,319	5,029
Other current liabilities.....	28,353	41,455
Total current liabilities.....	112,156	153,965
Long-term debt.....	1,023,403	924,540
Deferred tax liabilities.....	5,274	5,183
Other long-term liabilities.....	49,742	54,907
Total long-term liabilities.....	1,078,419	984,630
Commitments and contingencies (Note 9)		
Common shares of \$0.01 par value; 184,063 and 144,063 shares authorized at September 30, 2020 and December 31, 2019, respectively; 136,182 and 136,643 issued and outstanding at September 30, 2020 and December 31, 2019, respectively.....	1,362	1,366
Additional paid-in capital.....	1,001,814	1,000,298
Accumulated other comprehensive income.....	28	240
Accumulated losses.....	(624,927)	(440,454)
Total equity.....	378,277	561,450
Total liabilities and equity.....	\$ 1,568,852	\$ 1,700,045

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		Additional paid-in capital	Accumulated other comprehensive (loss) / income	Accumulated losses	Total equity
	Shares	Par value				
Three months ended September 30:						
Balance at June 30, 2020.....	136,182	\$ 1,362	\$ 1,000,710	\$ (413)	\$ (617,248)	\$ 384,411
Net loss.....	-	-	-	-	(7,679)	(7,679)
Net unrealized gain on derivative financial instruments.....	-	-	-	441	-	441
Share-based compensation expense, net of forfeitures.....	-	-	1,104	-	-	1,104
Balance at September 30, 2020.....	136,182	\$ 1,362	\$ 1,001,814	\$ 28	\$ (624,927)	\$ 378,277
Balance at June 30, 2019.....						
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
Nine months ended September 30:						
Balance at December 31, 2019.....	136,643	\$ 1,366	\$ 1,000,298	\$ 240	\$ (440,454)	\$ 561,450
Net loss.....	-	-	-	-	(184,473)	(184,473)
Net unrealized loss on derivative financial instruments.....	-	-	-	(212)	-	(212)
Issuance of common shares.....	260	3	(3)	-	-	-
Repurchase of common shares.....	(721)	(7)	(1,550)	-	-	(1,557)
Share-based compensation expense, net of forfeitures.....	-	-	3,069	-	-	3,069
Balance at September 30, 2020.....	136,182	\$ 1,362	\$ 1,001,814	\$ 28	\$ (624,927)	\$ 378,277
Balance at December 31, 2018.....						
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

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,	
	2020	2019
Cash flows from operating activities		
Net loss.....	\$ (184,473)	\$ (79,203)
Adjustments to reconcile net loss to net cash provided by / (used in) operating activities		
Depreciation	53,175	61,046
Loss on impairment of assets.....	188,017	-
Provision for / (reversal of) doubtful accounts, net.....	2,641	(112)
Amortization of deferred revenue.....	(8,413)	(3,818)
Loss / (gain) on derivative financial instruments, net.....	405	(224)
Share-based compensation expense, net of forfeitures.....	3,069	934
Amortization of debt issue costs and premium.....	2,402	2,013
Gain on disposal of assets.....	(5,613)	(1,264)
Deferred tax expense, net.....	1,443	912
(Payments of) / Proceeds from settlement of derivative financial instruments, net..	(405)	224
Changes in deferred costs, net*.....	5,067	(7,812)
Changes in operating assets and liabilities.....	(22,334)	9,229
Net cash provided by / (used in) operating activities.....	<u>34,981</u>	<u>(18,075)</u>
Cash flows from investing activities		
Additions to property and equipment*.....	(94,996)	(53,869)
Proceeds from disposal of assets.....	5,713	6,617
Net cash used in investing activities.....	<u>(89,283)</u>	<u>(47,252)</u>
Cash flows from financing activities		
Proceeds from issuance of debt.....	80,000	-
Proceeds from revolving credit facility.....	75,000	20,000
Repayments of revolving credit facility.....	(55,000)	-
Purchase of common shares.....	(1,639)	(644)
Payments for common shares issuance costs.....	-	(623)
Payments of debt financing costs.....	(3,083)	(147)
Net cash provided by financing activities.....	<u>95,278</u>	<u>18,586</u>
Net increase / (decrease) in cash, cash equivalents and restricted cash.....	<u>40,976</u>	<u>(46,741)</u>
Cash, cash equivalents and restricted cash at beginning of period*.....	<u>28,299</u>	<u>92,835</u>
Cash, cash equivalents and restricted cash at end of period*.....	<u>\$ 69,275</u>	<u>\$ 46,094</u>

* See Note 14 – Supplemental Cash Flow Information for a reconciliation of cash payment for additions to property and equipment and changes in deferred costs, net to total capital expenditures and deferred costs and a reconciliation of cash, cash equivalents and restricted cash balances.

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

Note 1 — Nature of Business

Business

Shelf Drilling, Ltd. (“SDL”) was incorporated on August 14, 2012 (“inception”) as a private corporation in the Cayman Islands. SDL with its majority owned subsidiaries (together, the “Company,” “we,” or “our”) is a leading international shallow water offshore drilling contractor providing equipment and services for the drilling, completion, maintenance and decommissioning of oil and natural gas wells. We are solely focused on shallow water operations in depths of up to 375 feet and our drilling fleet consists of 32 independent-leg cantilever (“ILC”) jack-up rigs as of September 30, 2020, excluding stacked rigs. Since June 25, 2018, SDL shares are 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 interests in its direct and indirect subsidiaries. All operations are conducted through Shelf Drilling Holdings, Ltd. (“SDHL”) an indirect wholly owned subsidiary of SDL. Our corporate offices are in Dubai, United Arab Emirates (“UAE”), geographically close to our operations in the Middle East North Africa and the Mediterranean (together, “MENAM”), South East Asia, India and West Africa. Our largest shareholders are affiliates of Castle Harlan, Inc., Lime Rock Partners and China Merchants & Great Wall Ocean Strategy & Technology Fund (“China Merchants”). Additionally, other shareholders may have large holdings as reported in public filings in accordance with the rules of the OSE.

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 (“GAAP”) for interim financial information. Pursuant to such rules and regulations, these financial statements do not include all disclosures required by 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, 2020 are not necessarily indicative of the results that may be expected for the year ending December 31, 2020 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, 2019. The amounts are presented in United States (“U.S.”) dollar (“US\$”) rounded to the nearest thousand, unless otherwise stated.

Summary of Significant Accounting Policies

The Company’s significant accounting policies were included in our Annual Report for the year ended December 31, 2019. See also the discussion of the Company’s accounting policy related to allowance for credit losses in Note 3 – Revenues, Contract Liabilities and Deferred Contract Costs and Allowance for Credit Losses.

Note 2 — Recently Adopted and Issued Accounting Pronouncements

Recently adopted accounting standards

In August 2018, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2018-13 – Fair Value Measurement (Topic 820) and related clarifying guidance: 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 has adopted this standard as of January 1, 2020. The adoption of this standard did not have a material effect on the condensed consolidated interim financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326) 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 U.S. Securities and Exchange Commission registered filers annual reporting periods beginning after December 15, 2019 and for other public companies for annual reporting periods beginning after December 15, 2022, with early adoption permitted. The Company has early adopted this standard effective January 1, 2020. The adoption of this standard did not have a material effect on the condensed consolidated interim financial statements as the Company’s allowance for credit losses did

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

not change materially from its previously estimated allowance. See Note 3 – Revenues, Contract Liabilities and Deferred Contract Costs and Allowance for Credit Losses for additional disclosures related to the adoption of this standard.

In April 2020, the FASB issued a Staff Q&A Topic 842 and Topic 840: Accounting for Lease Concessions Related to the Effects of the COVID-19 Pandemic (“Lease Q&A”). The Lease Q&A provides specific guidance on how to address rent concessions on leases due to the COVID-19 pandemic. During the nine months ended September 30, 2020, the Company has received rent concessions for various operating leases that do not result in a substantial increase in the rights of the lessor or the Company’s obligations. In accordance with the Lease Q&A, the Company has made an accounting policy election to account for these lease concessions under ASU No. 2016-02, Leases (Topic 842) as though enforceable rights and obligations for those concessions existed in the contract and, therefore, the Company will not account for these concessions as lease modifications under Topic 842. The Company will instead account for rent reductions as a negative variable lease payment in the period in which that payment would have come due and will account for temporary rent deferrals as a short-term lease payable until the amount becomes due and payable. As a result of these elections, the Company recorded \$45 thousand and \$0.1 million in rent reductions during the three and nine months ended September 30, 2020.

Recently issued accounting standards

In March 2020, the FASB issued ASU No. 2020-04—Reference Rate Reform (Topic 848)—Facilitation of the Effects of Reference Rate Reform on Financial Reporting, which provides relief for companies preparing for discontinuation of interest rates such as the London Interbank Offered Rate (“LIBOR”) in 2021. The ASU provides companies with optional expedients mainly relating to eligible contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met. The key optional expedients generally allow a Company (1) to account for and present contract modifications as an event that does not require contract remeasurement or reassessment of a previous accounting determination at the modification date, (2) to continue hedge accounting when certain critical terms of a hedging relationship change, and (3) to make a one-time election to sell and/or reclassify certain held-to-maturity debt securities. This ASU is effective for all entities as of March 12, 2020 and can be applied prospectively as of the beginning of the interim period that includes March 12, 2020 through December 31, 2022. As this ASU has an open effective date until December 31, 2022, the Company will continue to evaluate the impact of this standard on our condensed consolidated interim financial statements and will adopt this standard accordingly.

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 public business entities for fiscal years ending after December 15, 2020, with early adoption permitted. The Company does not intend to early adopt this standard. The Company believes that the adoption of this standard will not have a material effect on the condensed consolidated interim financial statements.

Note 3 — Revenues, Contract Liabilities and Deferred Contract Costs and Allowance for Credit Losses

Revenues

See condensed consolidated interim statements of operations for the amounts of operating and other revenues. See Note 16 – Segment and Related Information for disclosure of total revenues by country based on the location of the service provided.

Contract liabilities and deferred contract costs

Contract liabilities

The Company recognizes a contract liability when we transfer goods or services to a customer and invoice an amount which differs from the revenues allocated to the related performance obligations. Contract liabilities represent fees for mobilization or capital upgrades and advance payments from customers for future services and are recorded as other current liabilities and other long-term liabilities, as appropriate, in the condensed consolidated interim balance sheets.

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

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

	September 30, 2020	December 31, 2019
Current contract liabilities.....	\$ 9,305	\$ 11,188
Non-current contract liabilities.....	7,378	14,233
	<u>\$ 16,683</u>	<u>\$ 25,421</u>

Significant changes in contract liabilities during the periods ended September 30 are as follows (in thousands):

	Nine months ended September 30,	
	2020	2019
Balance, beginning of year.....	\$ 25,421	\$ 6,557
Increase due to contractual additions.....	500	13,185
Decrease due to amortization of deferred revenue.....	(8,413)	(3,818)
Decrease due to application of customer deposits and other.....	(825)	(3,423)
Balance, end of period.....	<u>\$ 16,683</u>	<u>\$ 12,501</u>

Approximately \$8.3 million and \$2.5 million of revenues recognized during the nine months ended September 30, 2020 and 2019, respectively was included in the beginning contract liabilities balance.

Expected future amortization of contract liabilities, net recorded as of September 30, 2020 is as follows (in thousands):

For the periods ending December 31,

Remainder of 2020.....	\$ 2,424
2021.....	8,914
2022.....	5,305
2023.....	40
	<u>\$ 16,683</u>

Deferred contract costs

The Company's deferred contract costs are mainly related to contract preparation and mobilization costs. Certain non-contractual costs such as regulatory inspections, major equipment overhauls (including rig upgrades), and stacked rig activations are expensed, deferred 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, 2020	December 31, 2019
Current deferred contract costs.....	\$ 13,855	\$ 20,364
Non-current deferred contract costs.....	11,718	18,686
	<u>\$ 25,573</u>	<u>\$ 39,050</u>

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

	Nine months ended September 30,	
	2020	2019
Balance, beginning of year.....	\$ 39,050	\$ 34,939
Increase due to contractual additions.....	8,050	33,281
Decrease due to amortization of deferred contract costs.....	(12,610)	(27,530)
Decrease due to impairment of deferred contract costs.....	(8,917)	-
Balance, end of period.....	<u>\$ 25,573</u>	<u>\$ 40,690</u>

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

Allowance for credit losses

The Company's accounts receivables consist primarily of trade accounts receivable from the provision of drilling services, with original credit terms of less than one year. Accounts receivable are recorded in the condensed consolidated interim balance sheets at their nominal amounts, net of allowance for credit losses, which approximates fair value. The Company determined its expected credit losses for its pools of assets with similar risk characteristics based on historical loss information as adjusted for future expectations. Amounts determined to be uncollectible are written-off against the allowance for credit losses. Allowance for credit losses was \$2.6 million and \$1.8 million as of September 30, 2020 and December 31, 2019, respectively.

Note 4 — Variable Interest Entities

The Company, through its wholly owned indirect subsidiary 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, 2020 and December 31, 2019:

	Third party country of incorporation	Third party 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 revenues and operating costs and expenses of the VIEs, after eliminating the effect of intercompany transactions, for the nine months ended September 30, 2020 and 2019 (in thousands):

	SDVM	PT Hitek	SDNL	SDOSL	Total
September 30, 2020:					
Revenues.....	\$ -	\$ -	\$ 36,830	\$ -	\$ 36,830
Operating costs and expenses...	155	643	33,039	5,426	39,263
September 30, 2019:					
Revenues.....	\$ -	\$ -	\$ 43,511	\$ -	\$ 43,511
Operating costs and expenses...	(12)	5,975	40,948	6,936	53,847

There are no material differences between the results of operations and cash flows of the consolidated company, inclusive of the VIEs listed above, than there would have been if the VIE operations were run out of a wholly owned subsidiary of the Company.

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

Following are the assets and liabilities of the VIEs, after eliminating the effect of intercompany transactions, as of September 30, 2020 (in thousands):

	SDVM	PT Hitek	SDNL	SDOSL	Total
Assets					
Cash and cash equivalents.....	\$ 21	\$ 107	\$ 1,977	\$ 112	\$ 2,217
Accounts and other receivables, net...	7	988	7,013	-	8,008
Other current assets.....	-	-	104	1,266	1,370
Total current assets.....	28	1,095	9,094	1,378	11,595
Property and equipment, net.....	-	-	2,163	-	2,163
Other long-term assets.....	9	77	4,425	861	5,372
Total non-current assets.....	9	77	6,588	861	7,535
Total assets.....	\$ 37	\$ 1,172	\$ 15,682	\$ 2,239	\$ 19,130
Liabilities					
Accounts payable.....	\$ 76	\$ 66	\$ 2,962	\$ 34	\$ 3,138
Accrued income taxes.....	9	-	947	-	956
Other current liabilities.....	29	49	2,479	420	2,977
Total current liabilities.....	114	115	6,388	454	7,071
Other long-term liabilities.....	191	164	4,707	546	5,608
Total long-term liabilities.....	191	164	4,707	546	5,608
Total liabilities.....	305	279	11,095	1,000	12,679
Carrying amount, net.....	\$ (268)	\$ 893	\$ 4,587	\$ 1,239	\$ 6,451

Following are the assets and liabilities of the VIEs, after eliminating the effect of intercompany transactions, as of December 31, 2019 (in thousands):

	SDVM	PT Hitek	SDNL	SDOSL	Total
Assets					
Cash and cash equivalents.....	\$ 12	\$ 107	\$ 542	\$ 29	\$ 690
Accounts and other receivables, net...	-	1,019	16,389	-	17,408
Other current assets.....	-	1	125	761	887
Total current assets.....	12	1,127	17,056	790	18,985
Property and equipment, net.....	-	-	2,215	-	2,215
Other long-term assets.....	15	91	8,397	592	9,095
Total non-current assets.....	15	91	10,612	592	11,310
Total assets.....	\$ 27	\$ 1,218	\$ 27,668	\$ 1,382	\$ 30,295
Liabilities					
Accounts payable.....	\$ -	\$ 85	\$ 5,960	\$ 178	\$ 6,223
Accrued income taxes.....	9	(1)	1,419	42	1,469
Other current liabilities.....	92	110	2,609	752	3,563
Total current liabilities.....	101	194	9,988	972	11,255
Other long-term liabilities.....	206	169	6,082	568	7,025
Total long-term liabilities.....	206	169	6,082	568	7,025
Total liabilities.....	307	363	16,070	1,540	18,280
Carrying amount, net.....	\$ (280)	\$ 855	\$ 11,598	\$ (158)	\$ 12,015

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 8 – Debt. Liability holders typically have recourse to the general credit of the Company when seeking to enforce settlement of liabilities. See Note 17 – Related Parties for additional discussion on the Company’s transactions with its VIEs.

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Note 5 — Assets Held for Sale and Asset Sales and Disposals

Assets Held for Sale

As of September 30, 2020, the Hibiscus, Randolph Yost, Trident 15, Key Hawaii and Galveston Key were recorded as assets held for sale. As of December 31, 2019, the Hibiscus, Randolph Yost and Trident 15 were recorded as assets held for sale. Assets held for sale are recorded at the lower of carrying value or fair value less estimated costs to sell.

Sales and Disposals

During the nine months ended September 30, 2020, the Company sold the Trident XIV with a carrying value of \$0.2 million, for total net proceeds of \$5.7 million which resulted in a gain of \$5.5 million. During the nine months ended September 30, 2019, the Company sold the Key Gibraltar, Adriatic X and Rig 124, previously classified as assets held for sale, 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. See also Note 6 – Loss on Impairment of Assets.

Sales and disposals of other property and equipment with a net carrying value of \$0.8 million and \$2.5 million during the nine months ended September 30, 2020 and 2019, respectively, were concluded for proceeds of \$0.9 million and \$0.6 million, respectively, which resulted in a gain on disposal of assets of \$0.1 million and loss of \$1.9 million, respectively.

In October and November 2020, the Company is negotiating and is in the process of executing agreements to sell the five rigs recorded as assets held for sale for total proceeds of \$3.9 million. The Company expects to record a loss on the sale of these assets of \$1.2 million to \$1.9 million in the fourth quarter of 2020, primarily due to certain costs related to the sale of a fully impaired rig that became obligations of the Company upon the signing of the sale agreement. The Company expects the rig sales to close during 2021.

Note 6 — Loss on Impairment of Assets

The Company assesses the recoverability of its long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company determines the fair value of its asset groups by using the income approach and utilizing a weighted average cost of capital for certain assets with indicators for impairment. The estimate of fair value requires the Company to use significant unobservable inputs such as rig utilization, dayrates, operating expenses, overhead and major project costs, remaining useful life and salvage value, representing a non-recurring Level 3 fair value measurement.

During the three months ended March 31, 2020, the Company identified several indicators of impairment, including an unprecedented decrease in global oil and gas demand and an increase in economic instability resulting from the COVID-19 pandemic, as well as the sharp decline in Brent crude oil prices exacerbated by disagreements between several of the world's largest oil producing countries over market share. Further, as the number of global cases of COVID-19 increased, many governments implemented lock downs and travel restriction measures. The resulting reduction in oil consumption and price created significant downward pressure on rig demand and dayrates. Due to these factors, the Company assessed its long-lived assets for impairment during the three months ended March 31, 2020.

The Company recorded a loss on impairment of assets of zero and \$188.0 million during the three and nine months ended September 30, 2020, respectively, in the condensed consolidated interim statements of operations. Impairment losses during the nine months ended September 30, 2020, were recognized on 15 rigs and other long-lived assets, and four rigs classified as assets held for sale. These impairment losses primarily related to the Company's property and equipment of \$144.7 million and also included the impairment of assets held for sale of \$2.7 million, current deferred costs of \$14.7 million, non-current deferred costs of \$18.3 million and right-of-use assets of \$7.6 million. There were no such transactions during the three and nine months ended September 30, 2019.

The continuing impact of the COVID-19 pandemic on the global economy, including but not limited to further reductions in oil and gas prices, on the number of new contract opportunities, dayrates, or utilization rates could require the Company to recognize additional impairment losses in future periods.

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Note 7 — Income Taxes

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 revenues rather than income before taxes, (c) rig movements between taxing jurisdictions, (d) changes in rig operating structures which may alter the basis on which the Company is taxed in a particular jurisdiction, and (e) fluctuations in foreign currency rates against the U.S. Dollar which are used to measure tax receivables in various jurisdictions.

The effective income tax rate for the Company's continuing operations was (8.3)% and (11.3)% for the nine months ended September 30, 2020 and 2019, respectively.

Income Tax Expense

Income tax expense for the three and nine months ended September 30, 2020 and 2019, 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, 2020 and 2019, 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 2020 and 2019 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 \$3.6 million and \$14.1 million for the three and nine months ended September 30, 2020, respectively, compared to \$3.2 million and \$8.1 million for the three and nine months ended September 30, 2019, respectively. Income tax expense for the three months ended September 30, 2020 was higher than for the same period in 2019 primarily due to a greater increase in liabilities for uncertain tax positions and a benefit realized in 2019 from reduction in valuation allowance against certain deferred tax assets with no corresponding benefit recorded in 2020. Income tax expense for the nine months ended September 30, 2020 was higher than for the same period in 2019 primarily due to higher revenue, higher tax expense related to adjustments in prior year tax receivables in 2020 resulting primarily from foreign currencies depreciating against the U.S. Dollar in which tax receivables are measured and a tax benefit related to an uncertain tax position realized in 2019 with no corresponding benefit recorded in 2020.

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 2027.

The Company's deferred tax liabilities as of September 30, 2020 and December 31, 2019 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 and liabilities related to the future income tax cost of repatriating the unremitted earnings of certain subsidiaries, none of which are considered permanently reinvested. 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.

Tax Returns and Examinations

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, 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.

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Note 8 — Debt

The following table provides details of the principal amounts and carrying values of debt (in thousands):

	September 30, 2020	December 31, 2019
Revolving Credit Facility, due April 2023		
Principal amount, carrying value.....	\$ 55,000	\$ 35,000
8.75% Senior Secured Notes, due November 2024		
Principal amount.....	\$ 80,000	\$ -
Unamortized debt issuance costs.....	(2,404)	-
Carrying value.....	\$ 77,596	\$ -
8.25% Senior Unsecured Notes, due February 2025		
Principal amount.....	\$ 900,000	\$ 900,000
Unamortized debt issuance costs.....	(11,344)	(12,907)
Unamortized premium.....	2,151	2,447
Carrying value.....	\$ 890,807	\$ 889,540
Total.....	\$ 1,023,403	\$ 924,540

The total unamortized debt issuance costs for the Revolving Credit Facility, due April 2023 were \$3.8 million and \$3.7 million, as of September 30, 2020 and December 31, 2019, respectively, recorded under other long-term assets on the condensed consolidated interim balance sheets.

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

Years ending December 31,	
Remainder of 2020.....	\$ -
2021.....	-
2022.....	-
2023.....	55,000
2024.....	80,000
2025 and thereafter.....	900,000
Total	\$ 1,035,000

Revolving Credit Facility, due April 2023

On February 24, 2014, SDHL entered into a revolving credit facility, which was subsequently amended four times, including on January 9, 2017 and June 4, 2018 and modified in related waivers and side letters (“SDHL Revolver”). The SDHL Revolver has a facility of \$225 million, which can be drawn as, or as a mixture of, cash, letters of credit or bank guarantees, subject to the satisfaction of contractual 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 certain rigs and other assets owned by the Guarantors.

The SDHL Revolver also contains various customary restrictive covenants, 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”). The covenants include a maximum Total Net Leverage Ratio of not greater than 5.0:1.0 for any test period ending on or prior to December 31, 2019 and 2020, and 4.0:1.0 for any test period thereafter. The SDHL Revolver also provides restrictions on dividend payments through April 30, 2023 if the Total Net Leverage Ratio exceeds 4.5:1.0. See also the relief from the Total Net Leverage Ratio financial covenant discussed below.

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There are certain contractual 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.

Interest for the SDHL Revolver is based on the London inter-bank offered rate ("LIBOR"), subject to certain adjustments ("Adjusted LIBOR") plus a specified margin ("Adjusted LIBOR Rate"), 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 a specified margin ("Alternative Base Rate"). The specified margin is a range from a minimum of 3.0% per year to a maximum of 5.0% per year for borrowings at the Adjusted LIBOR Rate and from a minimum of 2.0% per year to a maximum of 4.0% per year for borrowings at the Alternative Base Rate based on the higher of SDL's or SDHL's Total Net Leverage Ratio, the ("Applicable Margin"). The Applicable Margin range was adjusted in September 2020 as discussed below. As of September 30, 2020, the Applicable Margin was 5.5% per year for borrowings at the Adjusted LIBOR Rate.

The LIBOR rate is expected to be phased out after 2021, and a substitute benchmark rate, such as the Secured Overnight Financing Rate ("SOFR") or another benchmark rate, will be selected by our lenders in consultation with the Company. This substitute rate could vary from LIBOR and could exhibit increased volatility.

On September 21, 2020, the Company entered into the fifth amendment of the SDHL Revolver (the "Amendment"). The Amendment provides relief from the Total Net Leverage Ratio financial covenant from January 1, 2021 until September 29, 2021 or upon the Company's voluntary election to early terminate in accordance with the Amendment. Other changes include, for the term of the Amendment: increase of the applicable margin by 100 basis points, new financial covenants requiring a minimum 1.5:1.0 consolidated coverage ratio and a maximum 1.5:1.0 senior secured leverage ratio (defined in the Amendment to exclude liens junior to those securing the SDHL Revolver); and a prohibition of cash dividends by SDHL until the end of such covenant relief, which effectively limits cash dividends from the Company to its shareholders.

The Company owed \$55.0 million and \$35.0 million as of September 30, 2020 and December 31, 2019, respectively, under the SDHL Revolver. The Company issued bank guarantees and performance bonds totaling \$15.7 million and \$9.9 million as of September 30, 2020 and December 31, 2019, respectively, against the SDHL Revolver.

The weighted average interest rate on the outstanding borrowings of the SDHL Revolver was approximately 6.2% per year as of September 30, 2020 and is payable quarterly. These borrowings are currently classified as a long-term liability on the Company's condensed consolidated interim balance sheets. 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 on the daily unused amount of the SDHL Revolver at 35% of the Applicable Margin for borrowings at the Adjusted LIBOR Rate.

8.75% Senior Secured Notes, due November 2024

On February 20, 2020, SDHL completed the issuance through a private offering of \$80.0 million aggregate principal amount of new 8.75% Senior Secured Notes, due November 15, 2024 (the "8.75% Senior Secured Notes") issued at par. SDHL received proceeds of \$80.0 million, less \$2.7 million of fees and expenses, which were recorded as debt issuance costs and are being amortized over the life of the debt. The Company used the proceeds to replenish its liquidity following the acquisition of the Shelf Drilling Enterprise in January 2020 and to finance the reactivation and upgrade costs associated with the deployment of the rig in advance of its expected contract commencement in the fourth quarter of 2020 in the Gulf of Thailand.

SDHL's obligations under the 8.75% Senior Secured Notes are guaranteed by the majority of SDHL's subsidiaries (collectively, the "SSN Guarantors"), subject to certain exceptions. The obligations of SDHL and the SSN Guarantors are secured by second lien security interest on certain rigs and other assets owned by the SSN Guarantors.

Interest on the 8.75% Senior Secured Notes accrues from February 20, 2020 at a rate of 8.75% and is payable semiannually in arrears on May 15 and November 15 of each year. The effective interest rate on the 8.75% Senior Secured Notes is 9.65%.

At any time prior to August 20, 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 a premium of at least 1%, to be calculated based on the present value of the debt. On or after August 20, 2021, SDHL may redeem the 8.75% Senior Secured Notes, in whole or part, at the redemption prices set forth below, together with accrued and unpaid interest up to and including the redemption date.

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Period	Redemption Price
Between August 20, 2021 and August 19, 2022	102%
Between August 20, 2022 and August 19, 2023	101%
On or after August 20, 2023.....	100%

If SDHL experiences a change of control, as defined in the indenture governing the 8.75% Senior Secured Notes, it must offer to repurchase the 8.75% Senior Secured Notes at an offer price in cash equal to 101% of their principal amount, plus accrued and unpaid interest.

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 recorded as debt issuance costs and are being amortized over the life of the debt. 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 were recorded as debt issuance costs and are being amortized over the life of the debt.

Interest on the 8.25% Senior Unsecured Notes accrues at a rate of 8.25% per year and is payable semi-annually in arrears on February 15 and August 15 of each year. The effective interest rate on the 8.25% Senior Unsecured Notes is 8.54%.

SDHL’s obligations under the 8.25% Senior Unsecured Notes are guaranteed by the majority of SDHL’s subsidiaries (collectively, the “Note Guarantors”), subject to certain exceptions. The 8.25% Senior Unsecured Notes, and the 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, 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 a premium of at least 1%, to be calculated based on the present value of the debt. 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.

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

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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. An additional stamp duty of 0.2% per annum is to be paid quarterly on actual utilization. As of both September 30, 2020 and December 31, 2019, the Company had no outstanding borrowings under the Unsecured overdraft facility.

Terms Common to All Indebtedness

The SDHL Revolver, 8.75% Senior Secured Notes and 8.25% Senior Unsecured Notes 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 SDHL Revolver, 8.75% Senior Secured Notes and 8.25% Senior Unsecured Notes contain covenants that, among other things, limit SDHL's ability and the ability of their restricted subsidiaries in connection with:

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

The SDHL Revolver, 8.75% Senior Secured Notes and 8.25% Senior Unsecured Notes also contain standard events of default. The Company was in compliance with all covenants of its debt agreements as of September 30, 2020 and December 31, 2019.

Note 9 — Commitments and Contingencies

Legal Proceedings

The Company is involved in various claims and lawsuits in the normal course of business. The Company does not believe that the resolution of these legal proceedings will have a material adverse impact on its financial condition, results of operations, or cash flows.

China Merchants bareboat charter leases

The Company signed agreements with China Merchants to bareboat charter two premium newbuild jack-up rigs, each with an initial contract term of three years and options to extend the lease term or to buy the rig, as part of the Transaction (as defined in Note 11 – Shareholders' Equity). These operating leases provided for total lease payments of approximately \$16.4 million each to be paid over the respective lease terms.

In September 2020, the Company paid \$3.9 million to settle and terminate its obligations under the bareboat charter agreements with China Merchants. The Company did not take possession of the leased rigs prior to the terminations. The Company recorded \$3.6 million in operating and maintenance expenses on the condensed consolidated interim statements of operations during the nine months ended September 30, 2020 related to the lease terminations. The Company had zero and \$1.2 million of accrued liabilities recorded on its condensed consolidated interim balance sheets as of September 30, 2020 and December 31, 2019, respectively, for contractual but unpaid lease payments related to these agreements.

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 maintains surety bond facilities in either U.S. dollars or local currencies of approximately \$71.8 million provided by several banks to guarantee various contractual, performance, and customs obligations in India, Egypt, UAE and Nigeria. In addition, the Company had outstanding bank guarantees and performance bonds, which will expire over the next three years, drawn against the SDHL Revolver.

The total outstanding bank guarantees and surety bonds issued by the Company were \$55.3 million and \$69.3 million as of September 30, 2020 and December 31, 2019, respectively, which consisted of surety bond facilities of \$39.6 million and \$59.4

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million, respectively, and bank guarantees and performance bonds drawn against the SDHL Revolver of \$15.7 million and \$9.9 million, respectively.

Note 10 — 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 and operating lease liabilities, approximate their fair market values due to the short-term nature of the instruments.

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

	September 30, 2020		December 31, 2019	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
Revolving Credit Facility, due April 2023.....	\$ 55,000	\$ 55,000	\$ 35,000	\$ 35,000
8.75% Senior Secured Notes, due November 2024.....	77,596	39,369	-	-
8.25% Senior Unsecured Notes, due February 2025.....	890,807	355,644	889,540	859,536
	<u>\$ 1,023,403</u>	<u>\$ 450,013</u>	<u>\$ 924,540</u>	<u>\$ 894,536</u>

The Company believes the carrying values of the borrowings under the SDHL Revolver approximate their fair value due to the terms of the SDHL Revolver, including its variable interest rate. The estimated fair values of the 8.25% Senior Unsecured Notes and 8.75% Senior Secured Notes were determined using quoted market prices or Level 1 inputs.

The estimated fair values of the 8.75% Senior Secured Notes and the 8.25% Senior Unsecured Notes exclude unamortized debt issuance costs and premiums, as applicable. See also Note 8 – Debt.

Derivative financial instruments were measured at fair value on a recurring basis using Level 2 inputs. See Note 13 – Derivative Financial Instruments.

Note 11 — Shareholders’ Equity

Authorized share capital and issued and outstanding shares

As of June 25, 2018, following the completion of an initial public offering on the Oslo Stock Exchange (“OSE”), the Company was authorized to issue up to 144,063,473 common shares with a par value of \$0.01 per share.

On February 21, 2019, the Company entered into agreements with 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”). 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.

On August 31, 2020, the Company’s shareholders approved a resolution to increase the Company’s authorized shares to 184,063,473 common shares with a par value of \$0.01 per share. As of September 30, 2020, 136,182,177 of the Company’s authorized common shares were outstanding and 10,007,168 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 12 – 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, 2020, 103,102,064 shares were listed on the OSE, net of shares canceled by default, as discussed further below. The remaining shares represent shares held by Castle Harlan, Inc. and Lime Rock Partners (together, the “Sponsors”), or certain other shareholders, which have not been listed and are not currently required to be listed on the OSE.

All common shares have pari passu rights to participate in any common share dividends declared and represent the residual claim on the Company’s assets. The Company did not pay any common share dividends during the nine months ended September 30, 2020 or 2019.

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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 are canceled and 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 are made available for issuance in the future. Shares can be repurchased in the open market on the OSE. The Company has made an accounting policy election to allocate the purchase price of repurchased shares between additional paid-in-capital and retained earnings. In March 2020, the Company suspended its repurchase activities under the 2019 Repurchase Program. Repurchases may continue in future periods at the discretion of the Company's management and Board of Directors, subject to certain limitations under the Company's financing agreements.

The Company repurchased approximately 721,000 shares of common stock at an average price of \$2.16 (19.50 NOK) per share during the nine months ended September 30, 2020 under the 2019 Repurchase Program. No amounts were repurchased during the three months ended September 30, 2020. During the comparable three and nine month periods in 2019, the Company repurchased approximately 285,000 shares of common stock at an average price of \$2.45 (22.01 NOK). As of September 30, 2020, approximately \$20.5 million remains available for repurchase under the 2019 Repurchase Program.

In accordance with Cayman Islands law, the repurchased shares are 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 8 – Debt. As of September 30, 2020 and December 31, 2019, the Company was in compliance with the requirements of the SDHL Revolver, the 8.25% Senior Unsecured Notes, the 8.75% Senior Secured 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 12 — Share-based Compensation

2017 Long-Term Incentive Plan

The Company's 2017 long-term incentive plan or ("2017 LTIP") provides for the issuance of share options, restricted shares, deferred shares, share units, unrestricted shares and cash-based awards (the "awards").

Restricted Share Units ("RSU")

RSUs are contractual rights to receive shares in the future provided the specific vesting condition is met. All awards are 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 RSUs may not be sold or transferred and are subject to forfeiture. The RSU 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.

Time-based restricted share units ("TBRsUs")

The TBRsUs granted to key employees typically vest in one-third increments over a three-year period and to a nonemployee 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.

During the nine months ended September 30, 2020, the Company granted 1.4 million TBRsUs to key employees with a grant date fair value of \$2.05 per share and during the nine months ended September 30, 2019, the Company granted 0.8 million TBRsUs to key employees with a grant date fair value of \$4.29 per share. On May 15, 2020, 259,924 common shares were issued related to an equal number of vested RSUs. No shares vested during the nine months ended September 30, 2019. During the nine months ended September 30, 2020, 14,528 TBRsUs were forfeited. No TBRsUs were forfeited during the nine months ended September 30, 2019.

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Performance-based restricted share units (“PBRsUs”)

During the nine months ended September 30, 2020, the Company awarded 1.4 million PBRsUs to key employees and during the nine months ended September 30, 2019, the Company awarded 0.8 million PBRsUs to key employees. The PBRsUs awarded to key employees are subject to the achievement of specified performance goals, of which 75% of the awards are based on the market condition of total shareholder return against a predetermined peer group (“TSR share units”), and 25% of the awards are based on the performance condition of return on capital employed (“ROCE share units”). The total PBRsUs that may be earned could range from 0% to 200% of the granted units depending on performance. During the nine months ended September 30, 2020, 10,071 TSR share units and 3,357 ROCE share units were forfeited. No PBRsUs were forfeited during the nine months ended September 30, 2019.

The TSR share units granted in 2020 and 2019 were measured on the grant date using the Monte-Carlo option pricing model, which was prepared by an independent third party. Management reviewed the assumptions and methodologies used by the third-party experts to ensure they appear reasonable and consistent with the objective of determining fair value. 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 estimated fair value of the TSR share units granted in 2020 and 2019 of \$3.15 per share and \$5.60 per share, respectively, were determined based on several inputs and assumptions, including the market price of the shares on the date of grant of \$2.05 and \$4.29, respectively, and the risk-free interest rate, expected volatility and expected dividend yield over a period commensurate with the remaining term prior to vesting, as follows:

	Nine months ended September 30,	
	2020	2019
Valuation assumptions:		
Expected term.....	3.00 years	2.76 years
Risk free interest rate.....	1.30%	1.32%
Expected volatility.....	56.77%	49.11%
Expected dividend yield.....	0%	0%

For each period, the expected term represented the period from the grant date to the expected date of vesting, the risk-free interest rate was based on the rate of government securities with similar terms and the expected volatility was based on implied volatility from publicly traded peer group, historical volatility of the Company’s share price and other factors.

The final number of ROCE share units vested from the PBRsUs awarded in 2020 will be determined based on the average achievement of the performance goals for each of the calendar years 2020, 2021 and 2022. 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 2022. The grant date for the ROCE share units awarded in the second quarter of 2019 will be established once those performance goals are determined, which is expected to occur sometime in early 2021. Compensation cost is recognized for the number of ROCE awards expected to vest based on the anticipated achievement of the performance goals. Any subsequent changes in the estimate for the number of ROCE share units expected to vest will be recorded as cumulative catch-up adjustment to compensation cost in the period in which the change in estimate occurs.

Note 13 — Derivative Financial Instruments

Foreign Currency Forward Exchange Contracts

During the three and nine months ended September 30, 2020, the Company settled foreign currency forward exchange contracts (“forex contracts”) with aggregate notional values of approximately \$6.9 million and \$22.3 million, respectively, and approximately \$3.2 million and \$10.4 million during the three and nine months ended September 30, 2019, respectively, of which the aggregate amounts were designated as an accounting hedge.

Gain / (loss) on Derivative Financial Instruments

The following table presents the impact of gains and losses related to the Company’s derivative financial instruments designated as cash flow hedges on accumulated other comprehensive income / (loss) (“AOCIL”) in the Company’s condensed consolidated interim balance sheets for the three and nine months ended September 30, 2020 and 2019 (in thousands). Included are gains and losses recognized through AOCIL, less gains and losses reclassified from AOCIL and recorded under operating and maintenance expense in the condensed consolidated interim statements of operations.

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	Cash Flow Hedges			
	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Foreign currency forward contracts				
Unrealized gain / (loss) recognized through AOCIL.....	\$ 356	\$ (87)	\$ (617)	\$ 54
Less realized (loss) / gain reclassified from AOCIL and recognized through "Operating and maintenance".....	(85)	65	(405)	224
	<u>\$ 441</u>	<u>\$ (152)</u>	<u>\$ (212)</u>	<u>\$ (170)</u>

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

	September 30, 2020	December 31, 2019
Asset derivatives		
Short-term foreign currency forward contracts.....	\$ 28	\$ 240

Note 14 — 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 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,	
	2020	2019
Regulatory and capital maintenance.....	\$ 35,567	\$ 43,190
Contract preparation.....	7,999	28,620
Fleet spares and others.....	3,818	6,955
	<u>\$ 47,384</u>	<u>\$ 78,765</u>
Rig acquisitions.....	78,144	175,575
Total capital expenditures and deferred costs.....	<u>\$ 125,528</u>	<u>\$ 254,340</u>

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

	Nine months ended September 30,	
	2020	2019
Cash payments for additions to property and equipment.....	\$ 94,996	\$ 53,869
Net change in accrued but unpaid additions to property and equipment.....	1,362	13,801
	<u>\$ 96,358</u>	<u>\$ 67,670</u>
Add: Asset additions related to share issuance.....	-	121,772
Total capital expenditures.....	<u>\$ 96,358</u>	<u>\$ 189,442</u>
Changes in deferred costs, net.....	\$ (5,067)	\$ 7,812
Add: Amortization of deferred costs.....	34,237	57,086
Total deferred costs.....	<u>\$ 29,170</u>	<u>\$ 64,898</u>
Total capital expenditures and deferred costs.....	<u>\$ 125,528</u>	<u>\$ 254,340</u>

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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 interim 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):

	September 30, 2020	December 31, 2019
Cash and cash equivalents.....	\$ 69,240	\$ 26,055
Restricted cash included in other current assets.....	-	2,200
Restricted cash included in other long-term assets.....	35	44
Total cash, cash equivalents and restricted cash.....	\$ 69,275	\$ 28,299

Note 15 — Earnings / (Loss) Per Share

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

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Numerator for loss per share				
Net loss and net loss attributable to common shares.....	\$ (7,679)	\$ (35,931)	\$ (184,473)	\$ (79,203)
Denominator for loss per share				
Weighted average common shares:				
Basic outstanding common shares.....	136,182	137,961	136,142	125,442
Diluted common shares.....	136,182	137,961	136,142	125,442
Basic and diluted loss per common share.....	\$ (0.06)	\$ (0.26)	\$ (1.36)	\$ (0.63)

The restricted share units awarded in 2020 and 2019 contain forfeitable rights to dividends, and therefore would not be considered 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 12 – Share-based Compensation.

For both the three and nine months ended September 30, 2020, there were no dilutive common shares and for the three and nine months ended September 30, 2019, there were 6,484 and 3,197 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 16 — Segment and Related Information

Operating segments are defined as components of an entity for which separate financial statements are available and are regularly evaluated by the chief operating decision maker in deciding how to allocate resources and assess performance. The Company has one reportable segment, contract drilling services, which reflects how the Company manages its business, and the fact that the drilling fleet is dependent upon the worldwide oil industry.

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

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Saudi Arabia.....	\$ 33,024	\$ 39,253	\$ 125,908	\$ 121,746
Thailand.....	34,579	29,505	107,619	87,772
Nigeria.....	8,284	18,799	66,173	74,855
India	21,130	9,653	65,049	34,145
United Arab Emirates.....	16,625	19,498	51,937	53,876
Others.....	13,803	15,310	47,144	43,938
	\$ 127,445	\$ 132,018	\$ 463,830	\$ 416,332

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, 2020	December 31, 2019
Thailand.....	\$ 498,901	\$ 516,980
United Arab Emirates.....	231,462	210,317
Saudi Arabia.....	166,411	265,757
Bahrain.....	120,937	80,978
Nigeria.....	106,462	164,478
India.....	56,411	69,658
Others.....	128,453	153,177
	\$ 1,309,037	\$ 1,461,345

The total long-lived assets are comprised of property and equipment, right-of-use assets and short-term and long-term deferred costs. A substantial portion of the Company's assets are mobile, and as such, asset locations at the end of the period are not necessarily indicative of the geographic distribution of the revenues generated by such assets during the period. As of September 30, 2020, the long-lived assets in Bahrain included \$83.8 million relating to an acquired premium jack-up rig under operations readiness and \$37.0 million relating to rigs in shipyard. As of December 31, 2019, the long-lived assets in Bahrain included \$78.8 million relating to an acquired premium jack-up rig under operations readiness.

Note 17 — Related Parties

The Company's related parties consist of the VIEs, the Sponsors and China Merchants. Following the completion of the Transaction in May 2019, China Merchants became the largest shareholder of the Company and is a related party to the Company.

A related party provided rig related services to one of the Company's foreign subsidiaries. These services totaled \$0.1 million and \$0.9 million for the three and nine months ended September 30, 2020, respectively, and \$0.6 million for the three and nine months ended September 30, 2019, respectively. The total liability recorded under accounts payable was zero and \$0.3 million as of September 30, 2020 and December 31, 2019, respectively.

The Company recorded \$0.1 million and \$0.6 million for the three and nine months ended September 30, 2020, respectively, and \$0.4 million and \$1.2 million for the three and nine months ended September 30, 2019, respectively, of Sponsors' costs. Sponsors' costs include directors' fees and reimbursement of costs incurred by Sponsors, and by a former sponsor through the first quarter of 2020, and directors for attendance at meetings relating to the management and governance of the Company. The total liability recorded under accounts payable for such transactions was \$0.1 million as of September 30, 2020 and \$0.2 million as of December 31, 2019.

A VIE related party provided goods and services to drilling rigs owned by several of the Company's foreign subsidiaries. These goods and services totaled \$0.7 million and \$2.1 million during the three and nine months ended September 30, 2020, respectively, and \$0.5 million and \$1.8 million during the three and nine months ended September 30, 2019, respectively. The total liability recorded under accounts payable for such transactions was \$0.5 million and \$0.7 million as of September 30, 2020 and December 31, 2019.

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Lease with a related party

The Company entered into lease agreements for the lease of two bareboat charter rigs with a related party. These agreements were terminated prior to their commencement in September 2020. See Note 9 – Commitments and Contingencies.

The Company entered into an operating lease agreement for yard space with a VIE 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 was \$3.0 million and \$5.1 million as of September 30, 2020 and December 31, 2019, respectively. The corresponding operating lease liability was \$5.4 million (current: \$1.6 million; long-term: \$3.8 million) as of September 30, 2020 and \$5.7 million (current: \$1.5 million; long-term: \$4.2 million) as of December 31, 2019. The Company has recorded total lease expense of \$0.3 million and \$1.0 million for the three and nine months ended September 30, 2020, respectively, and \$0.4 million and \$1.2 million for the three and nine months ended September 30, 2019, respectively. See also Note 6 – Loss on Impairment of Assets.

Note 18 — Subsequent Events

The Company has evaluated subsequent events through November 13, 2020, 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, 2019.

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:

- the COVID-19 pandemic and its effect on demand for our services, global demand for oil and natural gas, the U.S. and world financial markets, our financial condition, results of operations and cash flows;
- our ability to renew or extend contracts, enter into new contracts when such contracts expire or are terminated, 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 newbuild rig construction and delivery and the return of idle rigs to operations;
- future capital expenditures and deferred costs, refurbishment, reactivation, transportation, repair and upgrade costs;
- the cost and timing of acquisitions and integration of additional rigs;
- our ability to reactivate rigs;
- the proceeds and timing of asset dispositions;
- the effects and results of our strategies;
- complex laws and regulations, including environmental, anti-corruption and tax laws and regulations, that can adversely affect the cost, manner or feasibility of doing business;
- litigation, investigations, claims and disputes and their effects on our financial condition and results of operations;
- effects of accounting changes and adoption of accounting policies;
- expectations, trends and outlook regarding offshore drilling activity and dayrates, industry and market conditions, operating revenues, operating and maintenance expense, insurance coverage, insurance expense and deductibles, interest expense and other matters with regard to outlook and future earnings;
- potential asset impairment as a result of Company specific, industry specific or market factors;
- the market value of our rigs and of any rigs we acquire in the future, which may decrease;
- effects of customer interest or inquiries;
- the global number of contracted rigs, and our ability to benefit from any increased activity;
- our ability to attract and retain skilled personnel on commercially reasonable terms, whether due to labor regulations, unionization or otherwise;
- the security and reliability of our technology systems and service providers;
- adverse changes in foreign currency exchange rates;
- changes in general economic, fiscal and business conditions in jurisdictions in which we operate and elsewhere;
- our ability to obtain financing and pursue other business opportunities may be limited by our debt levels, debt agreement restrictions and the credit ratings assigned to our debt by independent credit rating agencies; and
- our incorporation under the laws of the Cayman Islands and the limited rights to relief that may be available compared to United States ("U.S.") laws.

This Quarterly 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 Quarterly 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, 2019 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. ("SDL") was incorporated on August 14, 2012 ("inception") as a private corporation in the Cayman Islands. SDL, through its majority owned subsidiaries (together, the "Company", "we", "us" or "our"), is a leading international shallow water drilling contractor providing equipment and services for the drilling, completion and well maintenance of 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, 2020, we own 32 independent-leg cantilever ("ILC") jack-up rigs, excluding stacked rigs, making us one of the world's largest owners and operators of jack-up rigs by number of active shallow water rigs. 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

Since our inception, we have applied our "fit-for-purpose" strategy to enhance the performance of our business, people and processes, leveraging our sole focus on the shallow water segment and the decades of experience of our people with our customers, rigs and markets where we operate. The diversified geographical focus of our jack-ups and the allocation of resources to build or upgrade rigs is determined by the activities and needs of our customers. Currently, our main customers are national oil companies ("NOCs"), international oil companies ("IOCs") and independent oil and gas companies, who contract our rigs for varying durations.

SDL is a holding company with no significant operations or assets other than interests in its direct and indirect subsidiaries. All operations are conducted through Shelf Drilling Holdings, Ltd. ("SDHL"), an indirect wholly owned subsidiary of SDL. Our corporate offices are in Dubai, United Arab Emirates ("UAE"), geographically close to our operations in the Middle East North Africa and the Mediterranean ("MENAM"), South East Asia, India and West Africa. Our largest shareholders are affiliates of Castle Harlan, Inc., Lime Rock Partners and China Merchants & Great Wall Ocean Strategy & Technology Fund ("China Merchants"). Additionally, other shareholders may have large holdings as reported in public filings in accordance with the rules of the OSE.

Recent events

Brent crude oil prices, a key driver of exploration, development and production activity, continued to be significantly lower in the third quarter of 2020 compared to 2019, following sharp declines in global oil demand and economic instability resulting from the COVID-19 pandemic. This unprecedented global health and economic crisis is causing a significant contraction of the worldwide economic activity and creates near-term uncertainties with an oil and gas supply-demand imbalance.

In September 2020, the Company paid \$3.9 million to settle and terminate its obligations under the bareboat charter agreements with China Merchants. These agreements would have provided for total lease payments of approximately \$32.9 million over the lease term.

In September 2020, the Company entered into the fifth amendment (the "Amendment") of the Revolving Credit Facility, due April 2023 ("SDHL Revolver"). The Amendment provides relief from the Total Net Leverage Ratio financial covenant from January 1, 2021 until September 29, 2021 or upon the Company's voluntary election to early terminate in accordance with the Amendment. Other changes include, for the term of the Amendment: increase of the applicable margin by 100 basis points, new financial covenants requiring a minimum 1.5:1.0 consolidated coverage ratio and a maximum 1.5:1.0 senior secured leverage ratio (defined in the Amendment to exclude liens junior to those securing the SDHL Revolver); and a prohibition of cash dividends by SDHL until the end of such covenant relief.

In October 2020, the Company received a notification from a customer on suspension of operations for the Main Pass I for a period of up to 12 months, with automatic extension of the contract equal to the suspension period.

COVID-19 Pandemic and Market Conditions

One of the largest impacts of the COVID-19 pandemic has been a significant decrease of general economic activity and a corresponding decrease in global energy demand impacting commodity pricing. This situation has led to supply and demand imbalances and may continue to play a significant role in global economic contraction generally and in our industry in particular. For additional discussion regarding risks associated with the COVID-19 pandemic, see Item 1A “Risk Factors” in this report.

Like many other energy companies, our business, financial condition, results of operations and cash flows have been adversely affected by current industry conditions and the COVID-19 pandemic. While it is difficult to predict when the pandemic will regress and when the market will rebalance, the Company has taken a number of actions to protect its employees, ensure continuity of its operations, reduce costs and preserve liquidity. In March 2020, the Company requested as many employees and contractors as possible to work from home. These work from home operations are continuing on a jurisdiction-by-jurisdiction basis as determined by local laws and circumstances. For all other personnel working offshore or directly supporting the rig operations or shipyard activities and not able to work from home, new and specific procedures were put in place in each jurisdiction to help protect the health of all employees from COVID-19. Specific measures were also decided in order to preserve liquidity in this period with the suspension of the Company’s share repurchase activities, completion of the Amendment to the SDHL Revolver and the implementation in April 2020 of a range of cost cutting and restructuring measures at the Company’s headquarters, involving headcount reductions, compensation reductions at the executive and board level and targeted savings across all other cost categories. Management took these necessary steps in an effort to reduce general and administrative expenses beginning in the second quarter of 2020 and partially offset expected revenue reductions in future quarters.

Drilling fleet

The following table summarizes the Company’s offshore drilling rigs as of September 30, 2020 and 2019:

	As of September 30,	
	2020	2019
Jack-ups.....	36	37
Swamp barge.....	1	1
Total	37	38

Included in the 37 rigs are five rigs reported as Assets held for sale in the September 30, 2020 condensed consolidated interim balance sheets.

Outlook

Brent crude oil prices, a key driver of exploration, development and production activity, remained consistently in the low \$40 per barrel range during the third quarter of 2020 and throughout October. Significant declines in global oil demand combined with a challenging economic outlook have continued to put downward pressure on oil prices, the effects of which are impacting the entire drilling industry. The sustained low prices continue to drive lower utilization and lower dayrates in the jack-up market. A deteriorating market is expected to continue for the remainder of 2020 and into 2021. An acceleration of COVID-19 cases in Europe and the U.S. has begun to trigger a new wave of lockdowns. The global number of contracted jack-up rigs has decreased from 386 rigs in March 2020 to 350 in October 2020, and marketed utilization for the industry has fallen from 87% to 80% during this period and we expect the global rig count and marketed utilization to further decline in the coming months.

In the first half of 2020 we experienced a number of contract terminations, suspensions and renegotiation of prices that are now having a material impact on our financial results. Revenues in the third quarter of 2020 decreased both sequentially and compared to the corresponding prior year period. Replacement contracts for available rigs have been more difficult to secure and are typically shorter in duration and at lower dayrates than in the pre-pandemic period.

We have completed a series of actions to preserve liquidity and help secure the continuity of our operations. The cost cutting and restructuring measures implemented in April 2020 have reduced ongoing general and administrative expenses, and we continue to look for opportunities for incremental cost savings. We have also focused on divesting certain idle assets, with the sale of the Trident XIV in the third quarter of 2020 and the negotiation of agreements in October and November 2020 to sell five additional rigs. We also signed the Amendment to the SDHL Revolver in September 2020, which provides relief from the Total Net Leverage Ratio financial covenant until September 2021. We continue to proactively explore ways to address the evolving impacts of the pandemic on our business and industry.

Operational measures

We use various operational measures common to our industry to evaluate our operational performance including:

- *Contract backlog* is the maximum contract drilling dayrate revenues that can be earned from firm commitments for contract drilling services represented by executed definitive agreements based on the contracted operating dayrate during the contract period less any planned out-of-service periods for regulatory inspections and surveys or other work. Contract backlog excludes revenues resulting from mobilization and demobilization fees, capital or upgrade reimbursement, recharges, bonuses and other revenue sources. Contract backlog may also include the maximum contract amount of revenues under non-drilling contracts for the use of our rigs such as bareboat charters and contracts for accommodation units. The contract period excludes revenues from extension options under our contracts, unless such options have been exercised. The contract operating dayrate may differ from the amount estimated due to mobilization, weather, unscheduled downtime and repairs, among other factors. Actual dayrates may also include adjustments based on market factors, such as oil prices or cost increases, and such adjustments are not estimated in the backlog dayrate. Contract backlog is a key indicator of our potential future revenue generation.
- *Average dayrate* is the average contract dayrate earned by marketable rigs over the reporting period excluding mobilization fees, contract preparation, capital expenditure reimbursements, demobilization, recharges, bonuses and other revenues. Average dayrate can be calculated related to historical revenues or contract backlog.
- *Contracted rigs* consist of all of our rigs that are under contract, including contracted newbuild rigs under construction and rigs under non-drilling contracts.
- *Average contracted days per rig* is the total remaining contracted days for all contracted rigs divided by the number of contracted rigs.
- *Marketable rigs* consist of the total of our rigs that are operating or are available to operate, but excluding stacked rigs, rigs under non-drilling contracts and non-contracted newbuild rigs under construction.
- *Effective utilization* measures the dayrate revenue efficiency of our marketable rigs. This is the number of calendar days during which marketable rigs generate dayrate revenues 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 revenues from effective utilization.

The following tables include selected operating measures as of and for the periods presented:

	As of September 30,	
	2020	2019
Total contract backlog (in millions).....	\$ 1,443	\$ 977
Weighted average backlog dayrate (in thousands).....	\$ 66.0	\$ 65.0
Average contract days per rig	729	518
Number of contracted rigs.....	30	29
Marketable rigs.....	32	32

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Average dayrate (in thousands).....	\$ 56.6	\$ 64.7	\$ 59.8	\$ 64.8
Effective utilization.....	72%	65%	83%	69%

Financial measures

In addition to terms under U.S. generally accepted accounting principles (“GAAP”), we utilize certain non-GAAP financial measures. We present the non-GAAP measures, which include adjusted earnings before interest, taxes, depreciation and amortization (“Adjusted EBITDA”) and Adjusted EBITDA divided by revenues (“Adjusted EBITDA Margin”) in addition to net income (loss), which is the most directly comparable GAAP financial measure. We believe that Adjusted EBITDA and Adjusted EBITDA Margin are useful non-GAAP financial measures because they are widely used in our industry to measure a company’s operating performance without regard to the excluded items, 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 the 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 and Adjusted EBITDA Margin may not be comparable to similarly titled measures

employed by other companies and should not be considered in isolation or as a substitute for net income (loss) or other data prepared in accordance with GAAP. Adjusted EBITDA and Adjusted EBITDA Margin have significant limitations, including but not limited to the exclusion from these numbers of various cash requirements to operate our business.

Our financial measures for the three and nine months ended September 30, 2020 and 2019 were as follows (in thousands):

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
Net loss.....	\$ (7,679)	\$ (35,931)	\$ (184,473)	\$ (79,203)
Add back:				
Interest expense and financing charges, net of interest income ⁽¹⁾	22,542	19,754	66,705	59,262
Income tax expense.....	3,565	3,241	14,083	8,072
Depreciation.....	16,681	20,370	53,175	61,046
Amortization of deferred costs.....	9,495	19,836	34,237	57,086
Loss on impairment of assets.....	-	-	188,017	-
(Gain) / loss on disposal of assets.....	(5,680)	638	(5,613)	(1,264)
EBITDA	\$ 38,924	\$ 27,908	\$ 166,131	\$ 104,999
Acquired rig reactivation costs ⁽²⁾	113	4,097	416	16,663
Restructuring costs ⁽³⁾	265	14	1,907	132
Adjusted EBITDA	\$ 39,302	\$ 32,019	\$ 168,454	\$ 121,794
Adjusted EBITDA Margin	30.8%	24.3%	36.3%	29.3%

- (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.
- (2) Represents the expenditures accounted for as operating expenses in accordance with GAAP, which were incurred in connection with the reactivation of stacked or idle rigs acquired with the specific intention to reactivate and deploy.
- (3) Represents certain one-time expenses related to cost saving and restructuring measures and third-party professional services.

Our restricted subsidiaries accounted for 100% of our Adjusted EBITDA for the nine months ended September 30, 2020 and 100% for the nine months ended September 30, 2019; our restricted subsidiaries accounted for 100% of our assets as of September 30, 2020 and December 31, 2019.

Operating Results

The following table sets forth information regarding our consolidated results of operations:

	Three months ended September 30,		Change	% change
	2020	2019		
Revenues				
Operating revenues.....	\$ 125,106	\$ 128,958	\$ (3,852)	(3%)
Other revenues.....	2,339	3,060	(721)	(24%)
	<u>127,445</u>	<u>132,018</u>	<u>(4,573)</u>	<u>(3%)</u>
Operating costs and expenses				
Operating and maintenance.....	78,956	91,446	(12,490)	(14%)
Depreciation.....	16,681	20,370	(3,689)	(18%)
Amortization of deferred costs.....	9,495	19,836	(10,341)	(52%)
General and administrative.....	9,386	12,750	(3,364)	(26%)
(Gain) / loss on disposal of assets.....	(5,680)	638	(6,318)	(990%)
	<u>108,838</u>	<u>145,040</u>	<u>(36,202)</u>	<u>(25%)</u>
Operating income / (loss).....	<u>18,607</u>	<u>(13,022)</u>	<u>31,629</u>	<u>243%</u>
Other (expense) / income, net				
Interest income.....	18	317	(299)	(94%)
Interest expense and financing charges.....	(22,560)	(20,071)	(2,489)	(12%)
Other, net.....	(179)	86	(265)	(308%)
	<u>(22,721)</u>	<u>(19,668)</u>	<u>(3,053)</u>	<u>(16%)</u>
Loss before income taxes.....	<u>(4,114)</u>	<u>(32,690)</u>	<u>28,576</u>	<u>87%</u>
Income tax expense.....	3,565	3,241	324	10%
Net loss.....	<u>\$ (7,679)</u>	<u>\$ (35,931)</u>	<u>\$ 28,252</u>	<u>79%</u>
Nine months ended September 30,				
	2020	2019	Change	% change
Revenues				
Operating revenues	\$ 452,645	\$ 405,810	\$ 46,835	12%
Other revenues.....	11,185	10,522	663	6%
	<u>463,830</u>	<u>416,332</u>	<u>47,498</u>	<u>11%</u>
Operating costs and expenses				
Operating and maintenance.....	262,863	274,621	(11,758)	(4%)
Depreciation.....	53,175	61,046	(7,871)	(13%)
Amortization of deferred costs.....	34,237	57,086	(22,849)	(40%)
General and administrative.....	34,782	36,326	(1,544)	(4%)
Loss on impairment of assets.....	188,017	-	188,017	0%
Gain on disposal of assets.....	(5,613)	(1,264)	(4,349)	(344%)
	<u>567,461</u>	<u>427,815</u>	<u>139,646</u>	<u>33%</u>
Operating loss.....	<u>(103,631)</u>	<u>(11,483)</u>	<u>(92,148)</u>	<u>(802%)</u>
Other (expense) / income, net				
Interest income.....	162	1,047	(885)	(85%)
Interest expense and financing charges.....	(66,867)	(60,309)	(6,558)	(11%)
Other, net.....	(54)	(386)	332	86%
	<u>(66,759)</u>	<u>(59,648)</u>	<u>(7,111)</u>	<u>(12%)</u>
Loss before income taxes.....	<u>(170,390)</u>	<u>(71,131)</u>	<u>(99,259)</u>	<u>(140%)</u>
Income tax expense.....	14,083	8,072	6,011	74%
Net loss.....	<u>\$ (184,473)</u>	<u>\$ (79,203)</u>	<u>\$ (105,270)</u>	<u>(133%)</u>

Three months ended September 30, 2020 compared to the three months ended September 30, 2019 and the nine months ended September 30, 2020 compared to the nine months ended September 30, 2019

Revenues

Total revenues for the three months ended September 30, 2020 was \$127.4 million compared to \$132.0 million for the same period in 2019. Revenues for the three months ended September 30, 2020 consisted of \$125.1 million (98.2%) of operating

revenues and \$2.3 million (1.8%) of other revenues. In 2019, the corresponding revenues were \$129.0 million (97.7%) and \$3.0 million (2.3%), respectively.

Total revenues for the three months ended September 30, 2020 decreased by \$4.6 million compared to the same period in 2019 primarily due to a reduction of \$15.8 million from lower average earned dayrates mainly explained by lower pricing where customers renegotiated dayrates as a result of the COVID-19 pandemic and \$0.4 million from lower recharges and amortization of mobilization revenue, partially offset by \$11.6 million related to higher effective utilization across the fleet, as six additional rigs were operating in 2020 as compared to the same period in 2019.

Total revenues for the nine months ended September 30, 2020 was \$463.8 million compared to \$416.3 million for the same period in 2019. Revenues for the nine months ended September 30, 2020 consisted of \$452.6 million (97.6%) of operating revenues and \$11.2 million (2.4%) of other revenues. In 2019, the corresponding revenues were \$405.8 million (97.5%) and \$10.5 million (2.5%), respectively.

Total revenues for the nine months ended September 30, 2020 increased by \$47.5 million compared to the same period in 2019 primarily due to \$74.5 million related to higher effective utilization across the fleet, as six additional rigs were operating during 2020 that were not operating for the full comparative period in 2019, and \$4.6 million from higher recharges and amortization of mobilization revenues, partially offset by a reduction of \$31.6 million from lower average earned dayrates, primarily related to the effects of the COVID-19 pandemic.

We expect the decrease in revenues in the third quarter of 2020 to continue in the fourth quarter as recent contract suspensions, terminations and renegotiations put downward pressure on dayrates and marketed utilization.

Operating and maintenance

Total operating and maintenance expenses for the three months ended September 30, 2020 were \$79.0 million, or 62.0% of total revenue, compared to \$91.4 million, or 69.2% of total revenue, in the three months ended September 30, 2019. Operating and maintenance expenses in the three months ended September 30, 2020, consisted of \$71.0 million rig-related expenses and \$8.0 million shore-based expenses. In the three months ended September 30, 2019, these same expenses were \$82.1 million and \$9.3 million, respectively. The decrease in total rig-related expenses of \$11.1 million primarily consisted of \$5.6 million lower expenses related to rigs whose operations were suspended or terminated in 2020, \$5.4 million lower expenses for rigs disposed in the current or prior periods, \$3.7 million lower maintenance and shipyard expenses and \$1.6 million in other rig cost savings. This was partially offset by \$5.2 million increased expenses for acquired rigs or rigs that were not operating for the full comparative period in 2019. Shore-based expenses decreased by \$1.3 million for the three months ended September 30, 2020 compared to the same period in 2019.

Total operating and maintenance expenses for the nine months ended September 30, 2020 were \$262.8 million, or 56.7% of total revenue, compared to \$274.6 million, or 66.0% of total revenue, in the nine months ended September 30, 2019. Operating and maintenance expenses in the nine months ended September 30, 2020, consisted of \$235.9 million rig-related expenses and \$26.9 million shore-based expenses. In the nine months ended September 30, 2019, these same expenses were \$247.9 million and \$26.7 million, respectively. The decrease in total rig-related expenses of \$12.0 million primarily consisted of \$10.8 million lower expenses related to rigs whose operations were suspended or terminated in 2020, \$6.8 million lower expenses for rigs disposed in the current or prior periods, \$5.8 million lower maintenance and shipyard expenses and \$0.4 million in other rig cost savings. This was partially offset by \$8.2 million for acquired rigs or rigs that were not operating for the full comparative period in 2019 and \$3.6 million of expense related to the bareboat charter rigs with China Merchants. Shore-based expenses increased by \$0.2 million for the nine months ended September 30, 2020 compared to the same period in 2019.

Depreciation expense

Depreciation expense in the three months ended September 30, 2020 was \$16.7 million compared to \$20.4 million for the same period in 2019. Depreciation expense in the nine months ended September 30, 2020 was \$53.2 million compared to \$61.0 million for the same period in 2019.

For the three months ended September 30, 2020, depreciation expense was impacted by \$5.6 million of lower depreciation on drilling rigs and equipment which were impaired in March 2020 or December 2019 and by \$2.4 million of increased depreciation for three rigs that were placed into operation in late 2019 or 2020. For the nine months ended September 30, 2020 depreciation expense was impacted by \$12.7 million of lower depreciation on drilling rigs and equipment which were impaired in March 2020 or December 2019 and \$6.1 million of increased depreciation for three rigs that were placed into operation in late 2019 or 2020.

Amortization of deferred costs

The amortization of deferred costs in the three months ended September 30, 2020 was \$9.5 million compared to \$19.8 million for the same period in 2019. The amortization of deferred costs in the nine months ended September 30, 2020 was \$34.2 million compared to \$57.1 million for the same period in 2019.

The decrease in the three and nine months ended September 30, 2020 was primarily related to lower amortizations of contract preparation costs on drilling rigs that completed their firm contracts after the corresponding period in 2019 or that were impaired in March 2020 or December 2019. These effects were partially offset by increased amortization on drilling rigs which started new contracts in late 2019 or in 2020.

General and administrative expenses

General and administrative expenses were \$9.4 million in the three months ended September 30, 2020 compared to \$12.8 million for the same period in 2019. The \$3.4 million decrease primarily resulted from lower personnel and administrative costs due to a range of cost savings and restructuring measures implemented at the Company's headquarters in April 2020.

General and administrative expenses were \$34.8 million in the nine months ended September 30, 2020 compared to \$36.3 million for the same period in 2019. The \$1.5 million decrease in the nine months ended September 30, 2020 primarily resulted from lower personnel and administrative costs due to a range of cost savings and restructuring measures implemented at the Company's headquarters in April 2020, partially offset by a \$2.7 million increase in allowance for credit losses and a \$2.1 million increase in share-based compensation.

Loss on impairment of assets

Loss on impairment of assets was zero and \$188.0 million in the three and nine months ended September 30, 2020, respectively. The loss included impairment on 15 of our rigs and other long-lived assets and four rigs classified as assets held for sale. There were no such transactions during the three and nine months ended September 30, 2019.

Gain / (loss) on disposal of assets

Gain on disposal of assets was a \$5.7 million in the three months ended September 30, 2020, compared to a loss of (\$0.6) million for the same period in 2019. The increase in the gain on disposal of assets was due to the sale of the Trident XIV during the third quarter of 2020.

Gain on disposal of assets was a \$5.6 million in the nine months ended September 30, 2020, compared to \$1.3 million for the same period in 2019. The gain on disposal of assets includes a gain on the sale of one rig in the 2020 period and a gain on the sale of three rigs during the same period of 2019. The increase in the gain on sale of assets was primarily related to higher proceeds on the rig sale in 2020 as compared to the rig sales during the 2019 period.

Other (expense) / income, net

Other (expense) / income, net, consisting of interest expense and finance charges, interest income and other, net was an expense of (\$22.7) million in the three months ended September 30, 2020 compared to (\$19.7) million for the same period in 2019. During the three months ended September 30, 2020, other expense consisted primarily of interest expense and financing charges of (\$22.6) million, as well as interest income of \$18 thousand and other, net of \$(0.2) million in expense. This compares to (\$20.1) million, \$0.3 million and \$0.1 million in income for those respective categories during the same period in 2019.

Other (expense) / income, net was an expense of (\$66.8) million in the nine months ended September 30, 2020 compared to (\$59.6) million for the same period in 2019. During the nine months ended September 30, 2020, other expense consisted primarily of interest expense and financing charges of (\$66.9) million, as well as interest income of \$0.2 million and other, net of (\$0.1) million in expense. This compares to (\$60.3) million, \$1.0 million and (\$0.4) million in expense for those respective categories during the same period in 2019.

Interest expense and financing charges in the three months ended September 30, 2020 were \$2.5 million higher compared to the same period in 2019, primarily due to \$1.9 million interest on the 8.75% Senior Secured Notes issued during the first quarter of 2020 and \$0.6 million increased interest on the SDHL Revolver resulting from drawdowns in late 2019 and early 2020. For the nine months ended September 30, 2020, the \$6.6 million increase was primarily due to \$4.6 million interest on the 8.75% Senior Secured Notes issued during the first quarter of 2020 and \$1.9 million increased interest on the SDHL Revolver.

Income tax expense

Income tax expense for the three months ended September 30, 2020 was \$3.6 million compared to \$3.2 million for the three months ended September 30, 2019. Income tax expense for the nine months ended September 30, 2020 was \$14.1 million compared to \$8.1 million for the nine months ended September 30, 2019.

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, (d) changes in the Company's rig operating structures which may alter the basis on which the Company is taxed in a particular jurisdiction, and (e) fluctuations in foreign currency rates against the U.S. Dollar which are used to measure tax receivables in various jurisdictions.

Income tax expense for the three months ended September 30, 2020 was higher than for the same period in 2019 primarily due to a greater increase in liabilities for uncertain tax positions and a benefit realized in 2019 from reduction in valuation allowance against certain deferred tax assets with no corresponding benefit recorded in 2020.

Income tax expense for the nine months ended September 30, 2020 was higher than for the same period in 2019 primarily due to higher revenue, higher tax expense related to adjustments in prior year tax receivables in 2020 resulting primarily from foreign currencies depreciating against the U.S. Dollar in which tax receivables are measured and a tax benefit related to an uncertain tax position realized in 2019 with no corresponding benefit recorded in 2020.

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 from issuance of long-term debt and equity and availability under the SDHL Revolver. Our primary uses of cash were payments for capital and deferred expenditures, debt issuance costs, interest and income taxes.

We had \$69.2 million and \$26.1 million in cash and cash equivalents as of September 30, 2020 and December 31, 2019, respectively. As of September 30, 2020 and December 31, 2019, the Company owed \$55.0 million and \$35.0 million, respectively, under the SDHL Revolver. The Company issued bank guarantees and performance bonds totaling \$15.7 million and \$9.9 million as of September 30, 2020 and December 31, 2019, respectively, against the SDHL Revolver. There are certain contractual 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.

On February 20, 2020, the Company closed a private offering of \$80.0 million aggregate principal amount of the 8.75% Senior Secured Notes to replenish its liquidity following the acquisition of the premium jack-up rig Shelf Drilling Enterprise and to finance the remaining reactivation and upgrade costs associated with the deployment of the rig in advance of the contract commencement.

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 and deferred expenditures and other needs related to the operation of our business. 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. Any such transactions will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. We may seek to extend our maturities and/or reduce the overall principal amount of our debt through liability management transactions, which may include exchange offers and/or recapitalizations.

The existence of COVID-19 has caused disruptions to businesses and economic activity globally. As of September 30, 2020, certain of our contracts have been terminated, shortened or renegotiated which will adversely impact our business in future periods. We have adequate cash reserves and we are continuously managing our cash flows and cash forecasts to maintain our liquidity. In addition to our cash reserves, we also have amounts available under the SDHL Revolver. On September 21, 2020, the Company entered into the fifth amendment of the SDHL Revolver (the "Amendment"). The Amendment provides changes to the SDHL Revolver, including providing relief from the Total Net Leverage Ratio financial covenant from January 1, 2021 until the termination of the Amendment on September 29, 2021 or upon the Company's voluntary election to early terminate in accordance with the Amendment. The Company may initiate further discussions with its lenders for additional covenant relief if and as needed. As a result of these factors, management believes that we have adequate liquidity to fund our operations for the next twelve months, and, therefore, our financial statements have been prepared under the going concern assumption. Additional covenant relief, capital and/or refinancing of our existing debt may be required in the future if the current market situation continues and/or worsens.

Discussion of Cash flows

The following table sets out certain information regarding our cash flow statements for the nine months ended September 30, 2020 and 2019 (in thousands):

	Nine months ended September 30,	
	2020	2019
Net cash provided by / (used in) operating activities.....	\$ 34,981	\$ (18,075)
Net cash used in investing activities.....	(89,283)	(47,252)
Net cash provided by financing activities.....	95,278	18,586
Net increase / (decrease) in cash and cash equivalents	\$ 40,976	\$ (46,741)

Net cash provided by / (used in) operating activities

Net cash provided by operating activities totaled \$35.0 million during the nine months ended September 30, 2020 compared to net cash used of (\$18.1) million during the nine months ended September 30, 2019. The increase of \$53.1 million in cash from operations was primarily due to an increase in revenues when compared to the prior period.

During the nine months ended September 30, 2020 and 2019, we made cash payments of \$80.1 million and \$77.7 million, respectively, in interest and financing charges included in other operating assets and liabilities, net. We also made cash payments of \$12.7 million and \$14.3 million in income taxes included in other operating assets and liabilities, net during the nine months ended September 30, 2020 and 2019, respectively.

Net cash used in investing activities

Net cash used in investing activities totaled \$89.3 million during the nine months ended September 30, 2020 compared to \$47.3 million during the nine months ended September 30, 2019.

Cash used for capital expenditures totaled \$95.0 million and \$53.9 million during the nine months ended September 30, 2020 and 2019, respectively. The \$41.1 million increase was primarily due to the acquisition and readiness project costs for the Shelf Drilling Enterprise.

The net proceeds from disposal of assets totaled \$5.7 million and \$6.6 million during the nine months ended September 30, 2020 and September 30, 2019, respectively. The \$0.9 million decrease primarily related to the net proceeds for the sale of three stacked rigs during the 2019 period as compared to one rig disposed in 2020.

Net cash provided by financing activities

Net cash provided by financing activities totaled \$95.3 million in the nine months ended September 30, 2020 compared to \$18.6 million during the nine months ended September 30, 2019.

The increase of \$76.7 million was primarily due to \$80.0 million in proceeds from issuance of the 8.75% Senior Secured Notes, partly offset by the increase of \$2.9 million in payment of debt financing costs.

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 long-term 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, 2020 and 2019 (in thousands):

	Nine months ended September 30,	
	2020	2019
Regulatory and capital maintenance ⁽¹⁾	\$ 35,567	\$ 43,190
Contract preparation ⁽²⁾	7,999	28,620
Fleet spares and other ⁽³⁾	3,818	6,955
	\$ 47,384	\$ 78,765
Rig acquisitions ⁽⁴⁾	78,144	175,575
Total capital expenditures and deferred costs.....	\$ 125,528	\$ 254,340

- (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 readiness projects for the Shelf Drilling Enterprise acquired in January 2020 and for two newbuild premium jack-up drilling rigs acquired in May 2019 and the subsequent reactivation of one premium jack-up rig acquired in July 2018.

Capital expenditures and deferred costs were \$125.5 million and \$254.3 million in the nine months ended September 30, 2020 and 2019, respectively. The decrease of \$128.8 million was primarily due to the \$97.4 million decrease in rig acquisitions, mainly explained by \$159.5 million for the acquisition and operations readiness of the two newbuild premium CJ46 drilling jack-up rigs acquired in 2019 partly offset by \$70.7 million for the acquisition and operations readiness of the Shelf Drilling Enterprise in 2020. In addition, there was a \$23.8 million decrease in contract preparation and fleet spares expenditures and a \$7.6 million decrease in regulatory and capital maintenance expenditures, primarily due to higher contract preparation costs for rigs in UAE and Tunisia which started contracts in 2019 and higher spending for a planned out of service project in 2019 for a rig in Saudi Arabia.

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, 2020 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 outstanding in 2018 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, 2020 (In thousands)

	Shelf Drilling, Ltd.	Adjustments	Shelf Drilling Holdings, Ltd.
Revenues			
Operating revenues.....	\$ 452,645	\$ -	\$ 452,645
Other revenues	11,185	-	11,185
	<u>463,830</u>	<u>-</u>	<u>463,830</u>
Operating costs and expenses			
Operating and maintenance	262,863	-	262,863
Depreciation	53,175	-	53,175
Amortization of deferred costs	34,237	-	34,237
General and administrative.....	34,782	(117)	34,665
Loss on impairment of assets	188,017	-	188,017
Gain on disposal of assets	(5,613)	-	(5,613)
	<u>567,461</u>	<u>(117)</u>	<u>567,344</u>
Operating loss	<u>(103,631)</u>	<u>117</u>	<u>(103,514)</u>
Other (expense) / income, net			
Interest income	162	-	162
Interest expense and financing charges	(66,867)	-	(66,867)
Other, net.....	(54)	1	(53)
	<u>(66,759)</u>	<u>1</u>	<u>(66,758)</u>
Loss before income taxes	<u>(170,390)</u>	<u>118</u>	<u>(170,272)</u>
Income tax expense	14,083	-	14,083
Net loss attributable to common shares	<u>\$ (184,473)</u>	<u>\$ 118</u>	<u>\$ (184,355)</u>

Condensed Consolidated Interim Balance Sheets as of September 30, 2020
(In thousands)

	<u>Shelf Drilling, Ltd.</u>	<u>Adjustments</u>	<u>Shelf Drilling Holdings, Ltd.</u>
Assets			
Cash and cash equivalents	\$ 69,240	(3,506)	\$ 65,734
Accounts and other receivables, net ⁽¹⁾	134,727	517	135,244
Assets held for sale	2,514	-	2,514
Other current assets	49,044	-	49,044
Total current assets	<u>255,525</u>	<u>(2,989)</u>	<u>252,536</u>
Property and equipment	1,687,081	-	1,687,081
Less accumulated depreciation	(496,194)	-	(496,194)
Property and equipment, net	<u>1,190,887</u>	<u>-</u>	<u>1,190,887</u>
Deferred tax assets	1,380	-	1,380
Other long-term assets	121,060	-	121,060
Total assets	<u>\$ 1,568,852</u>	<u>\$ (2,989)</u>	<u>\$ 1,565,863</u>
Liabilities and equity			
Accounts payable	\$ 66,980	\$ (6)	\$ 66,974
Interest payable	12,504	-	12,504
Accrued income taxes	4,319	-	4,319
Other current liabilities	28,353	-	28,353
Total current liabilities	<u>112,156</u>	<u>(6)</u>	<u>112,150</u>
Long-term debt	1,023,403	-	1,023,403
Deferred tax liabilities	5,274	-	5,274
Other long-term liabilities	49,742	-	49,742
Total long-term liabilities	<u>1,078,419</u>	<u>-</u>	<u>1,078,419</u>
Commitments and contingencies			
Common shares ⁽²⁾	1,362	(1,362)	-
Additional paid-in capital ⁽³⁾	1,001,814	(93,512)	908,302
Accumulated other comprehensive income	28	-	28
Accumulated losses ⁽⁴⁾	(624,927)	91,891	(533,036)
Total equity	<u>378,277</u>	<u>(2,983)</u>	<u>375,294</u>
Total liabilities and equity	<u>\$ 1,568,852</u>	<u>\$ (2,989)</u>	<u>\$ 1,565,863</u>

(1) 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 136,182,177 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, preferred shares dividend at SDL, ordinary shares dividend at SDHL and certain general and administrative costs incurred at SDL.

Condensed Consolidated Interim Statements of Cash flows for the nine months ended September 30, 2020
(In thousands)

	<u>Shelf Drilling, Ltd.</u>	<u>Adjustments</u>	<u>Shelf Drilling Holdings, Ltd.</u>
Cash flows from operating activities			
Net loss	\$ (184,473)	\$ 118	\$ (184,355)
Adjustments to reconcile net loss to net cash provided by operating activities			
Depreciation	53,175	-	53,175
Loss on impairment of assets	188,017	-	188,017
Loss on derivative financial instruments, net	405	-	405
Provision for doubtful accounts, net	2,641	-	2,641
Amortization of deferred revenue	(8,413)	-	(8,413)
Share-based compensation expense, net of forfeitures / Capital contribution by Parent share-based compensation	3,069	(61)	3,008
Amortization of debt issue costs and premium	2,402	-	2,402
Gain on disposal of assets	(5,613)	-	(5,613)
Deferred tax expense, net	1,443	-	1,443
Payments of settlement of derivative financial instruments, net	(405)	-	(405)
Changes in deferred costs, net	5,067	-	5,067
Changes in operating assets and liabilities			
Intercompany receivables	-	(51)	(51)
Other operating assets and liabilities, net	(22,334)	3	(22,331)
Net cash provided by operating activities	<u>34,981</u>	<u>9</u>	<u>34,990</u>
Cash flows from investing activities			
Additions to property and equipment	(94,996)	-	(94,996)
Proceeds from disposal of assets	5,713	-	5,713
Net cash used in investing activities	<u>(89,283)</u>	<u>-</u>	<u>(89,283)</u>
Cash flows from financing activities			
Proceeds from issuance of debt	80,000	-	80,000
Proceeds from revolving credit facility	75,000	-	75,000
Repayments of revolving credit facility	(55,000)	-	(55,000)
Purchase of common shares ⁽¹⁾	(1,639)	1,639	-
Ordinary shares dividend paid ⁽²⁾	-	(3,000)	(3,000)
Payments of debt financing costs	(3,083)	-	(3,083)
Net cash provided by financing activities	<u>95,278</u>	<u>(1,361)</u>	<u>93,917</u>
Net increase in cash, cash equivalents and restricted cash	<u>40,976</u>	<u>(1,352)</u>	<u>39,624</u>
Cash, cash equivalents and restricted cash at beginning of period	28,299	(2,154)	26,145
Cash, cash equivalents and restricted cash at end of period...	<u>\$ 69,275</u>	<u>\$ (3,506)</u>	<u>\$ 65,769</u>

(1) This adjustment relates to the repurchase of common shares recorded at SDL level.

(2) 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, 2020 (in thousands):

	Years ending December 31,						Total
	Remainder of 2020	2021	2022	2023	2024	Thereafter	
Debt repayment.....	\$ -	\$ -	\$ -	\$ 55,000	\$ 80,000	\$ 900,000	\$ 1,035,000
Interest on debt ⁽¹⁾	21,941	86,990	86,573	83,020	80,453	9,281	368,258
Operating lease obligations....	2,671	9,167	7,106	4,450	2,931	356	26,681
Total.....	\$ 24,612	\$ 96,157	\$ 93,679	\$ 142,470	\$ 163,384	\$ 909,637	\$ 1,429,939

(1) Includes commitment fees on the SDHL Revolver assuming no change in the undrawn balance from September 30, 2020. Assumes the margin applied to the interest rate on the SDHL Revolver decreases by 100 basis points after the termination of the September 21, 2020 fifth amendment to the SDHL Revolver. Assumes no other changes in the current variable interest applied on the SDHL Revolver. See also “Note 8 – Debt” in “Item 1. Financial Statements” of “Part I. Financial Information”.

As of September 30, 2020, the Company has liabilities related to postemployment benefits of \$16.7 million and liabilities for uncertain tax positions of \$8.6 million that are not included in the table above as the Company cannot make a reasonable estimation of the timing of the payment of such amounts.

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.

The Company maintains surety bond facilities in either U.S. dollars or local currencies of approximately \$71.8 million provided by several banks to guarantee various contractual, performance, and customs obligations in India, Egypt, UAE and Nigeria. In addition, the Company had outstanding bank guarantees and performance bonds, which will expire over the next three years, drawn against the SDHL Revolver. The total outstanding bank guarantees and surety bonds issued by the Company were \$55.3 million and \$69.3 million as of September 30, 2020 and December 31, 2019, respectively, which consisted of surety bond facilities of \$39.6 million and \$59.4 million, respectfully, and bank guarantees and performance bonds drawn against the SDHL Revolver of \$15.7 million and \$9.9 million, respectively.

Contingencies

As of September 30, 2020, we are not exposed to any contingent liabilities that are expected to 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, certain contractual and customs obligations secured by surety bonds and bank guarantees and uncertain tax positions. See “Note 7 – Income Taxes” and “Note 9 – Commitments and Contingencies” in “Item 1. Financial Statements” of “Part I. Financial Information” for discussion of any material changes in our contingent liabilities from those previously reported in our Form 10-K Equivalent for the year ended December 31, 2019.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated interim financial statements, which have been prepared in accordance with GAAP. The preparation of our condensed consolidated interim financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, and related disclosure of contingent assets and liabilities at the date of the condensed consolidated interim financial statements and the reported amounts of revenues and expenses during the reporting period. 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 condensed consolidated interim 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, 2019. During the nine months ended September 30, 2020, there were no material changes to the judgments, assumptions or

policies upon which our critical accounting estimates are based. 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 “Item 1. Financial Statements” of “Part I. Financial Information”.

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 and debt facilities, and by continuously monitoring our actual and forecast cash flows and by matching the maturity profiles of financial assets and liabilities when possible.

Interest Rate Risk

We are exposed to interest rate risk related to the fixed rate debt under the 8.25% Senior Unsecured Notes, 8.75% Senior Secured Notes and variable rate debt under our revolving credit facility. In addition, the expected phase out of the LIBOR rate after 2021 exposes the Company to uncertainty as to the benchmark rate to be used in the future. 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. 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/letter of credit in our favor to cover the risk of non-payment under drilling contracts.

The Company determines its expected credit losses for its pools of assets with similar risk characteristics based on historical loss information as adjusted for future expectations. Allowance for credit losses was \$2.6 million and \$1.8 million as of September 30, 2020 and December 31, 2019, respectively.

Item 4. Controls and Procedures

We are not required to report this Item.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

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

See “Note 9 – Commitments and Contingencies” in “Item 1. Financial Statements” of “Part I. Financial Information”.

Item 1A. Risk Factors

The information set forth under the caption “Forward-looking Information” in “Part I. Item 2. Management’s Discussion and Analysis” 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, 2019, except as follows:

The COVID-19 pandemic has significantly reduced demand for our services, and has had, and may continue to have, a material adverse impact on our financial condition, results of operations and cash flows.

The existence of COVID-19 was confirmed in early 2020 and has spread to countries worldwide, causing disruptions to businesses and economic activity globally. The collapse in the demand for oil caused by this unprecedented global health and economic crisis, coupled with oil oversupply, has had, and is reasonably likely to continue to have, a material adverse impact on the demand for our services. These effects have included, and may continue to include, adverse effects on revenues and net income; disruptions to our operations; customer shutdowns of oil and gas exploration, development and production; employee impacts from illness, school closures and other community response measures; and temporary closures of our facilities or the facilities of our customers and suppliers. Certain of our contracts have been terminated, shortened or renegotiated which will adversely impact our business in future periods.

The extent to which our operating and financial results are affected by COVID-19 will depend on various factors and consequences beyond our control, such as the duration and scope of the pandemic and additional actions by businesses and governments in response to the pandemic, particularly within the geographic locations where we operate, as well as the speed and effectiveness of these responses to combat the virus, all of which are highly uncertain at this time. COVID-19, and the volatile global economic conditions stemming from the pandemic, could also aggravate the other risk factors previously included in our 10-K Equivalent for the year ended December 31, 2019. COVID-19 may also materially adversely affect our operating and financial results in a manner that is not currently known to us or that we do not currently expect to present significant risks to our operations.

Additionally, these market and industry conditions could place significant pressure on the liquidity and solvency of many offshore drilling contractors, leading them to pursue restructuring transactions or reorganizations under bankruptcy laws. We are unable to predict the timing or impact of any such transactions, if completed, on the capital structure and competitive dynamics among offshore drilling companies.

As the situation is fluid and rapidly evolving, we do not consider it practicable to provide a quantitative estimate of the potential impact of this outbreak on the Company at this time. We have adequate cash reserves and we are continuously managing our actual cash flows and cash forecasts to maintain our liquidity. In addition to our cash reserves, we also have amounts available under the SDHL Revolver. On September 21, 2020, the Company entered into the fifth amendment of the SDHL Revolver (the “Amendment”). The Amendment provides changes to the SDHL Revolver, including providing relief from the Total Net Leverage Ratio financial covenant from January 1, 2021 until the termination of the Amendment on September 29, 2021 or upon the Company’s voluntary election to early terminate in accordance with the Amendment. The Company may initiate further discussions with its lenders for additional covenant relief if and as needed. As a result of these factors, management believes that we have adequate liquidity to fund our operations for the next twelve months, and, therefore, our financial statements have been prepared under the going concern assumption. We may seek additional covenant relief, to extend our maturities and/or reduce the overall principal amount of our debt through liability management transactions, which may include exchange offers and/or recapitalizations in the future if the current market situation continues and/or worsens.

Our SDHL Revolver requires us to comply with restrictive covenants, including total net leverage ratios, and may restrict our ability to draw down on the line of credit.

Our SDHL Revolver requires us to comply with various customary restricted covenants, including limitations on the Company's leverage ratio. On September 21, 2020, the Company entered into the fifth amendment of the SDHL Revolver (the "Amendment"). The Amendment provision includes relief from the leverage ratio financial covenant from January 1, 2021 until the termination of the Amendment on September 29, 2021 or upon the Company's voluntary election to early terminate in accordance with the Amendment. Our ability to comply with these financial ratios, including the leverage ratio after the termination of the Amendment, may be affected by events beyond our control. These restrictions could limit our ability to plan for or react to market or economic conditions or meet capital needs or otherwise restrict our activities or business plans and adversely affect our ability to finance our operations, acquisitions, investments or strategic alliances or other capital needs or to engage in other business activities that would be in our interest. A breach of any of these covenants or our inability to comply with the required financial ratios could result in a default under all or certain of our debt instruments. If a default occurs, the applicable creditors of our secured debt could proceed against the collateral granted to them to secure such indebtedness which constitute substantially all of our worldwide operations.

The SDHL Revolver also contains certain customary limitations which may restrict our ability to draw down the available balance of the line of credit, including but not limited to prohibiting draw down while an event of default or material adverse event is ongoing and requiring us to be in compliance with financial covenant obligations both before and after the draw down.

Our failure to comply with the obligations under the SDHL Revolver could result in an event of default, which could result in the acceleration of our indebtedness, in whole or in part and trigger cross-default provisions of our other existing debt or financing agreements. Default under our debt agreement or inability to access our line of credit to fund operations, would have a material adverse effect on our financial condition, results of operations and cash flows and could have a significant negative impact on the market prices of our shares.

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

In September 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 million. As of September 30, 2020, approximately \$20.5 million remains available for repurchase under the 2019 Repurchase Program. In March 2020, the Company suspended its repurchase activities under the 2019 Repurchase Program and therefore no shares were repurchased during the second and third quarter of 2020. Repurchases may continue in future periods at the discretion of the Company's management and Board of Directors. See "Note 11 – Shareholders' Equity" in "Item 1. Financial Statements" of "Part I. Financial Information".

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 at www.shelfdrilling.com in the investor relations section under financial reports, key documents.