

Ship Finance International LTD  
Form 20-F  
March 26, 2019

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 20-F

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g)  
OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
Date of event requiring this shell company report

Commission file number 001-32199

Ship Finance International Limited  
(Exact name of Registrant as  
specified in its charter)

(Translation of Registrant's name  
into English)

Bermuda  
(Jurisdiction of incorporation or  
organization)

Par-la-Ville Place, 14 Par-la-Ville  
Road, Hamilton, HM 08, Bermuda  
(Address of principal executive  
offices)

James Ayers

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Par-la-Ville Place, 14 Par-la-Ville  
Road, Hamilton, HM 08, Bermuda  
Tel: +1 (441)295-9500, Fax:  
+1(441)295-3494  
(Name, Telephone, Email and/or  
Facsimile number and Address of  
Company Contact Person)

Securities registered or to be registered pursuant to section 12(b) of the Act

| Title of each class             | Name of each exchange on which registered |
|---------------------------------|---|
| Common Shares, \$0.01 Par Value | New York Stock Exchange                   |

Securities registered or to be registered pursuant to section 12(g) of the Act.

None  
(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

None  
(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

119,373,064 Common Shares, \$0.01 Par Value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
 Yes  No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
 Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).  
 Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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Large accelerated filer  Accelerated filer  Non-accelerated filer   
Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards<sup>†</sup> provided pursuant to Section 13(a) of the Exchange Act.

<sup>†</sup> The term new or revised financial accounting standard refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow:

Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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## CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Matters discussed herein may constitute forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides safe harbor protections for forward-looking statements in order to encourage companies to provide prospective information about their business. Forward-looking statements include, but are not limited to, statements concerning plans, objectives, goals, strategies, future events or performance, underlying assumptions and other statements, which are other than statements of historical facts.

The Company desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this cautionary statement pursuant to this safe harbor legislation. This report and any other written or oral statements made by the Company or on its behalf may include forward-looking statements, which reflect the Company's current views with respect to future events and financial performance. The words "believe," "anticipate," "intend," "estimate," "forecast," "project," "plan," "potential," "may," "should," "expect," "pending" and similar identify forward-looking statements.

The forward-looking statements herein are based upon various assumptions, many of which are based, in turn, upon further assumptions, including, without limitation, management's examination of historical operating trends, data contained in the Company's records and other data available from third parties. Although the Company believes that these assumptions were reasonable when made, because these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond its control, the Company cannot assure you that it will achieve or accomplish these expectations, beliefs or projections.

Such statements reflect the Company's current views with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended. The Company is making investors aware that such forward-looking statements, because they relate to future events, are by their very nature subject to many important factors that could cause actual results to differ materially from those contemplated. In addition to these important factors and matters discussed elsewhere herein, important factors that, in the Company's view, could cause actual results to differ materially from those discussed in the forward-looking statements include, but are not limited to:

- the strength of world economies;
- the Company's ability to generate cash to service its indebtedness;
- the Company's ability to continue to satisfy its financial and other covenants, or obtain waivers relating to such covenants from its lenders under its credit facilities;
- the Company's ability to obtain financing in the future to fund capital expenditures, acquisitions and other general corporate activities;
- the Company's counterparties' ability or willingness to honor their obligations under agreements with it;
- fluctuations in currencies and interest rates;
- general market conditions including fluctuations in charter hire rates and vessel values;
- changes in supply and generally the number, size and form of providers of goods and services in the markets in which the Company operates;
- changes in demand in the markets in which the Company operates;
- changes in demand resulting from changes in the Organization of the Petroleum Exporting Countries' petroleum production levels and worldwide oil consumption and storage;
- developments regarding the technologies relating to oil exploration;
- changes in market demand in countries which import commodities and finished goods and changes in the amount and location of the production of those commodities and finished goods;
- increased inspection procedures and more restrictive import and export controls;
- the imposition of sanctions by the Office of Foreign Assets Control of the Department of the U.S. Treasury or pursuant to other applicable laws or regulations against the Company or any of its subsidiaries;
- changes in the Company's operating expenses, including bunker prices, drydocking and insurance costs;

performance of the Company's charterers and other counterparties with whom the Company deals;  
the impact of any restructuring of the counterparties with whom the Company deals, including any ongoing  
restructurings of Deep Sea Supply Shipowing II AS and Solstad Offshore ASA or Solstad;  
timely delivery of vessels under construction within the contracted price;  
changes in governmental rules and regulations or actions taken by regulatory  
authorities;

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potential liability from pending or future litigation;  
general domestic and international political conditions;  
potential disruption of shipping routes due to accidents; and  
piracy or political events.

This report may contain assumptions, expectations, projections, intentions and beliefs about future events. These statements are intended as forward-looking statements. The Company may also from time to time make forward-looking statements in other documents and reports that are filed with or submitted to the Commission, in other information sent to the Company's security holders, and in other written materials. The Company also cautions that assumptions, expectations, projections, intentions and beliefs about future events may and often do vary from actual results and the differences can be material. The Company undertakes no obligation to publicly update or revise any forward-looking statement contained in this report, whether as a result of new information, future events or otherwise, except as required by law.



## PART I

## ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable.

## ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable.

## ITEM 3. KEY INFORMATION

Throughout this report, the "Company", "Ship Finance", "we", "us" and "our" all refer to Ship Finance International Limited and its subsidiaries. We use the term deadweight ton, or dwt, in describing the size of the vessels. Dwt, expressed in metric tons, each of which is equivalent to 1,000 kilograms, refers to the maximum weight of cargo and supplies that a vessel can carry. We use the term twenty-foot equivalent units, or TEU, in describing container vessels to refer to the number of standard twenty foot containers that the vessel can carry, and we use the term car equivalent units, or CEU, in describing car carriers to refer to the number of standard cars that the vessel can carry. Unless otherwise indicated, all references to "USD," "US\$" and "\$" in this report are to, and amounts are presented in, U.S. dollars.

## A. SELECTED FINANCIAL DATA

Our selected income statement and cash flow statement data with respect to the fiscal years ended December 31, 2018, 2017 and 2016 and our selected balance sheet data with respect to the fiscal years ended December 31, 2018 and 2017 have been derived from our consolidated financial statements included in Item 18 of this annual report, prepared in accordance with accounting principles generally accepted in the United States, which we refer to as US GAAP.

The selected income statement and cash flow statement data for the fiscal years ended December 31, 2015 and 2014 and the selected balance sheet data for the fiscal years ended December 31, 2016, 2015 and 2014 have been derived from our consolidated financial statements not included herein. The following table should be read in conjunction with Item 5. "Operating and Financial Review and Prospects" and our consolidated financial statements and the notes to those statements included herein.

|                              | Year Ended December 31,  |         |         |         |         |
|------------------------------|--|---------|---------|---------|---------|
|                              | 2018   | 2017    | 2016    | 2015    | 2014    |
|                              | (in thousands of dollars except common share and per share data) |         |         |         |         |
| Income Statement Data:       |  |         |         |         |         |
| Total operating revenues     | 418,713  | 380,878 | 412,951 | 406,740 | 327,487 |
| Net operating income         | 117,613  | 154,626 | 168,089 | 166,046 | 145,146 |
| Net income                   | 73,622   | 101,209 | 146,406 | 200,832 | 122,815 |
| Earnings per share, basic    | \$0.70   | \$ 1.06 | \$ 1.57 | \$ 2.15 | \$ 1.32 |
| Earnings per share, diluted  | \$0.69   | \$ 1.03 | \$ 1.50 | \$ 1.88 | \$ 1.24 |
| Dividends declared           | 149,261  | 152,907 | 168,289 | 162,594 | 152,142 |
| Dividends declared per share | \$1.40   | \$ 1.60 | \$ 1.80 | \$ 1.74 | \$ 1.63 |



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|  | Year Ended December 31,  |             |             |            |            |
|--|--|-------------|-------------|------------|------------|
|  | 2018   | 2017        | 2016        | 2015       | 2014       |
|  | (in thousands of dollars except common share and per share data) |             |             |            |            |
| <b>Balance Sheet Data (at end of period):</b>                                    |  |             |             |            |            |
| Cash and cash equivalents  | 211,394  | 153,052     | 62,382      | 70,175     | 50,818     |
| Vessels and equipment, net (including newbuildings)                              | 1,559,712  | 1,762,596   | 1,770,616   | 1,681,466  | 1,464,700  |
| Vessels and equipment under capital lease, net                                   | 749,889  | —           | —           | —          | —          |
| Investment in direct financing and sales-type leases (including current portion) | 802,159  | 618,071     | 556,035     | 511,443    | 746,531    |
| Investment in associated companies (including loans and receivables)             | 366,907  | 328,505     | 330,877     | 495,479    | 399,488    |
| Total assets   | 3,877,845  | 3,012,082   | 2,937,377   | 3,032,554  | 3,004,596  |
| Short and long term debt (including current portion)                             | 1,437,080  | 1,504,007   | 1,552,874   | 1,634,205  | 1,695,501  |
| Capital lease obligations (including current portion)                            | 1,172,051  | 239,607     | 122,403     | —          | —          |
| Share capital  | 1,194  | 1,109       | 1,015       | 93,468     | 93,404     |
| Stockholders' equity   | 1,180,032  | 1,194,997   | 1,134,095   | 1,241,810  | 1,153,492  |
| Common shares outstanding (1)  | 119,373,064  | 110,930,873 | 101,504,575 | 93,468,000 | 93,404,000 |
| Weighted average common shares outstanding(1)                                    | 105,897,798  | 95,596,644  | 93,496,744  | 93,449,904 | 93,330,622 |
| <b>Cash Flow Data:</b>   |  |             |             |            |            |
| Cash provided by operating activities  | 200,975  | 177,796     | 230,073     | 258,401    | 132,401    |
| Cash provided by (used in) investing activities                                  | (866,564   | ) 48,362    | 39,399      | (205,782   | ) (21,940  |
| Cash provided by (used in) financing activities                                  | 724,931  | (135,488    | ) (277,265  | ) (33,262  | ) (118,284 |

Note 1: The number of common shares outstanding at December 31, 2018 and 2017 includes 8,000,000 shares issued as part of a share lending arrangement relating to the issue in October 2016 of our 5.75% senior unsecured convertible bonds and 3,765,842 shares issued as of December 31, 2018 from up to 7,000,000 shares issuable under a share lending arrangement relating to the Company's issuance of its 4.875% senior unsecured convertible bonds in April and May 2018. These shares are owned by the Company and will be returned on or before maturity of the bonds in 2021 and 2023. Accordingly, they are not included in the weighted average number of common shares outstanding at December 31, 2018 and 2017.

**B. CAPITALIZATION AND INDEBTEDNESS**

Not Applicable.

**C. REASONS FOR THE OFFER AND USE OF PROCEEDS**

Not Applicable.

**D. RISK FACTORS**

Our assets are primarily engaged in transporting crude oil and oil products, dry bulk and containerized cargoes, and in offshore drilling and related activities. The following summarizes the risks that may materially affect our business, financial condition or results of operations. Unless otherwise indicated in this annual report on Form 20-F, all

information concerning our business and our assets is as of March 26, 2019.

## Risks Relating to Our Industry

The seaborne transportation industry is cyclical and volatile, and this may lead to reductions in our charter rates, vessel values and results of operations.

The international seaborne transportation industry is both cyclical and volatile in terms of charter rates and profitability. The degree of charter rate volatility for vessels has varied widely. Fluctuations in charter rates result from changes in the supply and demand for vessel capacity and changes in the supply and demand for energy resources, commodities, semi-finished and finished consumer and industrial products internationally carried at sea. If we enter into a charter when charterhire rates are low, our revenues and earnings will be adversely affected. In addition, a decline in charterhire rates is likely to cause the market value of our vessels to decline. We cannot assure you that we will be able to successfully charter our vessels in the future or renew our existing charters at rates sufficient to allow us to operate our business profitably, meet our obligations or pay dividends to our shareholders. The factors affecting the supply and demand for vessels are outside of our control, and the nature, timing and degree of changes in industry conditions are unpredictable.

Factors that influence demand for vessel capacity include:

- supply and demand for energy resources, commodities, semi-finished and finished consumer and industrial products;
- changes in the exploration for and production of energy resources, commodities, semi-finished and finished consumer and industrial products;
- the location of regional and global production and manufacturing facilities;
- the location of consuming regions for energy resources, commodities, semi-finished and finished consumer and industrial products;
- the globalization of production and manufacturing;
- global and regional economic and political conditions, including armed conflicts, terrorist activities, embargoes and strikes;
- developments in international trade;
- changes in seaborne and other transportation patterns, including the distance cargo is transported by sea;
- environmental and other regulatory developments;
- currency exchange rates; and
- weather and natural disasters.

Factors that influence the supply of vessel capacity include:

- the number of newbuilding deliveries;
- the scrapping rate of older vessels;
- the price of steel and vessel equipment;
- changes in environmental and other regulations that may limit the useful lives of vessels;
- vessel casualties;
- the number of vessels that are out of service; and
- port or canal congestion.

Demand for our vessels and charter rates are dependent upon, among other things, seasonal and regional changes in demand and changes to the capacity of the world fleet. We believe the capacity of the world fleet is likely to increase, and there can be no assurance that global economic growth will be at a rate sufficient to utilize this new capacity. Continued adverse economic, political or social conditions or other developments could further negatively impact charter rates, and therefore have a material adverse effect on our business, results of operations and ability to pay dividends.

An over-supply of vessel capacity may lead to reductions in charter hire rates and profitability.

The supply of vessels generally increases with deliveries of new vessels and decreases with the scrapping of older vessels, conversion of vessels to other uses, such as floating production and storage facilities, and loss of tonnage as a result of casualties. An over-supply of vessel capacity, combined with a decline in the demand for such vessels, may result in a reduction of charter hire rates. Upon the expiration or termination of our vessels' current charters, if we are unable to re-charter our vessels at rates sufficient to allow us to operate our vessels profitably or at all, it would have a material adverse effect on our revenues and profitability.

If economic conditions throughout the world deteriorate or become more volatile, it could impede our operations. Our ability to secure funding is dependent on well-functioning capital markets and on an appetite to provide funding to the shipping industry. At present, capital markets are well-functioning and funding is available for the shipping industry. However, if global economic conditions worsen or lenders for any reason decide not to provide debt financing to us, we may not be able to secure additional financing to the extent required, on acceptable terms or at all. If additional financing is not available when needed, or is available only on unfavorable terms, we may be unable to meet our obligations as they come due, or we may be unable to enhance our existing business, complete additional vessel acquisitions or otherwise take advantage of business opportunities as they arise.

The world economy faces a number of challenges, including the effects of volatile oil prices, continuing turmoil and hostilities in the Middle East, the Korean Peninsula, North Africa and other geographic areas and countries. If one or more of the major national or regional economies should weaken, there is a substantial risk that such a downturn will impact the world economy. There has historically been a strong link between the development of the world economy and demand for energy, including oil and gas.

In Europe, large sovereign debts and fiscal deficits, low growth prospects and high unemployment rates in a number of countries have contributed to the rise of Eurosceptic parties, which would like their countries to leave the Euro. The exit of the United Kingdom from the European Union and potential new trade policies in the United States further increase the risk of additional trade protectionism.

In China, a transformation of the Chinese economy is underway, as China transforms from a production-driven economy towards a service or consumer-driven economy. The Chinese economic transition implies that we do not expect the Chinese economy to return to double digit GDP growth rates in the near term. The quarterly year-over-year growth rate of China's GDP decreased to 6.6% for the year ending December 31, 2018 as compared to 6.9% for the year ending December 31, 2017 and continues to remain below pre-2008 levels. Furthermore, there is a rising threat of a Chinese financial crisis resulting from massive personal and corporate indebtedness.

While the recent developments in Europe and China have been without significant immediate impact on our charter rates, an extended period of deterioration in the world economy could reduce the overall demand for our services. Such changes could adversely affect our future performance, results of operations, cash flows and financial position.

The United Kingdom's decision to leave the European Union following a referendum in June 2016 ("Brexit"), contributes to considerable uncertainty concerning the current and future economic environment. Brexit could adversely affect European or worldwide political, regulatory, economic or market conditions and could contribute to instability in global political institutions, regulatory agencies and financial markets. We believe that these effects of Brexit won't materially affect our business, results of operations and financial condition.

Further, governments may turn to trade barriers to protect their domestic industries against foreign imports, thereby depressing shipping demand. In particular, leaders in the United States have indicated the United States may seek to implement more protective trade measures. President Trump was elected on a platform promoting trade protectionism. The results of the presidential election have thus created significant uncertainty about the future relationship between the United States, China and other exporting countries, including with respect to trade policies, treaties, government regulations and tariffs. For example, on January 23, 2017, President Trump signed an executive order withdrawing the United States from the Trans-Pacific Partnership, a global trade agreement intended to include the United States, Canada, Mexico, Peru and a number of Asian countries. In March 2018, President Trump announced tariffs on imported steel and aluminum into the United States that could have a negative impact on international trade generally. Most recently, in January 2019, the United States announced expanded sanctions against Venezuela, which may have an effect on its oil output and in turn affect global oil supply. Protectionist developments, or the perception they may occur, may have a material adverse effect on global economic conditions, and may significantly reduce global trade. Moreover, increasing trade protectionism may cause an increase in (a) the cost of goods exported from regions

globally, (b) the length of time required to transport goods and (c) the risks associated with exporting goods. Such increases may significantly affect the quantity of goods to be shipped, shipping time schedules, voyage costs and other associated costs, which could have an adverse impact on our charterers' business, operating results and financial condition and could thereby affect their ability to make timely charter hire payments to us and to renew and increase the number of their time charters with us. This could have a material adverse effect on our business, results of operations and financial condition.



Also, as a result of concerns about the stability of financial markets generally and the solvency of counterparties specifically, the availability and cost of obtaining money from the public and private equity and debt markets has become more difficult. Many lenders have increased interest rates, enacted tighter lending standards, refused to refinance existing debt at all or on terms similar to current debt, and reduced, and in some cases ceased, to provide funding to borrowers and other market participants, including equity and debt investors, and some have been unwilling to invest on attractive terms or even at all. Due to these factors, we cannot be certain that financing will be available if needed and to the extent required on acceptable terms. If financing is not available when needed, or is available only on unfavorable terms, we may be unable to meet our obligations as they come due or we may be unable to enhance our existing business, complete additional vessel acquisitions or otherwise take advantage of business opportunities as they arise.

As of December 31, 2018, we had total outstanding indebtedness of \$2.1 billion under our various credit facilities and bond loans, including our equity-accounted subsidiaries and a further \$1.2 billion of capital lease obligations.

Prospective investors should consider the potential impact, uncertainty and risk associated with the development in the wider global economy. Further economic downturn in any of these countries could have a material effect on our future performance, results of operations, cash flows and financial position.

Safety, environmental and other governmental and other requirements expose us to liability, and compliance with current and future regulations could require significant additional expenditures, which could have a material adverse effect on our business and financial results.

Our operations are affected by extensive and changing international, national, state and local laws, regulations, treaties, conventions and standards in force in international waters, the jurisdictions in which our tankers and other vessels operate, and the country or countries in which such vessels are registered, including those governing the management and disposal of hazardous substances and wastes, the cleanup of oil spills and other contamination, air emissions, and water discharges and ballast and bilge water management. These regulations include, but are not limited to, the U.S. Oil Pollution Act of 1990, or OPA, requirements of the U.S. Coast Guard, or the USCG, and the U.S. Environmental Protection Agency, or EPA, the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980, or CERCLA, the U.S. Clean Water Act, the U.S. Maritime Transportation Security Act of 2002, and regulations of the International Maritime Organization, or IMO, including the International Convention for the Safety of Life at Sea of 1974, or SOLAS, the International Convention for the Prevention of Pollution from Ships of 1973, or MARPOL, including the designation thereunder of Emission Control Areas, or ECAs, the International Convention on Civil Liability for Oil Pollution Damage of 1969, or CLC, and the International Convention on Load Lines of 1966. In particular, MEPC 73, amendments to Annex VI to prohibit the carriage of bunkers above 0.5% sulfur on ships will take effect March, 1 2020 may cause us to incur substantial costs. Compliance with these regulations could have a material adverse effect our business and financial results.

In addition, vessel classification societies and the requirements set forth in the IMO's International Management Code for the Safe Operation of Ships and for Pollution Prevention, or the ISM Code, also impose significant safety and other requirements on our vessels. In complying with current and future environmental requirements, vessel owners and operators may also incur significant additional costs in meeting new maintenance and inspection requirements, in developing contingency arrangements for potential spills and in obtaining insurance coverage. Government regulation of vessels, particularly in the areas of safety and environmental requirements, can be expected to become stricter in the future and require us to incur significant capital expenditures on our vessels to keep them in compliance, or even to scrap or sell certain vessels altogether.

Many of these requirements are designed to reduce the risk of oil spills and other pollution, and our compliance with these requirements can be costly. These requirements can also affect the resale value or useful lives of our vessels, require reductions in cargo capacity, ship modifications or operational changes or restrictions, lead to decreased availability of insurance coverage for environmental matters or result in the denial of access to certain jurisdictional waters or ports, or detention in certain ports.

Under local, national and foreign laws, as well as international treaties and conventions, we could incur material liabilities, including cleanup obligations, natural resource damages and third-party claims for personal injury or property damages, in the event that there is a release of petroleum or other hazardous substances from our vessels or otherwise in connection with our current or historic operations. We could also incur substantial penalties, fines and other civil or criminal sanctions, including in certain instances seizure or detention of our vessels, as a result of violations of or liabilities under environmental laws, regulations and other requirements. Environmental laws often impose strict liability for remediation of spills and releases of oil and hazardous substances, which could subject us to liability without regard to whether we were negligent or at fault. For example, OPA affects all vessel owners shipping oil to, from or within the United States. Under OPA, owners, operators and bareboat charterers are jointly and severally strictly liable for the discharge of oil in U.S. waters, including the 200 nautical mile exclusive economic zone around the United States. Similarly, the CLC, which has been adopted by most countries outside of the United States, imposes liability for oil pollution in international waters. OPA expressly permits individual states to impose their own liability regimes with regard to hazardous materials and oil pollution incidents occurring within their boundaries, provided they accept, at a minimum, the levels of liability established under OPA. Coastal states in the United States have enacted pollution prevention liability and response laws, many providing for unlimited liability. Furthermore, the 2010 explosion of the drilling rig Deepwater Horizon, which is unrelated to Ship Finance, and the subsequent release of oil into the Gulf of Mexico, or other events, may result in further regulation of the shipping and offshore industries and modifications to statutory liability schemes, which could have a material adverse effect on our business, financial condition, results of operations and cash flows. An oil spill could also result in significant liability, including fines, penalties, criminal liability and remediation costs for natural resource damages under other international and U.S. federal, state and local laws, as well as third-party damages, and could harm our reputation with current or potential charterers of our vessels. We are required to satisfy insurance and financial responsibility requirements for potential oil (including marine fuel) spills and other pollution incidents. Although we have arranged insurance to cover certain environmental risks, there can be no assurance that such insurance will be sufficient to cover all such risks or that any claims will not have a material adverse effect on our business, results of operations, cash flows and financial condition and available cash.

Regulations relating to ballast water discharge coming into effect during September 2019 may adversely affect our revenues and profitability.

The IMO has imposed updated guidelines for ballast water management systems specifying the maximum amount of viable organisms allowed to be discharged from a vessel's ballast water. Depending on the date of the IOPP renewal survey, existing vessels constructed before September 8, 2017 must comply with the updated D-2 standard on or after September 8, 2019. For most vessels, compliance with the D-2 standard will involve installing on-board systems to treat ballast water and eliminate unwanted organisms. Ships constructed on or after September 8, 2017 are to comply with the D-2 standards on or after September 8, 2017. We currently have 18 vessels that do not comply with the updated guideline and where the cost of complying rests with the owner. Such costs may be substantial and adversely affect our revenues and profitability.

Furthermore, United States regulations are currently changing. Although the 2013 Vessel General Permit ("VGP") program and U.S. National Invasive Species Act ("NISA") are currently in effect to regulate ballast discharge, exchange and installation, the Vessel Incidental Discharge Act ("VIDA"), which was signed into law on December 4, 2018, requires that the U.S. Coast Guard develop implementation, compliance, and enforcement regulations regarding ballast water within two years. The new regulations could require the installation of new equipment, which may cause us to incur substantial costs.

We currently have 11 vessels that are on fixed price management agreements with Frontline Management (Bermuda) Ltd., or Frontline Management, and Golden Ocean Group Management (Bermuda) Ltd, or Golden Ocean Management, which include the cost of complying with regulations. We have an additional 38 vessels and three

drilling rigs employed under bareboat charters where the cost of fitting ballast water treatment systems would lie with the charterer, if such vessel is still employed under the relevant bareboat charter at the time the regulations become applicable. We also have 34 vessels employed in the spot market or under time charter agreements. These have either already been fitted with ballast water treatment systems or will have them fitted within the required deadlines. The costs of compliance may be substantial and adversely affect our revenues and profitability.

Acts of piracy on ocean-going vessels could adversely affect our business.

Acts of piracy have historically affected ocean-going vessels. At present, most piracy and armed robbery incidents are recurrent in the Gulf of Aden region off the coast of Somalia, Gulf of Guinea region off Nigeria, South China Sea, Sulu Sea and Celebes Sea. Sporadic incidents of robbery are also reported in many parts of Asia. The political turmoil in the Middle East region may also lead to collateral damages in waters off Yemen. The current diplomatic crisis between Gulf Co-operation Council (GCC) countries may lead to an uncertain security situation in the Middle East region.

The security arrangements made for ship staff and vessels to counteract the ever-evolving security threat and to comply with Best Management Practices (BMP) add to the cost of operations of our ships.

The "war risks" areas are established by the Joint War Risks Committee. Our vessels have to trade in such areas due to the nature of our business. Due to the above issues when vessels trade in such areas, the insurance premiums are increased significantly to cover for the additional risks.

The above factors could have a material adverse effect on our future performance, results of operations, cash flows and financial position.

Our vessels may call on ports located in countries that are subject to restrictions imposed by the U.S. or other governments, which could adversely affect our reputation and the market for our common shares.

We do not directly engage in any shipping or drilling contracts or have plans to directly initiate any shipping or drilling contracts involving operations in countries or with government-controlled entities in violation of any sanctions and embargoes imposed by the U.S. government and/or identified by the U.S. government as state sponsors of terrorism. Our contracts with our charterers may prohibit them from causing our vessels to call in sanctioned ports or carrying cargo for entities that are subject to sanctions. However, our customers who are bareboat charterers control the operation of our vessels, and may cause our vessels to trade in violation of sanctions provisions without our consent. Accordingly, our charterers may currently or in the future enter into shipping and drilling contracts with countries or government-controlled entities that are subject to sanctions and embargoes imposed by the U.S. government and/or identified by the U.S. government as state sponsors of terrorism, or they may enter into shipping and drilling contracts involving operations in countries or with government-controlled entities that are subject to sanctions and embargoes imposed by the U.S. government and/or identified by the U.S. government as state sponsors of terrorism.

Although we believe that we have been in compliance with all applicable sanctions and embargo laws and regulations, and intend to maintain such compliance, there can be no assurance that we or our charterers will be in compliance in the future.

Any such violation could result in fines, penalties or other sanctions that could negatively impact our ability to access U.S. capital markets and conduct our business, and could result in some investors deciding, or being required, to divest their interest, or not to invest, in us. In addition, certain institutional investors may have investment policies or restrictions that prevent them from holding securities of companies that have contracts with countries identified by the U.S. government as state sponsors of terrorism. The determination by these investors not to invest in, or to divest from, our shares may adversely affect the price at which our shares trade. Moreover, our charterers may violate applicable sanctions and embargo laws and regulations as a result of actions that do not involve us or our vessels, and those violations could in turn negatively affect our reputation.

In the highly competitive international seaborne transportation industry, we may not be able to compete for charters with new entrants or established companies with greater resources, and as a result we may be unable to employ our vessels profitably.

We employ our vessels in a highly competitive market that is capital intensive and highly fragmented, and competition arises primarily from other vessel owners. Competition for seaborne transportation of goods and products is intense and depends on charter rates and the location, size, age, condition and acceptability of the vessel and its operators to charterers. Due in part to the highly fragmented market, competitors with greater resources could operate larger fleets than we may operate and thus be able to offer lower charter rates and higher quality vessels than we are able to offer. If this were to occur, we may be unable to retain or attract new charterers on attractive terms or at all, which may have a material adverse effect on our business, financial condition and results of operations. Although we believe that no single competitor has a dominant position in the markets in which we compete, we are aware that certain competitors may be able to devote greater financial and other resources to certain activities than we can, resulting in a significant competitive threat to us. We cannot give assurances that we will continue to compete successfully with our competitors or that these factors will not erode our competitive position in the future.

Increased inspection procedures, tighter import and export controls and new security regulations could increase costs and disrupt our business.

International shipping is subject to various security and customs inspection and related procedures in countries of origin, destination and trans-shipment points. Inspection procedures can result in the seizure of the contents of our vessels, delays in loading, offloading or delivery, and the levying of customs duties, fines or other penalties against us.

It is possible that changes to inspection procedures could impose additional financial and legal obligations on us. Changes to inspection procedures could also impose additional costs and obligations on our customers and may, in certain cases, render the shipment of certain types of cargo uneconomical or impractical. Any such changes or developments may have a material adverse effect on our business, financial condition and results of operations.

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The offshore drilling sector and also demand for offshore support vessels depend primarily on the level of activity in the offshore oil and gas industry, which is significantly affected by, among other things, volatile oil and gas prices, and may be materially and adversely affected by a decline in the offshore oil and gas industry.

The offshore contract drilling industry and also demand for offshore support vessels is cyclical and volatile, and depends on the level of activity in oil and gas exploration and development and production in offshore areas worldwide. The availability of quality drilling prospects, exploration success, relative production costs, the stage of reservoir development and political and regulatory environments affect our customers' drilling campaigns. Oil and gas prices, and market expectations of potential changes in these prices, also significantly affect the level of activity and demand for drilling units.

Oil and gas prices are extremely volatile and are affected by numerous factors beyond our control, including the following:

- worldwide production and demand for oil and gas;
- the cost of exploring for, developing, producing and delivering oil and gas;
- expectations regarding future energy prices;
- advances in exploration, development and production technology;
- the ability of the Organization of Petroleum Exporting Countries, or OPEC, to set and maintain production levels and pricing;
- the level of production in non-OPEC countries;
- international sanctions on oil-producing countries or the lifting of such sanctions;
- government regulations, including restrictions on offshore transportation of oil and gas;
- local and international political, economic and weather conditions;
- domestic and foreign tax policies;
- the development and implementation of policies to increase the use of renewable energy;
- increased supply of oil and gas from onshore hydraulic fracturing and shale development, and the relative costs of offshore and onshore production of oil and gas;
- worldwide economic and financial problems and any resulting decline in demand for oil and gas and, consequently, our services;
- the policies of various governments regarding exploration and development of their oil and gas reserves;
- accidents, severe weather, natural disasters and other similar incidents relating to the oil and gas industry; and
- the worldwide military and political environment, including uncertainty or instability resulting from an escalation or additional outbreak of armed hostilities, insurrection, or other crises in the Middle East, eastern Europe or other geographic areas, or further acts of terrorism in the United States, Europe or elsewhere.

Lower oil and gas prices have negatively affected, and could continue to negatively affect, the offshore drilling sector and have resulted, and could continue to result, in reduced exploration and drilling. These reductions in commodity prices have reduced the demand for drilling units. Continued weakness in oil and gas prices may result in an excess supply of drilling units and intensify competition in the industry, which may result in drilling units, particularly older and lower specification drilling units, being idle for long periods of time. We cannot predict the future level of demand for drilling units or future conditions of the oil and gas industry.

In addition to oil and gas prices, the offshore drilling industry is influenced by additional factors, including:

- the availability of competing offshore drilling units;
- the availability of debt financing on reasonable terms;
- the level of costs for associated offshore oilfield and construction services;
- oil and gas transportation costs;

- the level of rig operating costs, including crew and maintenance;
- the discovery of new oil and gas reserves;
- the cost of non-conventional hydrocarbons, such as the exploitation of oil sands; and
- regulatory restrictions on offshore drilling.

Any of these factors could reduce demand for our offshore drilling assets and adversely affect our business and results of operations.



An over-supply of drilling units has led to a reduction in day-rates and therefore has adversely affected the ability of certain of our rig charterers to make lease payments to us.

We have leased two of our drilling units to two subsidiaries of Seadrill, namely Seadrill Deepwater Charterer Ltd., or Seadrill Deepwater, and Seadrill Offshore AS, or Seadrill Offshore. In addition, we have chartered one drilling unit to North Atlantic Linus Charterer Ltd., or North Atlantic Linus, which is a subsidiary of North Atlantic Drilling Limited, or NADL. The performance under the above leases is guaranteed by Seadrill, and Seadrill Deepwater, Seadrill Offshore and North Atlantic Linus are collectively referred to as the Seadrill Charterers. Lower oil prices have resulted in reduced demand for drilling units, which has adversely affected the Seadrill Charterers' ability to secure drilling contracts and, therefore, their ability to make lease payments to us and resulted in the Bankruptcy of their parent company Seadrill.

In July, 2018, Seadrill emerged from Chapter 11 successfully completing its reorganization pursuant its plan of reorganization, or the Plan of Reorganization. The Company and our three subsidiaries owning the relevant drilling units were a part of the Plan of Reorganization and we have agreed to reduce the contractual charter hire for the three rigs by approximately 29% for a period of five years starting in 2018, with the reduced amounts added back in the period thereafter. The term of the leases for West Hercules and West Taurus will also be extended by 13 months until December 2024, and the call options on behalf of the Seadrill Charterers under the relevant leases have also been amended as part of the Plan of Reorganization.

There are no assurances that the Seadrill Charterers will be able to meet their obligations under the Plan of Reorganization following bankruptcy and if they fail to do so, we could sustain significant losses which could have a material adverse effect on our business, financial condition, results of operations and cash flows, if any, in the future, and compliance with covenants in our credit facilities.

One of the rigs leased to the Seadrill Charterers, the West Taurus, is currently idle, as the Seadrill Charterers have not been able to secure new drilling contracts in the current market. In the event that the Seadrill Charterers default on their obligations under the leases and the drilling units are redelivered to us, there is a significant risk that we would not be able to secure new employment for the rigs in the current market, which may have a material adverse effect on our business and our ability to pay dividends.

Governmental laws and regulations, including environmental laws and regulations, may add to the costs of the Seadrill Charterers or other charterers of our drilling units, or limit their drilling activity, and may adversely affect their ability to make lease payments to us.

The Seadrill Charterers' business in the offshore drilling industry is affected by public policy and laws and regulations relating to the energy industry and the environment in the geographic areas where they operate.

The offshore drilling industry is dependent on demand for services from the oil and gas exploration and production industry, and, accordingly, the Seadrill Charterers are directly affected by the adoption of laws and regulations that, for economic, environmental or other policy reasons, curtail exploration and development drilling for oil and gas. The Seadrill Charterers may be required to make significant capital expenditures to comply with governmental laws and regulations. It is also possible that these laws and regulations may in the future add significantly to the Seadrill Charterers' operating costs or significantly limit drilling activity. Governments in some countries are increasingly active in regulating and controlling the ownership of concessions, the exploration for oil and gas, and other aspects of the oil and gas industries. In recent years, increased concern has been raised over protection of the environment. Offshore drilling in certain areas has been opposed by environmental groups and has in certain cases been restricted.

Further operations in less developed countries can be subject to legal systems that are not as mature or predictable as those in more developed countries, which can lead to greater uncertainty in legal matters and proceedings.

In certain jurisdictions there are or may be imposed restrictions or limitations on the operation of foreign flag vessels and rigs, and these restrictions may prevent us or our charterers from operating our assets as intended. We cannot guarantee that we or our charterers will be able to accommodate such restrictions or limitations, nor that we or our charterers can relocate the assets to other jurisdictions where such restrictions or limitations do not apply. A violation of such restrictions, or expropriation in particular, could result in the total loss of our investments and/or financial loss for our charterers, and we cannot guarantee that we have sufficient insurance coverage to compensate for such loss. This may have a material adverse effect on our business and financial results.

To the extent that new laws are enacted or other governmental actions are taken that prohibit or restrict offshore drilling or impose additional environmental protection requirements that result in increased costs to the oil and gas industry in general or the offshore drilling industry in particular, the Seadrill Charterers' business or prospects could be materially adversely affected. The operation of our drilling units will require certain governmental approvals, the number and prerequisites of which cannot be determined until the Seadrill Charterers identify the jurisdictions in which they will operate upon securing contracts for the drilling units. Depending on the jurisdiction, these governmental approvals may involve public hearings and costly undertakings on the part of the Seadrill Charterers. The Seadrill Charterers may not obtain such approvals, or such approvals may not be obtained in a timely manner. If the Seadrill Charterers fail to secure the necessary approvals or permits in a timely manner, their customers may have the right to terminate or seek to renegotiate their drilling services contracts to the Seadrill Charterers' detriment. The amendment or modification of existing laws and regulations, or the adoption of new laws and regulations curtailing or further regulating exploratory or development drilling and production of oil and gas, could have a material adverse effect on the Seadrill Charterers' business, operating results or financial condition. Future earnings of the Seadrill Charterers may be negatively affected by compliance with any such new legislation or regulations. In addition, the Seadrill Charterers may become subject to additional laws and regulations as a result of future rig operations or repositioning. These factors may adversely affect the ability of the Seadrill Charterers to make lease payments to us.

We rely on our information systems to conduct our business, and failure to protect these systems against security breaches could adversely affect our business and results of operations. Additionally, if these systems fail or become unavailable for any significant period of time, our business could be harmed.

The efficient operation of our business, including processing, transmitting and storing electronic and financial information, is dependent on computer hardware and software systems. Information systems are vulnerable to security breaches by computer hackers and cyber terrorists. We rely on industry accepted security measures and technology to securely maintain confidential and proprietary information maintained on our information systems. However, these measures and technology may not adequately prevent security breaches. In addition, the unavailability of the information systems or the failure of these systems to perform as anticipated for any reason could disrupt our business and could result in decreased performance and increased operating costs, causing our business and results of operations to suffer. Any significant interruption or failure of our information systems or any significant breach of security could adversely affect our business and results of operations.

New technologies may cause our current drilling methods to become obsolete, resulting in an adverse effect on our business.

The offshore contract drilling industry is subject to the introduction of new drilling techniques and services using new technologies, some of which may be subject to patent protection. As competitors and others use or develop new technologies, we may be placed at a competitive disadvantage and competitive pressures may force us to implement new technologies at substantial cost. In addition, competitors may have greater financial, technical and personnel resources that allow them to benefit from technological advantages and implement new technologies before we can. We may not be able to implement technologies on a timely basis or at a cost that is acceptable to us.

Prolonged or significant downturns in the tanker, dry bulk carrier, container, offshore drilling and offshore support vessel charter markets may have an adverse effect on our earnings.

Although most of our vessels are employed on medium or long term charters, prolonged or significant downturns in the markets in which we operate could have a significant and adverse effect in finding new customers in the short and long term market and on our existing customers' ability to continue to fulfill their obligations to us. It also affects the

resale value of vessels.

The tanker market has experienced volatility over the last three year, due in part to an oversupply of vessels and the cut in OPEC production agreed in early 2017. This was countered in part in the second half of 2018 by increased scrapping. According to industry sources, spot earnings for Very Large Crude Carriers, or VLCCs, declined from an average of \$54,000 per day in December 2016 to an average of \$10,377 per day in December 2017, but increased to an average of \$40,938 per day in December 2018. However, by January 2019, this had fallen to an average of \$28,067 per day. While the rates increased in 2018, there can be no assurance that the tanker market has recovered, and the market could decline, as it has declined in recent months.

We currently have three vessels on charter to Frontline Shipping Limited (“Frontline Shipping”), an unguaranteed subsidiary of Frontline Ltd. (“Frontline”). With the downturn in the tanker market, there is a significant risk that Frontline Shipping may not have sufficient funds to fulfill their obligations under the charters.

During the period from 2008 to 2016, the abrupt and dramatic downturn in the dry bulk charter market, from which we derive some of our revenues, has severely affected the dry bulk shipping industry. The Baltic Dry Index, or BDI, an index published by The Baltic Exchange of shipping rates for 20 key dry bulk routes, has fallen 97% from a peak of 11,793 in May 2008 to a low of 290 in February 2016. The market has been negatively affected by the recent dam collapse at Vale's mine in Brazil, potentially idling production capacity of 40 million metric tonnes per annum, over the next three years. There can be no assurance that the dry bulk charter market will recover.

The container market saw improvements in 2018. Charter rates generally improved through most of the year, with some variation across the vessel sizes due in part to a reduction in excess capacity. In some segments, however, we have seen a decline in charter rates the last few months. Significant overcapacity continues to affect the balance of supply and demand, and there can be no assurance that the container market will continue to recover and the market will not decline.

From 2011 to 2013, the oil price (Brent crude spot) averaged around \$110 per barrel, however, over the course of 2014 the oil price fell to below \$50 per barrel in December 2014 and the fall continued to under \$30 per barrel in January 2016, although this recovered to an average of \$43 per barrel in 2016 and increased to an average of \$54 per barrel in 2017 and reached \$71 per barrel in 2018. As a consequence of this fall in oil prices after 2013, oil and gas companies significantly reduced their exploration and development activities, resulting in many drilling companies laying up rigs and experiencing financial difficulties, including our customer Seadrill, who successfully emerged from Chapter 11 in July 2018.

According to industry sources, the Offshore Support Vessel ("OSV") market remains one of the most severely affected by the offshore downturn. During 2018 the OSV market remained depressed with several owners leaving this market during the year.

We have five offshore supply vessels on long term charters to Deep Sea Supply Shipowning II AS (the "Solstad Charterer"), which was a wholly owned subsidiary of Deep Sea Supply Plc. ("Deep Sea"). Due to the downturn in the offshore support vessel market, the terms of the charters have been renegotiated three times over the last years, most recently in July 2018. In light of the depressed market, Solstad Offshore ASA ("Solstad Offshore"), the parent company to the Solstad Charterer along with the Company and other financial creditors entered into a restructuring agreement in July 2018, under which we will receive 50% of the agreed charter hire for the vessels Sea Cheetah and Sea Jaguar until the end of 2019. All other payments under the respective charters will be deferred until the end of 2019. We have been approached by Solstad with a request to participate in discussions on a further potential restructuring of their company. We are dependent on Solstad Offshore complying with its restructured credit agreements and if they fail to do so, we could sustain significant losses which could have a material adverse effect on our business, financial condition, results of operations and cash flows, if any, in the future, and compliance with covenants in our credit facilities.

Downturns in these markets and resulting volatility has had a number of adverse consequences, including, among other things:

- an absence of financing for vessels or rigs;
- no active second-hand market for the sale of vessels or rigs;
- extremely low charter rates, particularly for vessels employed in the spot market;
- widespread loan covenant defaults in the shipping and offshore industries; and
- declaration of bankruptcy by some operators, rig and ship owners as well as charterers.

The occurrence of one or more of these events could adversely affect our business, results of operations, cash flows, financial condition and ability to pay cash distributions.

In addition, because the market value of the Company's vessels may fluctuate significantly, we may incur losses when we sell vessels, which may adversely affect earnings. If we sell vessels at a time when vessel prices have fallen and before we have recorded an impairment adjustment to our financial statements, the sale may be at less than the vessel's carrying amount in those financial statements, resulting in a loss and a reduction in earnings.

World events could adversely affect our results of operations and financial condition.

Continuing conflicts and recent developments in the Middle East and North Africa, and the presence of United States and other armed forces in Afghanistan, Syria or Iraq, may lead to additional acts of terrorism and armed conflict around the world, which may contribute to further economic instability in the global financial markets. These uncertainties could also adversely affect our ability to obtain financing on terms acceptable to us or at all. In the past, political conflicts have also resulted in attacks on vessels, mining of waterways and other efforts to disrupt international shipping, particularly in the Arabian Gulf region. Acts of terrorism and piracy have also affected vessels trading in regions such as the South China Sea and the Gulf of Aden off the coast of Somalia. Any of these occurrences, or the perception that our vessels are potential terrorist targets, could have a material adverse impact on our business, financial condition, results of operations and ability to pay dividends.

Our business has inherent operational risks, which may not be adequately covered by insurance.

Our vessels and their cargoes are at risk of being damaged or lost, due to events such as marine disasters, bad weather, mechanical failures, human error, environmental accidents, war, terrorism, piracy, political circumstances and hostilities in foreign countries, labor strikes and boycotts, changes in tax rates or policies, and governmental expropriation of our vessels. Any of these events may result in loss of revenues, increased costs and decreased cash flows to our customers, which could impair their ability to make payments to us under our charters.

In the event of a vessel casualty or other catastrophic event, we will rely on our insurance to pay the insured value of the vessel or the damages incurred. Through the agreements with our vessel managers, we procure insurance for most of the vessels in our fleet employed under time charters against those risks that we believe the shipping industry commonly insures against. These insurances include marine hull and machinery insurance, protection and indemnity insurance, which include pollution risks and crew insurances, and war risk insurance. Currently, the amount of coverage for liability for pollution, spillage and leakage available to us on commercially reasonable terms through protection and indemnity associations and providers of excess coverage is \$1 billion per vessel per occurrence.

We cannot assure you that we will be adequately insured against all risks. Our vessel managers may not be able to obtain adequate insurance coverage at reasonable rates for our vessels in the future. For example, in the past more stringent environmental regulations have led to increased costs for, and in the future may result in the lack of availability of, insurance against risks of environmental damage or pollution. Additionally, our insurers may refuse to pay particular claims. For example, the circumstances of a spill, including non-compliance with environmental laws, could result in denial of coverage, protracted litigation, and delayed or diminished insurance recoveries or settlements. Any significant loss or liability for which we are not insured could have a material adverse effect on our financial condition. Under the terms of our bareboat charters, the charterer is responsible for procuring all insurances for the vessel.

We procure insurance for our fleet against risks commonly insured against by vessel owners and operators. Even if our insurance coverage is adequate to cover our losses, we may not be able to timely obtain a replacement vessel in the event of a loss. Furthermore, in the future, we may not be able to obtain adequate insurance coverage at reasonable rates for our fleet. We may also be subject to calls, or premiums, in amounts based not only on our own claim records but also the claim records of all other members of the protection and indemnity associations through which we receive indemnity insurance coverage for tort liability. Our insurance policies also contain deductibles, limitations and exclusions which, although we believe are standard in the shipping industry, may nevertheless increase our costs. If our insurance is not enough to cover claims that may arise, the deficiency may have a material adverse effect on our financial condition and results of operations. We may also be subject to calls, or premiums, in amounts based not only on our own claim records but also the claim records of all other members of the protection and indemnity associations

through which we receive indemnity insurance coverage for tort liability, including pollution-related liability. Our payment of these calls could result in significant expenses to us.



Maritime claimants could arrest or attach one or more of our vessels, which could interrupt our customers' or our cash flows.

Crew members, suppliers of goods and services to a vessel, shippers of cargo and other parties may be entitled to a maritime lien against one or more of our vessels for unsatisfied debts, claims or damages. In many jurisdictions, a maritime lien holder may enforce its lien by arresting a vessel through foreclosure proceedings. The arrest or attachment of one or more of our vessels could interrupt the cash flow of the charterer and/or the Company and require us to pay a significant amount of money to have the arrest lifted, which would have an adverse effect on our financial condition and results of operations.

In addition, in some jurisdictions, such as South Africa, under the "sister ship" theory of liability, a claimant may arrest both the vessel which is subject to the claimant's maritime lien and any "associated" vessel, which is any vessel owned or controlled by the same owner. Claimants could try to assert "sister ship" liability against vessels in our fleet managed by our vessel managers for claims relating to another vessel managed by that manager.

Governments could requisition our vessels during a period of war or emergency without adequate compensation, resulting in a loss of earnings.

A government could requisition one or more of our vessels for title or for hire. Requisition for title occurs when a government takes control of a vessel and becomes her owner, while requisition for hire occurs when a government takes control of a vessel and effectively becomes her charterer at dictated charter rates. Generally, requisitions occur during periods of war or emergency, although governments may elect to requisition vessels in other circumstances. Although we would be entitled to compensation in the event of a requisition of one or more of our vessels, the amount and timing of payment could be materially less than the charterhire that would have been payable otherwise. In addition, we would bear all risk of loss or damage to a vessel under requisition for hire. Government requisition of one or more of our vessels may negatively impact our revenues and reduce the amount of dividends paid, if any, to our shareholders.

The aging of our fleet may result in increased operating costs or loss of hire in the future, which could adversely affect our earnings.

In general, the costs to maintain a vessel in good operating condition increase as the vessel ages. Due to improvements in engine technology, older vessels are typically less fuel-efficient than more recently constructed vessels. Cargo insurance rates increase with the age of a vessel, making older vessels less desirable to charterers.

Governmental regulations, safety, environmental or other equipment standards related to the age of tankers and other types of vessels may require expenditures for alterations or the addition of new equipment to our vessels to comply with safety or environmental laws or regulations that may be enacted in the future. These laws or regulations may also restrict the type of activities in which our vessels may engage or prohibit their operation in certain geographic regions. We cannot predict what alterations or modifications our vessels may be required to undergo as a result of requirements that may be promulgated in the future, or that as our vessels age market conditions will justify any required expenditures or enable us to operate our vessels profitably during the remainder of their useful lives.

There are risks associated with the purchase and operation of second-hand vessels.

Our current business strategy includes additional growth through the acquisition of both newbuildings and second-hand vessels. Although we generally inspect second-hand vessels prior to purchase, this does not normally provide us with the same knowledge about the vessels' condition that we would have had if such vessels had been built for and operated exclusively by us. Therefore, our future operating results could be negatively affected if the vessels do not perform as we expect. Also, we do not receive the benefit of warranties from the builders if the vessels we buy are older than one year.

## Risks Relating to Our Company

Changes in our dividend policy could adversely affect holders of our common shares.

Any dividend that we declare is at the discretion of our Board of Directors. We cannot assure you that our dividend will not be reduced or eliminated in the future. Our profitability and corresponding ability to pay dividends is substantially affected by amounts we receive through charter hire and profit sharing payments from our charterers. Our entitlement to profit sharing payments, if any, is based on the financial performance of our vessels which is outside of our control. If our charter hire and profit sharing payments decrease substantially, we may not be able to continue to pay dividends at present levels, or at all. We are also subject to contractual limitations on our ability to pay dividends pursuant to certain debt agreements, and we may agree to additional limitations in the future. Additional factors that could affect our ability to pay dividends include statutory and contractual limitations on the ability of our subsidiaries to pay dividends to us, including under current or future debt arrangements.

We depend on our charterers, including companies which are affiliated with us, for our operating cash flows and for our ability to pay dividends to our shareholders and repay our outstanding borrowings.

Three of the tanker vessels in our fleet are chartered to a subsidiary of Frontline, namely Frontline Shipping. In addition, we have chartered three of our drilling units to the Seadrill Charterers and eight dry bulk carriers to Golden Ocean Trading Limited, or the Golden Ocean Charterer, all of which are related parties. In addition, we have 29 container vessels on long-term bareboat charters to MSC and 10 container vessels on long-term time charters to Maersk, and multiple other assets chartered to a number of counterparties. Our other vessels that have charters attached to them are chartered to other customers under short, medium or long term time and bareboat charters.

The charter-hire payments that we receive from our customers constitute substantially all of our operating cash flows.

The performance under the leases with the Seadrill Charterers is currently guaranteed by Seadrill. The performance under the charters with the Golden Ocean Charterer is guaranteed by Golden Ocean Group Limited, or Golden Ocean. If Frontline Shipping, the Seadrill Charterers, the Golden Ocean Charterer or any of our other charterers are unable to make charter hire payments to us, our results of operations and financial condition will be materially adversely affected and we may not have cash available to pay dividends to our shareholders and to repay our outstanding borrowings. A significant portion of our net income and operating cash flows are generated from our leases with the Seadrill Charterers, and a termination of these leases may have a material adverse effect on our earnings and profitability, and our ability to pay dividends to our shareholders.

We have three remaining VLCCs on long term charters to Frontline Shipping and in which performance under the charters is not guaranteed by Frontline. With the current depressed tanker market, there is a significant risk that Frontline Shipping may not have sufficient funds to fulfil their obligations under the charters, which may have an adverse effect on our earnings and profitability, and our ability to pay dividends to our shareholders.

We have five offshore supply vessels on long term charters to the Solstad Charterer, which is a wholly owned subsidiary of Solship Invest 3 AS (“Solship”) who also acts as charter guarantor under the charters. Solship is a wholly owned subsidiary of Solstad Offshore ASA (“Solstad”), but there are no parent company guarantees for the obligations of Solship. Many of the vessels in Solship are in lay-up, including the five vessels on charter from us. With the severe downturn in the market for offshore support vessels, the financial situation in Solship has deteriorated, and we agreed to a restructuring agreement in July 2018, under which we will receive 50% of the agreed charter hire for the vessels Sea Cheetah and Sea Jaguar until the end of 2019. All other payments under the respective charters will be deferred

until the end of 2019. We have been approached by Solstad with a request to participate in discussions on a further potential restructuring of their company. The outcome of these discussions is pending at the current time, but there is a significant risk that the Solstad Charterer will not have sufficient funds to fulfill its current obligations under the charters, and the charters may be renegotiated at lower levels, or terminated. If the vessels are redelivered to us, we may not be able to secure new employment in the current market. A termination or renegotiation of the charters may also result in a breach of covenants under the credit facility for the financing of the vessels, which, unless waived or modified by our lenders, may give our lenders the right to, among other things, call on the guarantees provided, increase our interest payments and/or accelerate our indebtedness and foreclose their liens on the assets securing the credit facility.

The amount of profit sharing payment we receive under our charters with Frontline Shipping, the Golden Ocean Charterer, the Solstad Charterer and other charterers, if any, may depend on prevailing spot market rates, which are volatile.

Some of our tanker vessels operate under time charters to Frontline Shipping. These charter contracts provide for base charterhire and additional profit sharing payments when Frontline Shipping's earnings from deploying our vessels exceed certain levels. The majority of our vessels chartered to Frontline Shipping are sub-chartered by them in the spot market, which is subject to greater volatility than the long-term time charter market, and the amount of future profit sharing payments that we receive, if any, will be primarily dependent on the strength of the spot market.

We have eight Capesize dry bulk carriers employed under time charters to the Golden Ocean Charterer. These charter contracts provide for base charterhire and additional profit sharing payments when the Golden Ocean Charterer's earnings from deploying our vessels exceed certain levels. The majority of our vessels chartered to the Golden Ocean Charterer are sub-chartered by them in the spot market, which is subject to greater volatility than the long-term time charter market, and the amount of future profit sharing payments we receive, if any, will be primarily dependent on the strength of the spot market.

We have five offshore support vessels chartered to the Solstad Charter. These charter contracts provide for base charterhire and additional profit sharing payments when the Solstad Charterer's earnings from deploying our vessels exceed certain levels. Our vessels chartered to the Solstad Charterer are currently in lay-up and there are thus not currently any prospects for profit sharing payments under these agreements. The amount of future profit sharing payments we receive, if any, will be primarily dependent on the strength of the spot market.

We may also enter into agreements which include profit sharing provisions with other charterers.

We cannot assure you that we will receive any profit sharing payments for any periods in the future, which may have an adverse effect on our results and financial condition and our ability to pay dividends in the future.

The charter-free market values of our vessels and drilling units may decrease, which could limit the amount of funds that we can borrow or trigger certain financial covenants under our current or future credit facilities and we may incur a loss if we sell vessels or drilling units following a decline in their charter-free market value. This could affect future dividend payments.

We are generally prohibited from selling our vessels or drilling units during periods which they are subject to charters without the charterer's consent, and may therefore be unable to take advantage of increases in vessel or drilling unit values during such times. Conversely, if the charterers were to default under the charters due to adverse market conditions, causing a termination of the charters, it is likely that the charter-free market value of our vessels and drilling units would also be depressed. The charter-free market values of our vessels and drilling units have experienced high volatility in recent years.

The charter-free market value of our vessels and drilling units may increase and decrease depending on a number of factors including, but not limited to, the prevailing level of charter rates and day rates, general economic and market conditions affecting the international shipping and offshore drilling industries, types, sizes and ages of vessels and drilling units, supply and demand for vessels and drilling units, availability of or developments in other modes of transportation, competition from other shipping companies, cost of newbuildings, governmental or other regulations and technological advances.

In addition, as vessels and drilling units grow older, they generally decline in value. If the charter-free market values of our vessels and drilling units decline, we may not be in compliance with certain provisions of our credit facilities and we may not be able to refinance our debt, obtain additional financing or make distributions to our shareholders. Additionally, if we sell one or more of our vessels or drilling units at a time when vessel and drilling unit prices have fallen and before we have recorded an impairment adjustment to our consolidated financial statements, the sale price may be less than the vessel's or drilling unit's carrying value on our consolidated financial statements, resulting in a loss and a reduction in earnings. Furthermore, if vessel and drilling unit values fall significantly, we may have to record an impairment adjustment in our financial statements, which could adversely affect our financial results and condition.

Volatility in the international shipping and offshore markets may cause our counterparties on contracts to fail to meet their obligations which could cause us to suffer losses or otherwise adversely affect our business.

From time to time, we enter into, among other things, charter parties with our customers, newbuilding contracts with shipyards, credit facilities with banks, guarantees, interest rate swap agreements, and currency swap agreements, total return bond swaps, and total return equity swaps. Such agreements subject us to counterparty risks. The ability and willingness of each of our counterparties to perform their obligations under a contract with us will depend on a number of factors that are beyond our control. As a result, our revenues and results of operations may be adversely affected. These factors include:

- global and regional economic and political conditions;
- supply and demand for oil and refined petroleum products, which is affected by, among other things, competition from alternative sources of energy;
- supply and demand for energy resources, commodities, semi-finished and finished consumer and industrial products;
- developments in international trade;
- changes in seaborne and other transportation patterns, including changes in the distances that cargoes are transported;
- environmental concerns and regulations;
- weather;
- the number of newbuilding deliveries;
- the improved fuel efficiency of newer vessels;
- the scrapping rate of older vessels; and
- changes in production of crude oil, particularly by OPEC and other key producers.

Tanker charter rates also tend to be subject to seasonal variations, with demand (and therefore charter rates) normally higher in winter months in the northern hemisphere.

In addition, in depressed market conditions, our charterers and customers may no longer need a vessel or drilling unit that is currently under charter or contract, or may be able to obtain a comparable vessel or drilling unit at a lower rate. As a result, charterers and customers may seek to renegotiate the terms of their existing charter parties and drilling contracts, or avoid their obligations under those contracts. Should a counterparty fail to honor its obligations under agreements with us, we could sustain significant losses which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Certain of our directors, executive officers and major shareholders may have interests that are different from the interests of our other shareholders.

Certain of our directors, executive officers and major shareholders may have interests that are different from, or are in addition to, the interests of our other shareholders. In particular, Hemen, a company indirectly controlled by trusts established by Mr. John Fredriksen, for the benefit of his immediate family, and certain of its affiliates, may be deemed to beneficially own approximately 22.5% of our issued and outstanding common shares as at March 26, 2019.

Hemen is also a principal shareholder of a number of other large publicly traded companies involved in various sectors of the shipping and oil services industries, or the Hemen Related Companies. In addition, certain directors, including Mr. Bekker, Mr. Thorstein, Mr Cordia and Mr O'Shaughnessy, also serve on the boards of one or more of the Hemen Related Companies, including but not limited to Frontline, Golden Ocean, Northern Drilling Ltd, Archer Limited, Seadrill and Seadrill Partners LLC. There may be real or apparent conflicts of interest with respect to matters affecting Hemen and other Hemen Related Companies whose interests in some circumstances may be adverse to our

interests.

To the extent that we do business with or compete with other Hemen Related Companies for business opportunities, prospects or financial resources, or participate in ventures in which other Hemen Related Companies may participate, these directors and officers may face actual or apparent conflicts of interest in connection with decisions that could have different implications for us. These decisions may relate to corporate opportunities, corporate strategies, potential acquisitions of businesses, newbuilding acquisitions, inter-company agreements, the issuance or disposition of securities, the election of new or additional directors and other matters. Such potential conflicts may delay or limit the opportunities available to us, and it is possible that conflicts may be resolved in a manner adverse to us or result in agreements that are less favorable to us than terms that would be obtained in arm's-length negotiations with unaffiliated third-parties.



The agreements between us and affiliates of Hemen may be less favorable to us than agreements that we could obtain from unaffiliated third parties.

The charters, management agreements, charter ancillary agreements and the other contractual agreements we have with companies affiliated with Hemen were made in the context of an affiliated relationship. Although every effort was made to ensure that such agreements were made on an arm's-length basis, the negotiation of these agreements may have resulted in prices and other terms that are less favorable to us than terms we might have obtained in arm's-length negotiations with unaffiliated third parties for similar services.

Hemen and its associated companies' business activities may conflict with our business activities.

While Frontline and Golden Ocean have agreed to cause Frontline Shipping and the Golden Ocean Charterer, respectively, to use their commercial best efforts to employ our vessels on market terms and not to give preferential treatment in the marketing of any other vessels owned or managed by Frontline and Golden Ocean or its other affiliates, it is possible that conflicts of interests in this regard will adversely affect us. Under our charter ancillary agreements with Frontline Shipping, Frontline, the Golden Ocean Charterer and Golden Ocean, we are entitled to receive quarterly profit sharing payments to the extent that the average daily time-charter equivalent ("TCE"), rates realized by Frontline Shipping and the Golden Ocean Charterer exceed specified levels. Because Frontline, and Golden Ocean also own or manage other vessels in addition to our fleet, which are not included in the profit sharing calculations, conflicts of interest may arise between us, Frontline and Golden Ocean in the allocation of chartering opportunities that could limit our fleet's earnings and reduce profit sharing payments or charterhire due under our charters.

Our shareholders must rely on us to enforce our rights against our contract counterparties.

Holders of our common shares and other securities have no direct right to enforce the obligations of Frontline Shipping, Frontline Management, Frontline, the Golden Ocean Charterer, Golden Ocean Management, Golden Ocean, the Seadrill Charterers and Seadrill, or any of our other customers under the charters, or any of the other agreements to which we are a party. Accordingly, if any of those counterparties were to breach their obligations to us under any of these agreements, our shareholders would have to rely on us to pursue our remedies against those counterparties.

There is a risk that U.S. tax authorities could treat us as a "passive foreign investment company", which would have adverse U.S. federal income tax consequences to U.S. shareholders.

A foreign corporation will be treated as a "passive foreign investment company," or PFIC, for U.S. federal income tax purposes if either (1) at least 75% of its gross income for any taxable year consists of certain types of "passive income" or (2) at least 50% of the average value of the corporation's assets produce or are held for the production of those types of "passive income." For purposes of these tests, "passive income" includes dividends, interest and gains from the sale or exchange of investment property and rents and royalties other than rents and royalties, which are received from unrelated parties in connection with the active conduct of a trade or business. For purposes of these tests, income derived from the performance of services does not constitute "passive income", but income from bareboat charters does constitute "passive income."

U.S. shareholders of a PFIC are subject to a disadvantageous U.S. federal income tax regime with respect to the income derived by the PFIC, the distributions they receive from the PFIC and the gain, if any, they derive from the

sale or other disposition of their shares in the PFIC.

Under these rules, if our income from our time charters is considered to be passive rental income, rather than income from the performance of services, we will be considered to be a PFIC. We believe that it is more likely than not that our income from time charters will not be treated as passive rental income for purposes of determining whether we are a PFIC. Correspondingly, we believe that the assets that we own and operate in connection with the production of such income do not constitute passive assets for purposes of determining whether we are a PFIC. This position is principally based upon the positions that (1) our time charter income will constitute services income, rather than rental income, and (2) Frontline Management and Golden Ocean Management, which provide services to certain of our time-chartered vessels, will be respected as separate entities from Frontline Shipping and the Golden Ocean Charterer, with which they are respectively affiliated. We do not believe that we will be treated as a PFIC for our 2018 taxable year. Nevertheless, for the 2019 taxable year and future taxable years, depending upon the relative amounts of income we derive from our various assets as well as their relative fair market values, we may be treated as a PFIC.

We note that there is no direct legal authority under the PFIC rules addressing our current and expected method of operation. Accordingly, no assurance can be given that the Internal Revenue Service, or the IRS, or a court of law will accept our position, and there is a significant risk that the IRS or a court of law could determine that we are a PFIC. Furthermore, even if we would not be a PFIC under the foregoing tests, no assurance can be given that we would not constitute a PFIC for any future taxable year if the nature and extent of our operations were to change.

If the IRS were to find that we are or have been a PFIC for any taxable year, our U.S. shareholders will face adverse U.S. federal income tax consequences. For example, U.S. non-corporate shareholders would not be eligible for the preferential rate on dividends that we pay.

We may have to pay tax on U.S. source income, which would reduce our earnings.

Under the U.S. Internal Revenue Code of 1986 as amended, or the Code, 50% of the gross shipping income of a vessel owning or chartering corporation, such as ourselves and our subsidiaries, that is attributable to transportation that begins or ends, but that does not both begin and end, in the United States may be subject to a 4% U.S. federal income tax without allowance for deduction, unless that corporation qualifies for exemption from tax under Section 883 of the Code and the applicable Treasury Regulations promulgated thereunder.

We believe that we and each of our subsidiaries qualify for this statutory tax exemption and we will take this position for U.S. federal income tax return reporting purposes for the 2018 taxable year. However, there are factual circumstances beyond our control that could cause us to lose the benefit of this tax exemption and thereby become subject to U.S. federal income tax on our U.S. source shipping income. For example, if Hemen, who we believe to be a non-qualified shareholder, were to, in combination with other non-qualified shareholders, come to own 50% or more of our outstanding common shares for more than half the days during the taxable year, there is a risk that we could no longer qualify for exemption under Section 883 of the Code for a particular taxable year. Due to the factual nature of the issues involved, we can give no assurances on our tax-exempt status or that of any of our subsidiaries.

If we, or our subsidiaries, are not entitled to exemption under Section 883 of the Code for any taxable year, we, or our subsidiaries, could be subject for those years to an effective 2% U.S. federal income tax on the gross shipping income these companies derive during the year that is attributable to the transport of cargoes to or from the United States. The imposition of this tax would have a negative effect on our business and would result in decreased earnings available for distribution to our shareholders.

As an exempted company incorporated under Bermuda law, our operations may be subject to economic substance requirements.

On December 5, 2017, following an assessment of the tax policies of various countries by the Code of Conduct Group for Business Taxation of the European Union (the "COCG"), the Council of the EU approved and published Council conclusions containing a list of non-cooperative jurisdictions for tax purposes (the "Conclusions"). Although not considered so-called "non-cooperative jurisdictions," certain countries, including Bermuda, were listed as having "tax regimes that facilitate offshore structures which attract profits without real economic activity." In connection with the Conclusions, and to avoid being placed on the list of "non-cooperative jurisdictions," the government of Bermuda, among others, committed to addressing COCG proposals relating to economic substance for entities doing business in or through their respective jurisdictions and to pass legislation to implement any appropriate changes by the end of 2018.

The Economic Substance Act 2018 and the Economic Substance Regulations 2018 of Bermuda (the "Economic Substance Act" and the "Economic Substance Regulations", respectively) became operative on December 31, 2018. The Economic Substance Act applies to every registered entity in Bermuda that engages in a relevant activity and requires

that every such entity shall maintain a substantial economic presence in Bermuda. Relevant activities for the purposes of the Economic Substance Act are banking business, insurance business, fund management business, financing business, leasing business, headquarters business, shipping business, distribution and service center business, intellectual property holding business and conducting business as a holding entity, which may include a pure equity holding entity

The Bermuda Economic Substance Act provides that a registered entity that carries on a relevant activity complies with economic substance requirements if (a) it is directed and managed in Bermuda, (b) its core income-generating activities (as may be prescribed) are undertaken in Bermuda with respect to the relevant activity, (c) it maintains adequate physical presence in Bermuda, (d) it has adequate full time employees in Bermuda with suitable qualifications and (e) it incurs adequate operating expenditure in Bermuda in relation to the relevant activity.

A registered entity that carries on a relevant activity is obliged under the Bermuda Economic Substance Act to file a declaration in the prescribed form (the “Declaration”) with the Registrar of Companies (the “Registrar”) on an annual basis.

The Economic Substance Regulations provide that minimum economic substance requirements shall apply in relation to an entity if the entity is a pure equity holding entity which only holds or manages equity participations, and earns passive income from dividends, distributions, capital gains and other incidental income only. The minimum economic substance requirements include a) compliance with applicable corporate governance requirements set forth in the Bermuda Companies Act 1981 including keeping records of account, books and papers and financial statements and b) submission of an annual economic substance declaration form. Additionally, the Economic Substance Regulations provide that a pure equity holding entity complies with economic substance requirements where it also has adequate employees for holding and managing equity participations, and adequate premises in Bermuda.

If we fail to comply with our obligations under the Bermuda Economic Substance Act or any similar law applicable to us in any other jurisdictions, we could be subject to financial penalties and spontaneous disclosure of information to foreign tax officials in related jurisdictions and may be struck from the register of companies in Bermuda or such other jurisdiction. Any of these actions could have a material adverse effect on our business, financial condition and results of operations.

On March 12, 2019, Bermuda was placed by the EU on its list of non-cooperative jurisdictions for tax purposes due to an issue with Bermuda's economic substance legislation which was not resolved in time for the EU's deadline. At present, the impact of being included on the list of non-cooperative jurisdictions for tax purposes is unclear. While Bermuda has now amended its legislation which the Bermuda Government has stated has addressed this issue and expects to be removed from the list of non-cooperative jurisdictions at the EU's Economic and Financial Affairs Council's next meeting which is scheduled to be in May 2019, there can be no assurance that Bermuda will be removed from such list. If Bermuda is not removed from the list and sanctions or other financial, tax or regulatory measures were applied by European Member States to countries on the list or further economic substance requirements were imposed by Bermuda, our business could be harmed.

If our long-term time or bareboat charters or management agreements with respect to our vessels employed on long-term time charters terminate, we could be exposed to increased volatility in our business and financial results, our revenues could significantly decrease and our operating expenses could significantly increase.

If any of our charters terminate, we may not be able to re-charter those vessels on a long-term basis with terms similar to the terms of our existing charters, or at all.

The vessels in our fleet that have charters attached to them are generally contracted to expire between one and 15 years from now. However, we have granted some of our charterers purchase or early termination options that, if exercised, may effectively terminate our charters with these customers at an earlier date. One or more of the charters with respect to our vessels may also terminate in the event of a requisition for title or a loss of a vessel.

Under our vessel management agreements with Frontline Management and Golden Ocean Management, for fixed management fees, Frontline Management and Golden Ocean Management are responsible for all of the technical and operational management of the vessels chartered by Frontline Shipping and the Golden Ocean Charterer, respectively, and will indemnify us against certain loss of hire and various other liabilities relating to the operation of these vessels. If the relevant charter is terminated, the corresponding management agreement will also be terminated.

In addition to the three vessels on charter to Frontline Shipping and the eight vessels on charter to Golden Ocean Charterer, we also have 14 container vessels, five dry bulk carriers and two product tankers employed on time charters, and two Suezmax tankers, nine dry bulk carriers and two car carriers employed in the spot or short term time charter market. The agreements for the technical and operational management of these vessels are not fixed price agreements, and we cannot assure you that any further vessels which we may acquire in the future will be operated

under fixed price management agreements.

Therefore, to the extent that we acquire additional vessels, our cash flow could be more volatile in the future and we could be exposed to increases in our vessel operating expenses, each of which could materially and adversely affect our results of operations and business.

Certain of our vessels and drilling units are subject to purchase options held by the charterer of the vessel or drilling unit, which, if exercised, could reduce the size of our fleet and reduce our future revenues.

The charter-free market values of our vessels and drilling units are expected to change from time to time depending on a number of factors including general economic and market conditions affecting the shipping and offshore industries, competition, cost of vessel or drilling unit construction, governmental or other regulations, prevailing levels of charter rates and technological changes. We have granted fixed price purchase options to certain of our customers with respect to the vessels and drilling units they have chartered from us, and these prices may be less than the respective vessel's or drilling unit's charter-free market value at the time the option may be exercised. In addition, we may not be able to obtain a replacement vessel or drilling unit for the price at which we sell the vessel or drilling unit. In such a case, we could incur a loss and a reduction in earnings.

Volatility of LIBOR and potential changes of the use of LIBOR as a benchmark could affect our profitability, earnings and cash flow.

London Interbank Offered Rate ("LIBOR") is the subject of recent national, international and other regulatory guidance and proposals for reform. These reforms and other pressures may cause LIBOR to be eliminated or to perform differently than in the past. The consequences of these developments cannot be entirely predicted, but could include an increase in the cost of our variable rate indebtedness and obligations. LIBOR has been volatile in the past, with the spread between LIBOR and the prime lending rate widening significantly at times. Because the interest rates borne by a majority of our outstanding indebtedness fluctuates with changes in LIBOR, significant changes in LIBOR would have a material effect on the amount of interest payable on our debt, which in turn, could have an adverse effect on our financial condition.

Furthermore, interest in most financing agreements in our industry has been based on published LIBOR rates. Recently, however, there is uncertainty relating to the LIBOR calculation process, which may result in the phasing out of LIBOR in the future. As a result, lenders have insisted on provisions that entitle the lenders, in their discretion, to replace published LIBOR as the base for the interest calculation with their cost-of-funds rate. If we are required to agree to such a provision in future financing agreements, our lending costs could increase significantly, which would have an adverse effect on our profitability, earnings and cash flow. In addition, the banks currently reporting information used to set LIBOR will likely stop such reporting after 2021, when their commitment to reporting information ends. The Alternative Reference Rate Committee, or "Committee", a committee convened by the Federal Reserve that includes major market participants, has proposed an alternative rate to replace U.S. Dollar LIBOR: the Secured Overnight Financing Rate, or "SOFR." The impact of such a transition away from LIBOR would be significant for us because of our substantial indebtedness.

In order to manage our exposure to interest rate fluctuations, we may from time to time use interest rate derivatives to effectively fix some of our floating rate debt obligations. No assurance can however be given that the use of these derivative instruments, if any, may effectively protect us from adverse interest rate movements. The use of interest rate derivatives may affect our results through mark to market valuation of these derivatives. Also, adverse movements in interest rate derivatives may require us to post cash as collateral, which may impact our free cash position.

A change in interest rates could materially and adversely affect our financial performance.

As of December 31, 2018, the Company and its consolidated subsidiaries had approximately \$1.1 billion in floating rate debt outstanding under our credit facilities, and a further approximately \$0.7 billion in floating rate debt held by our unconsolidated wholly-owned subsidiaries accounted for under the equity method. Although we use interest rate

swaps to manage our interest rate exposure and have interest rate adjustment clauses in some of our chartering agreements, we are exposed to fluctuations in interest rates. For a portion of our floating rate debt, if interest rates rise, interest payments on our floating rate debt that we have not swapped into effectively fixed rates would increase.

As of December 31, 2018, the Company, its consolidated subsidiaries and its wholly-owned subsidiaries accounted for under the equity method have entered into interest rate swaps which fix the interest on approximately \$0.9 billion of our outstanding indebtedness.



An increase in interest rates could cause us to incur additional costs associated with our debt service, which may materially and adversely affect our results of operations. Our maximum exposure to interest rate fluctuations on our outstanding debt at December 31, 2018, was approximately \$0.9 billion, including our equity-accounted subsidiaries. A one percentage change in interest rates would, based on the Company's estimates, increase or decrease interest rate exposure by approximately \$8.8 million per year as of December 31, 2018. The figure does not take into account that certain of our charter contracts include interest adjustment clauses, whereby the charter rate is adjusted to reflect the actual interest paid on a deemed outstanding debt related to the assets on charter. At December 31, 2018, \$0.8 billion of our floating rate debt was subject to such interest adjustment clauses, including our equity-accounted subsidiaries. None of this was subject to interest rate swaps and the balance of \$0.8 billion remained on a floating rate basis. Our net exposure to floating rate debt is therefore \$114.8 million.

The interest rate swaps that have been entered into by the Company and its subsidiaries are derivative financial instruments that effectively translate floating rate debt into fixed rate debt. US GAAP requires that these derivatives be valued at current market prices in our financial statements, with increases or decreases in valuations reflected in results of operations or, if the instrument is designated as a hedge, in other comprehensive income. Changes in interest rates give rise to changes in the valuations of interest rate swaps and could adversely affect results of operations and other comprehensive income.

We may have difficulty managing our planned growth properly.

Since our original acquisitions from Frontline, we have expanded and diversified our fleet, and we are performing certain administrative services through our wholly-owned subsidiaries SFL Management AS, Ship Finance Management (UK) Ltd. and Ship Finance Management (Bermuda) Ltd.

We intend to continue to expand our fleet. We continuously evaluate potential transactions, which may include pursuit of other business combinations, the acquisition of vessels or related businesses, the expansion of our operations, repayment of existing debt, share repurchases, short term investments or other transactions that we believe will be accretive to earnings, enhance shareholder value or are in our best interests. Our future growth will primarily depend on our ability to locate and acquire suitable vessels and drilling units, identify and consummate acquisitions or joint ventures, obtain required financing, integrate any acquired vessels and drilling units with our existing operations, enhance our customer base, and manage our expansion.

The growth in the size and diversity of our fleet will continue to impose additional responsibilities on our management, and may present numerous risks, such as undisclosed liabilities and obligations, difficulty in recruiting additional qualified personnel and managing relationships with customers and suppliers, and integrating newly acquired operations into existing infrastructures. We cannot assure you that we will be successful in executing our growth plans or that we will not incur significant expenses and losses in connection with our future growth.

We are highly leveraged and subject to restrictions in our financing agreements that impose constraints on our operating and financing flexibility.

We have significant indebtedness outstanding under our senior unsecured convertible notes and our Norwegian kroner, or NOK, senior unsecured bonds. We have also entered into loan facilities that we have used to refinance existing indebtedness and to acquire additional vessels. We may need to refinance some or all of our indebtedness on maturity of our convertible notes, bonds or loan facilities and to acquire additional vessels in the future. We cannot assure you that we will be able to do so on terms acceptable to us or at all. If we cannot refinance our indebtedness, we will have to dedicate some or all of our cash flows, and we may be required to sell some of our assets, to pay the

principal and interest on our indebtedness. In such a case, we may not be able to pay dividends to our shareholders and may not be able to grow our fleet as planned. We may also incur additional debt in the future.

Our loan facilities and the indentures for our convertible notes and bonds subject us to limitations on our business and future financing activities, including:

- limitations on the incurrence of additional indebtedness, including issuance of additional guarantees;
- limitations on incurrence of liens;
- limitations on our ability to pay dividends and make other distributions; and
- limitations on our ability to renegotiate or amend our charters, management agreements and other material agreements.

Further, our loan facilities contain financial covenants that require us to, among other things:

- provide additional security under the loan facility or prepay an amount of the loan facility as necessary to maintain the fair market value of our vessels securing the loan facility at not less than specified percentages (ranging from 100% to 150%) of the principal amount outstanding under the loan facility;
- maintain available cash on a consolidated basis of not less than \$25 million;
- maintain positive working capital on a consolidated basis; and
- maintain a ratio of total liabilities to adjusted total assets of less than 0.80.

Under the terms of our loan facilities, we may not make distributions to our shareholders if we do not satisfy these covenants or receive waivers from the lenders. We cannot assure you that we will be able to satisfy these covenants in the future.

Due to these restrictions, we may need to seek permission from our lenders in order to engage in some corporate actions. Our lenders' interests may be different from ours and we cannot guarantee that we will be able to obtain our lenders' permission when needed. This may prevent us from taking actions that are in our best interests.

Our debt service obligations require us to dedicate a substantial portion of our cash flows from operations to required payments on indebtedness and could limit our ability to obtain additional financing, make capital expenditures and acquisitions, and carry out other general corporate activities in the future. These obligations may also limit our flexibility in planning for, or reacting to, changes in our business and the shipping industry or detract from our ability to successfully withstand a downturn in our business or the economy generally. This may place us at a competitive disadvantage to other less leveraged competitors.

Furthermore, our debt agreements, including our bond agreements, contain cross-default provisions that may be triggered by a default under one of our other debt agreements. The cross default provisions imply that a failure by Ship Finance International Limited, as guarantor or issuer, to pay any financial indebtedness above certain thresholds when due, or within any applicable grace period, could result in a default under our other debt agreements.

The occurrence of any event of default, or our inability to obtain a waiver from our lenders in the event of a default, could result in certain or all of our indebtedness being accelerated or the foreclosure of the liens on our vessels by our lenders. If our secured indebtedness is accelerated in full or in part, it would be very difficult in the current financing environment for us to refinance our debt or obtain additional financing and we could lose our vessels and other assets securing our credit facilities if our lenders foreclose their liens, which would adversely affect our ability to conduct our business.

Moreover, in connection with any waivers of or amendments to our credit facilities that we have obtained, or may obtain in the future, our lenders may impose additional operating and financial restrictions on us or modify the terms of our existing credit facilities. These restrictions may further restrict our ability to, among other things, pay dividends, make capital expenditures or incur additional indebtedness, including through the issuance of guarantees. Our lenders may also require the payment of additional fees, require prepayment of a portion of our indebtedness to them, accelerate the amortization schedule for our indebtedness and increase the interest rates they charge us on our outstanding indebtedness. See "Item 5. Operating and Financial Review and Prospects - B. Liquidity and Capital Resources.

In addition, under the terms of our credit facilities, our payment of dividends or other payments to shareholders as well as our subsidiaries' payment of dividends to us is subject to no event of default having occurred. See "Item 8. Financial Information -Dividend Policy."

We may be subject to litigation that, if not resolved in our favor and not sufficiently insured against, could have a material adverse effect on us.

We may be, from time to time, involved in various litigation matters. These matters may include, among other things, contract disputes, personal injury claims, environmental claims or proceedings, asbestos and other toxic tort claims, employment matters, governmental claims for taxes or duties, and other litigation that arises in the ordinary course of our business. Although we intend to defend these matters vigorously, we cannot predict with certainty the outcome or effect of any claim or other litigation matter, and the ultimate outcome of any litigation or the potential costs to resolve them may have a material adverse effect on us. Insurance may not be applicable or sufficient in all cases and/or insurers may not remain solvent, which may have a material adverse effect on our financial condition.

## Risks Relating to Our Common Shares

We are a holding company, and we depend on the ability of our subsidiaries to distribute funds to us in order to satisfy our financial and other obligations and to make dividend payments.

We are a holding company, and have no significant assets other than the equity interests in our subsidiaries. Our subsidiaries own all of our vessels and drilling units, and payments under our charter agreements are made to our subsidiaries. As a result, our ability to make distributions to our shareholders depends on the performance of our subsidiaries and their ability to distribute funds to us. The ability of a subsidiary to make these distributions could be affected by a claim or other action by a third party or by the law of its respective jurisdiction of incorporation which regulates the payment of dividends by companies. Under the terms of our credit facilities, we may be restricted from making distributions from our subsidiaries if they are not in compliance with the terms of the relevant agreements. If we are unable to obtain funds from our subsidiaries, we will not be able to pay dividends to our shareholders.

The market price of our common shares may be unpredictable and volatile.

The market price of our common shares has been volatile. For the year ended December 31, 2018, the closing market price of our common shares ranged from a high of \$15.90 on January 23 and 24, 2018, to a low of \$10.53 on December 31, 2018. The market price of our common shares may continue to fluctuate due to factors such as actual or anticipated fluctuations in our quarterly and annual results and those of other public companies in our industry, changes in key management personnel, any reductions in the payment of our dividends or changes in our dividend policy, mergers and strategic alliances in the shipping and offshore industries, market conditions in the shipping and offshore industries, changes in government regulation, shortfalls in our operating results from levels forecast by securities analysts, perceived or actual inability by our chartering counterparts to fully perform under the charter parties, including the Seadrill Charterers, Frontline Shipping and the Solstad Charterer, announcements concerning us or our competitors and the general state of the securities market. The shipping and offshore industries have been highly unpredictable and volatile. The market for common shares in these industries may be equally volatile. Therefore, we cannot assure you that you will be able to sell any of our common shares you may have purchased at a price greater than or equal to its original purchase price. Additionally, to the extent that the price of our common shares declines, our ability to raise funds through the issuance of equity, or otherwise using our common shares as consideration, will be reduced.

Future sales of our common shares or conversion of our convertible notes could cause the market price of our common shares to decline.

The market price of our common shares could decline due to sales of a large number of our shares in the market or the perception that such sales could occur or conversion of our convertible notes. This could depress the market price of our common shares and make it more difficult for us to sell equity securities in the future at a time and price that we deem appropriate, or at all.

Because we are a foreign corporation, you may not have the same rights as a shareholder in a U.S. corporation may have.

We are a Bermuda exempted company. Our Memorandum of Association and Bye-Laws and the Bermuda Companies Act 1981, as amended, govern our affairs. Investors may have more difficulty in protecting their interests and enforcing judgments in the face of actions by our management, directors or controlling shareholders than would shareholders of a corporation incorporated in a United States jurisdiction. Under Bermuda law a director generally owes a fiduciary duty only to the company and not to the company's shareholders. Our shareholders may not have a direct course of action against our directors. In addition, Bermuda law does not provide a mechanism for our shareholders to bring a class action lawsuit under Bermuda law. Further, our bye-laws provide for the indemnification of our directors or officers against any liability arising out of any act or omission except for an act or omission constituting fraud, dishonesty or illegality.

Because our offices and the majority of our assets are located outside the United States, you may not be able to bring suit against us, or enforce a judgment obtained against us in the United States

Our executive offices, administrative activities and the majority of our assets are located outside the United States. In addition, most of our directors and officers are not resident in the United States. As a result, it may be more difficult for investors to effect service of process within the United States upon us, or to enforce both in the United States and outside the United States judgments against us in any action, including actions predicated upon the civil liability provisions of the federal securities laws of the United States.

#### ITEM 4. INFORMATION ON THE COMPANY

##### A. HISTORY AND DEVELOPMENT OF THE COMPANY

###### The Company

We are Ship Finance International Limited, a Bermuda-based company incorporated in Bermuda on October 10, 2003, as a Bermuda exempted company under the Bermuda Companies Law of 1981 (Company No. EC-34296). We are engaged primarily in the ownership and operation of vessels and offshore related assets, and also involved in the charter, purchase and sale of assets. Our registered and principal executive offices are located at Par-la-Ville Place, 14 Par-la-Ville Road, Hamilton, HM 08, Bermuda, and our telephone number is +1 (441) 295-9500.

We operate through subsidiaries located in Bermuda, Cyprus, Malta, Liberia, Norway, the United Kingdom and the Marshall Islands.

We are an international ship owning and chartering company with a large and diverse asset base across the maritime and offshore industries. As at March 26, 2019, our assets consist of five crude oil tankers, 22 dry bulk carriers, 45 container vessels (including 11 capital lease vessels), two car carriers, one jack-up drilling rig, two ultra-deepwater drilling units, five offshore support vessels, two chemical tankers and two oil product tankers. Our crude oil tankers, chemical tankers and oil product tankers are all double-hull vessels.

Our primary objective is to continue to grow our business through accretive acquisitions across a diverse range of marine and offshore asset classes. In doing so, our strategy is to generate stable and increasing cash flows by

chartering our assets primarily under medium to long-term bareboat or time charters.

#### History of the Company

We were formed in 2003 as a wholly owned subsidiary of Frontline, a major operator of large crude oil tankers. In 2004, Frontline distributed 25% of our common shares to its ordinary shareholders in a partial spin off, and our common shares commenced trading on the New York Stock Exchange, or the NYSE, under the ticker symbol "SFL" on June 17, 2004. Frontline subsequently made six further dividends of our shares to its shareholders and its ownership in our Company is now less than one percent. Our assets at the time consisted of a fleet of Suezmax tankers, VLCCs, and oil/bulk/ore carriers.

Since 2004, we have diversified our asset base and now have nine asset types, which comprise crude oil tankers, chemical tankers, oil product tankers, container vessels, car carriers, dry bulk carriers, jack-up drilling rigs, ultra-deepwater drilling units and offshore support vessels. In addition, we have certain financial investments.

## Acquisitions and Disposals

### Acquisitions

In the year ended December 31, 2018, we took delivery of the following vessels:

- In April 2018, the Company took delivery of a fleet of 15 second-hand feeder size containerships, ranging from 1,100 TEU to 4,400 TEU. Upon delivery, the vessels immediately commenced seven year bareboat charters to a leading container line.

In May 2018, the Company acquired and took delivery of four 2014-built 13,800 TEU containerships, Thalassa Mana, Thalassa Tyhi, Thalassa Doxa and Thalassa Axia. Upon delivery, the vessels were employed under long term time charters for six years to a leading container line. In September and October 2018, the Company entered into lease financing agreements totaling \$400 million with an Asian based leasing institution to finance these four vessels.

In September and October, the Company acquired and took delivery of three 2015-built 10,600 TEU containerships, Cap San Juan, Cap San Lazaro and Cap San Vincent. Upon delivery, the vessels were employed under long term time charters from Maersk Line A/S (“Maersk”) for six years. In December 2018, the Company entered into a lease financing agreement totaling \$270 million with an Asian based leasing institution to finance the three vessels.

In December, the Company chartered-in two 2016-built 19,400 TEU containerships, MSC Erica and MSC Reef. Upon delivery, the vessels each commenced a 15 year bareboat charter to a leading container line.

The Company has not taken delivery of any new vessels between December 31, 2018 and March 26, 2019.

### Disposals

In the year ended December 31, 2018, we entered into agreements for the disposal of vessels, as follows:

In February 2018, the Company delivered the 1999-built VLCC Front Circassia to an unrelated third party for gross sale proceeds of \$17.9 million. Furthermore, the Company agreed with Frontline Shipping Limited (“FSL”), to terminate the long-term charter for the vessel upon the sale and delivery. The charter with FSL was terminated in February 2018, and the Company received an interest bearing loan note of \$8.9 million from FSL as compensation for the early termination of the charter.

In March 2018, the Company agreed to sell the 2010-built 1,700 TEU container vessel SFL Avon to an unrelated third party for gross sales proceeds of \$12.7 million. The vessel was delivered to its new owners in May 2018.

In July 2018, the Company agreed to sell the 2002-built VLCCs Front Serenade, Front Page and Front Stratus to an unrelated third party, ADS Crude Carriers Ltd (“ADS”) for gross sale proceeds of \$22.5 million for each vessel. Also as part of the sale, the Company received 4,031,800 shares worth \$10.0 million in ADS, representing 17.24% ownership in ADS. Upon the sale and delivery, the Company agreed with FSL to terminate the long-term charter of the three vessels. The Company received compensation in the form of three promissory notes of \$3.4 million each in respect of the charter terminations from Frontline Ltd.

In September 2018, the Company agreed to sell the 2001-built VLCC Front Ariake to an unrelated third party, for gross sale proceeds of \$17.5 million. The vessel was delivered to its new owners in October 2018. Upon delivery, the Company agreed to terminate its long term charter with FSL and Frontline made a compensation payment to the Company in the form of a loan note with a value of \$3.4 million.

In November 2018, the Company agreed to sell the 2002-built VLCC Front Falcon to an unrelated third party, for gross sale proceeds of \$31.0 million. The vessel was delivered to its new owners in December 2018. Upon delivery, the Company agreed to an early termination of its long term charter with FSL, and no compensation was due to the Company.

In December 2018, the Company sold the 2007-built jack up rig, Soehanah, through the disposal of its shares in its subsidiary, Rig Finance Limited, for gross proceeds of \$84.6 million and a gain of \$7.6 million was recorded.



The Company has not disposed of any vessels between December 31, 2018 and March 26, 2019.

## B. BUSINESS OVERVIEW

### Our Business Strategies

Our primary objectives are to profitably grow our business and increase long-term distributable cash flow per share by pursuing the following strategies:

Expand our asset base. We have increased, and intend to further increase, the size of our asset base through timely and selective acquisitions of additional assets that we believe will be accretive to long-term distributable cash flow per share. We will seek to expand our asset base through placing newbuilding orders, acquiring second-hand (1) vessels and entering into medium or long-term charter arrangements. We also make financial investments or provide loans secured by vessels and rigs. From time to time we may also acquire vessels with no or limited initial charter coverage. We believe that by entering into newbuilding contracts or acquiring second-hand vessels or rigs we can provide for long-term growth of our assets.

Diversify our asset base. Since 2004, we have diversified our asset base and now have nine asset types, which comprise crude oil tankers, chemical tankers, oil product tankers, container vessels, car carriers, dry bulk carriers, jack-up drilling rigs, ultra-deepwater drilling units and offshore support vessels. We believe that there are other (2) attractive markets that could provide us with the opportunity to further diversify our asset base. These markets include vessels and other assets that are of long-term strategic importance to certain operators in the shipping and offshore industries. We believe that the expertise and relationships of our management, together with our relationship and affiliation with Mr. John Fredriksen, could provide us with incremental opportunities to expand our asset base.

Expand and diversify our customer relationships. Since 2004, we have increased our customer base from one to more than 10 customers. Of these long term customers, Frontline Shipping, Seadrill and Golden Ocean are related (3) parties. We intend to continue to expand our relationships with our existing customers and also to add new customers, as companies servicing the international shipping and offshore oil exploration markets continue to expand their use of chartered-in assets to add capacity.

Pursue medium to long-term fixed-rate charters. We intend to continue to pursue medium to long-term fixed rate charters, which provide us with stable future cash flows. Our customers typically employ long-term charters for strategic expansion as most of their assets are typically of strategic importance to certain operating pools, (4) established trade routes or dedicated oil-field installations. We believe that we will be well positioned to participate in their growth. In addition, we will also seek to enter into charter agreements that are shorter and provide for profit sharing, so that we can generate incremental revenue and share in the upside during strong markets.

### Customers

As at March 26, 2019, our customers included Frontline Shipping Limited (“Frontline Shipping”), Seadrill Limited (“Seadrill”), Golden Ocean Group Limited (“Golden Ocean”), Deep Sea Supply Shipowning II AS (the “Solstad Charterer”), Sinochem Shipping Co. Ltd (“Sinochem”), Heung-A Shipping Co. Ltd (“Heung-A”), Hyundai Glovis Co. Ltd. (“Hyundai Glovis”), Sinotrans Shipping Limited (“Sinotrans”), Maersk Line A/S (“Maersk”), MSC Mediterranean Shipping Company S.A. and its affiliate Conglomerate Shipping Ltd. (“MSC”), Phillips 66 Company (“Phillips 66”), Mitsui OSK Lines Ltd (“MOL”) and Evergreen Marine Corporation (Taiwan) Ltd. and its affiliate Evergreen Marine (Singapore) Pte Ltd (“Evergreen”), or subsidiaries thereof.

In the year ended December 31, 2018, Frontline Shipping accounted for 8% of our consolidated operating revenues (2017: 15%, 2016: 28%). In the year ended December 31, 2018, the Company had eight Capesize dry bulk carriers leased to a subsidiary of Golden Ocean which accounted for approximately 13% of our consolidated operating revenues (2017: 14%, 2016: 12%).

The Company also had 29 container vessels on long-term bareboat charters to MSC, which accounted for approximately 11% of our consolidated operating revenues in the year ended December 31, 2018 (2017: 10%, 2016: 4%).

Following the acquisition of Hamburg Süd by Maersk Line A/S (“Maersk”) in November 2017, the Company had 10 container vessels on long-term time charters to Maersk at December 31, 2018, which accounted for approximately 27% of our consolidated operating revenues (2017: 14%; 2016: 9%).

Our income earned from Seadrill is through three wholly owned subsidiaries which are accounted for using the equity method, that lease drilling units to subsidiaries of Seadrill. In the year ended December 31, 2018, income from associated companies accounted for 39.1% of our net income (2017: 38.6%, 2016: 31.7%).

## Competition

We currently operate in several sectors of the shipping and offshore industry, including oil transportation, dry bulk shipments, chemical transportation, oil product transportation, container transportation, car transportation, drilling rigs and offshore support vessels.

The markets for international seaborne oil transportation services, dry bulk transportation services, and container and car transportation services are highly fragmented and competitive. Seaborne oil transportation services are generally provided by two main types of operators: major oil companies or captive fleets (both private and state-owned) and independent shipowner fleets.

In addition, several owners and operators pool their vessels together on an ongoing basis, and such pools are available to customers to the same extent as independently owned and operated fleets. Many major oil companies and other commodity carriers also operate their own vessels and use such vessels not only to transport their own cargoes but also to transport cargoes for third parties, in direct competition with independent owners and operators.

Container vessels and car carriers are generally operated by logistics companies, where the vessels are used as an integral part of their services. Therefore, container vessels and car carriers are typically chartered more on a period basis and single voyage chartering is less common. As the market has grown significantly over recent decades, we expect in the future to see more vessels chartered by logistics companies on a shorter term basis, particularly smaller vessels.

One of our jack-up drilling rigs, our ultra-deepwater drilling units and our offshore support vessels are chartered out on long-term charters to contractors. Jack-up drilling rigs, ultra-deepwater drilling units and offshore support vessels are normally chartered by oil companies on a shorter-term basis linked to area-specific well drilling or oil exploration activities, but there have also been longer period charters available when oil companies want to cover their longer term requirements for such vessels. Offshore support vessels and ultra-deepwater semi-submersible drilling rigs are self-propelled, and can therefore easily move between geographic areas. Jack-up drilling rigs are not self-propelled, but it is common to move these assets over long distances on heavy-lift vessels. Therefore, the markets and competition for these rigs are effectively world-wide.

Competition for charters in all the above sectors is intense and is based upon price, location, size, age, condition and acceptability of the vessel/rig and its manager. Competition is also affected by the availability of other size vessels/rigs to compete in the trades in which we engage. Most of our existing vessels are chartered at fixed rates on a long-term basis and are thus not directly affected by competition in the short-term. However, tankers chartered to Frontline Shipping, dry bulk carriers chartered to the Golden Ocean Charterer and our five offshore support vessels chartered to the Solstad Charterer are subject to profit sharing agreements, which will be affected by competition experienced by the charterers.

## Environmental and Other Regulations in the Shipping Industry

Government regulation and laws significantly affect the ownership and operation of our fleet. We are subject to international conventions and treaties, national, state and local laws and regulations in force in the countries in which our vessels may operate or are registered relating to safety and health and environmental protection including the storage, handling, emission, transportation and discharge of hazardous and non-hazardous materials, and the remediation of contamination and liability for damage to natural resources. Compliance with such laws, regulations and other requirements entails significant expense, including vessel modifications and implementation of certain operating procedures.

A variety of government and private entities subject our vessels to both scheduled and unscheduled inspections. These entities include the local port authorities (applicable national authorities such as the United States Coast Guard (“USCG”), harbor master or equivalent), classification societies, flag state administrations (countries of registry) and charterers, particularly terminal operators. Certain of these entities require us to obtain permits, licenses, certificates and other authorizations for the operation of our vessels. Failure to maintain necessary permits or approvals could require us to incur substantial costs or result in the temporary suspension of the operation of one or more of our vessels.

Increasing environmental concerns have created a demand for vessels that conform to stricter environmental standards. We are required to maintain operating standards for all of our vessels that emphasize operational safety, quality maintenance, continuous training of our officers and crews and compliance with United States and international regulations. We believe that the operation of our vessels is in substantial compliance with applicable environmental laws and regulations and that our vessels have all material permits, licenses, certificates or other authorizations necessary for the conduct of our operations. However, because such laws and regulations frequently change and may impose increasingly stricter requirements, we cannot predict the ultimate cost of complying with these requirements, or the impact of these requirements on the resale value or useful lives of our vessels. In addition, a future serious marine incident that causes significant adverse environmental impact could result in additional legislation or regulation that could negatively affect our profitability.

#### Flag State

The flag state, as defined by the United Nations Convention on the Law of the Sea, is responsible for implementing and enforcing a broad range of international maritime regulations with respect to all ships granted the right to fly its flag. The "Shipping Industry Guidelines on Flag State Performance" evaluates flag states based on factors such as ratification, implementation and enforcement of principal international maritime treaties, supervision of surveys, compliance with International Labour Organization reporting, and participation at IMO meetings. Our vessels are flagged in Liberia, the Bahamas, Cyprus, Malta, the Marshall Islands, Panama, Hong Kong, Portugal and Norway.

#### International Maritime Organization

The International Maritime Organization, the United Nations agency for maritime safety and the prevention of pollution by vessels (the "IMO"), has adopted the International Convention for the Prevention of Pollution from Ships, 1973, as modified by the Protocol of 1978 relating thereto, collectively referred to as MARPOL 73/78 and herein as "MARPOL," adopted the International Convention for the Safety of Life at Sea of 1974 ("SOLAS Convention"), and the International Convention on Load Lines of 1966 (the "LL Convention"). MARPOL establishes environmental standards relating to oil leakage or spilling, garbage management, sewage, air emissions, handling and disposal of noxious liquids and the handling of harmful substances in packaged forms. MARPOL is applicable to drybulk, tanker and LNG carriers, among other vessels, and is broken into six Annexes, each of which regulates a different source of pollution. Annex I relates to oil leakage or spilling; Annexes II and III relate to harmful substances carried in bulk in liquid or in packaged form, respectively; Annexes IV and V relate to sewage and garbage management, respectively; and Annex VI, lastly, relates to air emissions. Annex VI was separately adopted by the IMO in September of 1997. In 2012, the IMO's Marine Environmental Protection Committee, or the "MEPC," adopted a resolution amending the International Code for the Construction and Equipment of Ships Carrying Dangerous Chemicals in Bulk, or the "IBC Code." The provisions of the IBC Code are mandatory under MARPOL and the SOLAS Convention. These amendments, which entered into force in June 2014, pertain to revised international certificates of fitness for the carriage of dangerous chemicals in bulk and identifying new products that fall under the IBC Code. We may need to make certain financial expenditures to comply with these amendments.

In 2013, the IMO's MEPC adopted a resolution amending MARPOL Annex I Condition Assessment Scheme, or "CAS." These amendments became effective on October 1, 2014, and require compliance with the 2011 International Code on the Enhanced Programme of Inspections during Surveys of Bulk Carriers and Oil Tankers, or "ESP Code," which provides for enhanced inspection programs. We may need to make certain financial expenditures to comply with these amendments.

#### Air Emissions

In September of 1997, the IMO adopted Annex VI to MARPOL to address air pollution from vessels. Effective May 2005, Annex VI sets limits on sulfur oxide and nitrogen oxide emissions from all commercial vessel exhausts and prohibits "deliberate emissions" of ozone depleting substances (such as halons and chlorofluorocarbons), emissions of volatile compounds from cargo tanks, and the shipboard incineration of specific substances. Annex VI also includes a global cap on the sulfur content of fuel oil and allows for special areas to be established with more stringent controls on sulfur emissions, as explained below. Emissions of "volatile organic compounds" from certain vessels, and the shipboard incineration (from incinerators installed after January 1, 2000) of certain substances (such as polychlorinated biphenyls, or PCBs) are also prohibited. We believe that all our vessels are currently compliant in all

material respects with these regulations.

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The MEPC adopted amendments to Annex VI regarding emissions of sulfur oxide, nitrogen oxide, particulate matter and ozone depleting substances, which entered into force on July 1, 2010. The amended Annex VI seeks to further reduce air pollution by, among other things, implementing a progressive reduction of the amount of sulfur contained in any fuel oil used on board ships. On October 27, 2016, at its 70th session, the MEPC agreed to implement a global 0.5% m/m sulfur oxide emissions limit (reduced from 3.50%) starting from January 1, 2020. This limitation can be met by using low-sulfur compliant fuel oil, alternative fuels, or certain exhaust gas cleaning systems. Once the cap becomes effective, ships will be required to obtain bunker delivery notes and International Air Pollution Prevention (“IAPP”) Certificates from their flag states that specify sulfur content. Additionally, at MEPC 73, amendments to Annex VI to prohibit the carriage of bunkers above 0.5% sulfur on ships were adopted and will take effect March 1, 2020. These regulations subject ocean-going vessels to stringent emissions controls, and may cause us to incur substantial costs.

Sulfur content standards are even stricter within certain “Emission Control Areas,” or (“ECAs”). As of January 1, 2015, ships operating within an ECA were not permitted to use fuel with sulfur content in excess of 0.1%. Amended Annex VI establishes procedures for designating new ECAs. Currently, the IMO has designated four ECAs, including specified portions of the Baltic Sea area, North Sea area, North American area and United States Caribbean area. Ocean-going vessels in these areas will be subject to stringent emission controls and may cause us to incur additional costs. Areas in China are subject to local regulations that impose stricter emission controls. If other ECAs are approved by the IMO, or other new or more stringent requirements relating to emissions from marine diesel engines or port operations by vessels are adopted by the U.S Environmental Protection Agency (“EPA”) or the states where we operate, compliance with these regulations could entail significant capital expenditures or otherwise increase the costs of our operations.

Amended Annex VI also establishes new tiers of stringent nitrogen oxide emissions standards for marine diesel engines, depending on their date of installation. At the MEPC meeting held from March to April 2014, amendments to Annex VI were adopted which address the date on which Tier III Nitrogen Oxide (“NOx”) standards in ECAs will go into effect. Under the amendments, Tier III NOx standards apply to ships that operate in the North American and U.S. Caribbean Sea ECAs designed for the control of NOx produced by vessels with a marine diesel engine installed and constructed on or after January 1, 2016. Tier III requirements could apply to areas that will be designated for Tier III NOx in the future. At MEPC 70 and MEPC 71, the MEPC approved the North Sea and Baltic Sea as ECAs for nitrogen oxide for ships built after January 1, 2021. The EPA promulgated equivalent (and in some senses stricter) emissions standards in late 2009. As a result of these designations or similar future designations, we may be required to incur additional operating or other costs.

As determined at the MEPC 70, the new Regulation 22A of MARPOL Annex VI became effective as of March 1, 2018 and requires ships above 5,000 gross tonnage to collect and report annual data on fuel oil consumption to an IMO database, with the first year of data collection commencing on January 1, 2019. The IMO intends to use such data as the first step in its roadmap (through 2023) for developing its strategy to reduce greenhouse gas emissions from ships, as discussed further below.

As of January 1, 2013, MARPOL made mandatory certain measures relating to energy efficiency for ships. All ships are now required to develop and implement Ship Energy Efficiency Management Plans (“SEEMPS”), and new ships must be designed in compliance with minimum energy efficiency levels per capacity mile as defined by the Energy Efficiency Design Index (“EEDI”). Under these measures, by 2025, all new ships built will be 30% more energy efficient than those built in 2014.

We may incur costs to comply with these revised standards. Additional or new conventions, laws and regulations may be adopted that could require the installation of expensive emission control systems and could adversely affect our business, results of operations, cash flows and financial condition.

#### Safety Management System Requirements

The SOLAS Convention was amended to address the safe manning of vessels and emergency training drills. The Convention of Limitation of Liability for Maritime Claims (the “LLMC”) sets limitations of liability for a loss of life or



personal injury claim or a property claim against ship owners. We believe that our vessels are in substantial compliance with SOLAS and LLMC standards.

Under Chapter IX of the SOLAS Convention, or the International Safety Management Code for the Safe Operation of Ships and for Pollution Prevention (the "ISM Code"), our operations are also subject to environmental standards and requirements. The ISM Code requires the party with operational control of a vessel to develop an extensive safety management system that includes, among other things, the adoption of a safety and environmental protection policy setting forth instructions and procedures for operating its vessels safely and describing procedures for responding to emergencies. We rely upon the safety management system that we and our technical management team have developed for compliance with the ISM Code. The failure of a vessel owner or bareboat charterer to comply with the ISM Code may subject such party to increased liability, may decrease available insurance coverage for the affected vessels and may result in a denial of access to, or detention in, certain ports.

The ISM Code requires that vessel operators obtain a safety management certificate for each vessel they operate. This certificate evidences compliance by a vessel's management with the ISM Code requirements for a safety management system. No vessel can obtain a safety management certificate unless its manager has been awarded a document of compliance, issued by each flag state, under the ISM Code. We have obtained applicable documents of compliance for our offices and safety management certificates for all of our vessels for which the certificates are required by the IMO. The document of compliance and safety management certificate are renewed as required.

Regulation II-1/3-10 of the SOLAS Convention governs ship construction and stipulates that ships over 150 meters in length must have adequate strength, integrity and stability to minimize risk of loss or pollution. Goal-based standards amendments in SOLAS regulation II-1/3-10 entered into force in 2012, with July 1, 2016 set for application to new oil tankers and bulk carriers. The SOLAS Convention regulation II-1/3-10 on goal-based ship construction standards for bulk carriers and oil tankers, which entered into force on January 1, 2012, requires that all oil tankers and bulk carriers of 150 meters in length and above, for which the building contract is placed on or after July 1, 2016, satisfy applicable structural requirements conforming to the functional requirements of the International Goal-based Ship Construction Standards for Bulk Carriers and Oil Tankers ("GBS Standards").

Amendments to the SOLAS Convention Chapter VII apply to vessels transporting dangerous goods and require those vessels be in compliance with the International Maritime Dangerous Goods Code ("IMDG Code"). Effective January 1, 2018, the IMDG Code includes (1) updates to the provisions for radioactive material, reflecting the latest provisions from the International Atomic Energy Agency, (2) new marking, packing and classification requirements for dangerous goods, and (3) new mandatory training requirements.

The IMO has also adopted the International Convention on Standards of Training, Certification and Watchkeeping for Seafarers ("STCW"). As of February 2017, all seafarers are required to meet the STCW standards and be in possession of a valid STCW certificate. Flag states that have ratified SOLAS and STCW generally employ the classification societies, which have incorporated SOLAS and STCW requirements into their class rules, to undertake surveys to confirm compliance.

Furthermore, recent action by the IMO's Maritime Safety Committee and United States agencies indicate that cybersecurity regulations for the maritime industry are likely to be further developed in the near future in an attempt to combat cybersecurity threats. For example, cyber-risk management systems must be incorporated by ship-owners and managers by 2021. This might cause companies to create additional procedures for monitoring cybersecurity, which could require additional expenses and/or capital expenditures. The impact of such regulations is difficult to predict at this time.

#### Pollution Control and Liability Requirements

The IMO has negotiated international conventions that impose liability for pollution in international waters and the territorial waters of the signatories to such conventions. For example, the IMO adopted an International Convention for the Control and Management of Ships' Ballast Water and Sediments (the "BWM Convention") in 2004. The BWM Convention entered into force on September 9, 2017. The BWM Convention requires ships to manage their ballast water to remove, render harmless, or avoid the uptake or discharge of new or invasive aquatic organisms and pathogens within ballast water and sediments. The BWM Convention's implementing regulations call for a phased introduction of mandatory ballast water exchange requirements, to be replaced in time with mandatory concentration limits, and require all ships to carry a ballast water record book and an international ballast Water management certificate.

On December 4, 2013, the IMO Assembly passed a resolution revising the application dates of BWM Convention so that the dates are triggered by the entry into force date and not the dates originally in the BWM Convention. This, in effect, makes all vessels delivered before the entry into force date "existing vessels" and allows for the installation of ballast water management systems on such vessels at the first International Oil Pollution Prevention ("IOPP") renewal survey following entry into force of the convention. The MEPC adopted updated guidelines for approval of ballast water management systems (G8) at MEPC 70. At MEPC 71, the schedule regarding the BWM Convention's implementation dates was also discussed and amendments were introduced to extend the date existing vessels are

subject to certain ballast water standards. Ships over 400 gross tons generally must comply with a “D-1 standard,” requiring the exchange of ballast water only in open seas and away from coastal waters. The “D-2 standard” specifies the maximum amount of viable organisms allowed to be discharged, and compliance dates vary depending on the IOPP renewal dates. Depending on the date of the IOPP renewal survey, existing vessels must comply with the D-2 standard on or after September 8, 2019. For most ships, compliance with the D-2 standard will involve installing on-board systems to treat ballast water and eliminate unwanted organisms. Ballast Water Management systems, which include systems that make use of chemical, biocides, organisms or biological mechanisms, or which alter the chemical or physical characteristics of the Ballast Water, must be approved in accordance with IMO Guidelines (Regulation D-3). Costs of compliance with these regulations may be substantial.

Once mid-ocean ballast water treatment requirements become mandatory under the BWM Convention, the cost of compliance could increase for ocean carriers and may have a material effect on our operations. However, many countries already regulate the discharge of ballast water carried by vessels from country to country to prevent the introduction of invasive and harmful species via such discharges. The U.S., for example, requires vessels entering its waters from another country to conduct mid-ocean ballast exchange, or undertake some alternate measure, and to comply with certain reporting requirements.

The IMO adopted the International Convention on Civil Liability for Oil Pollution Damage of 1969, as amended by different Protocols in 1976, 1984, and 1992, and amended in 2000 (“the CLC”). Under the CLC and depending on whether the country in which the damage results is a party to the 1992 Protocol to the CLC, a vessel’s registered owner may be strictly liable for pollution damage caused in the territorial waters of a contracting state by discharge of persistent oil, subject to certain exceptions. The 1992 Protocol changed certain limits on liability expressed using the International Monetary Fund currency unit, the Special Drawing Rights. The limits on liability have since been amended so that the compensation limits on liability were raised. The right to limit liability is forfeited under the CLC where the spill is caused by the shipowner’s actual fault and under the 1992 Protocol where the spill is caused by the shipowner’s intentional or reckless act or omission where the shipowner knew pollution damage would probably result. The CLC requires ships over 2,000 tons covered by it to maintain insurance covering the liability of the owner in a sum equivalent to an owner’s liability for a single incident. We have protection and indemnity insurance for environmental incidents. P&I Clubs in the International Group issue the required Bunkers Convention “Blue Cards” to enable signatory states to issue certificates. All of our vessels are in possession of a CLC State issued certificate attesting that the required insurance coverage is in force.

The IMO also adopted the International Convention on Civil Liability for Bunker Oil Pollution Damage (the “Bunker Convention”) to impose strict liability on ship owners (including the registered owner, bareboat charterer, manager or operator) for pollution damage in jurisdictional waters of ratifying states caused by discharges of bunker fuel. The Bunker Convention requires registered owners of ships over 1,000 gross tons to maintain insurance for pollution damage in an amount equal to the limits of liability under the applicable national or international limitation regime (but not exceeding the amount calculated in accordance with the LLMC). With respect to non-ratifying states, liability for spills or releases of oil carried as fuel in ship’s bunkers typically is determined by the national or other domestic laws in the jurisdiction where the events or damages occur.

Ships are required to maintain a certificate attesting that they maintain adequate insurance to cover an incident. In jurisdictions, such as the United States where the CLC or the Bunker Convention has not been adopted, various legislative schemes or common law govern, and liability is imposed either on the basis of fault or on a strict-liability basis.

#### Anti Fouling Requirements

In 2001, the IMO adopted the International Convention on the Control of Harmful Anti fouling Systems on Ships, or the “Anti fouling Convention.” The Anti fouling Convention, which entered into force on September 17, 2008, prohibits the use of organotin compound coatings to prevent the attachment of mollusks and other sea life to the hulls of vessels. Vessels of over 400 gross tons engaged in international voyages will also be required to undergo an initial survey before the vessel is put into service or before an International Anti fouling System Certificate is issued for the first time; and subsequent surveys when the anti fouling systems are altered or replaced. We have obtained Anti fouling System Certificates for all of our vessels that are subject to the Anti fouling Convention.

#### Compliance Enforcement

Noncompliance with the ISM Code or other IMO regulations may subject the ship owner or bareboat charterer to increased liability, may lead to decreases in available insurance coverage for affected vessels and may result in the denial of access to, or detention in, some ports. The USCG and European Union authorities have indicated that vessels not in compliance with the ISM Code by applicable deadlines will be prohibited from trading in U.S. and European Union ports, respectively. As of the date of this report, March 26, 2019, each of our vessels is ISM Code certified.

However, there can be no assurance that such certificates will be maintained in the future. The IMO continues to review and introduce new regulations. It is impossible to predict what additional regulations, if any, may be passed by the IMO and what effect, if any, such regulations might have on our operations.

#### United States Regulations

The U.S. Oil Pollution Act of 1990 and the Comprehensive Environmental Response, Compensation and Liability Act  
The U.S. Oil Pollution Act of 1990 (“OPA”) established an extensive regulatory and liability regime for the protection and cleanup of the environment from oil spills. OPA affects all “owners and operators” whose vessels trade or operate within the U.S., its territories and possessions or whose vessels operate in U.S. waters, which includes the U.S.’s territorial sea and its 200 nautical mile exclusive economic zone around the U.S. The U.S. has also enacted the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”), which applies to the discharge of hazardous substances other than oil, except in limited circumstances, whether on land or at sea. OPA and CERCLA both define “owner and operator” in the case of a vessel as any person owning, operating or chartering by demise, the vessel. Both OPA and CERCLA impact our operations.

Under OPA, vessel owners and operators are “responsible parties” and are jointly, severally and strictly liable (unless the spill results solely from the act or omission of a third party, an act of God or an act of war) for all containment and clean-up costs and other damages arising from discharges or threatened discharges of oil from their vessels, including bunkers (fuel). OPA defines these other damages broadly to include:

- (i) injury to, destruction or loss of, or loss of use of, natural resources and related assessment costs;
- (ii) injury to, or economic losses resulting from, the destruction of real and personal property;
- (iv) loss of subsistence use of natural resources that are injured, destroyed or lost;
- (iii) net loss of taxes, royalties, rents, fees or net profit revenues resulting from injury, destruction or loss of real or personal property, or natural resources;
- (v) lost profits or impairment of earning capacity due to injury, destruction or loss of real or personal property or natural resources; and
- (vi) net cost of increased or additional public services necessitated by removal activities following a discharge of oil, such as protection from fire, safety or health hazards, and loss of subsistence use of natural resources.

OPA contains statutory caps on liability and damages; such caps do not apply to direct cleanup costs. Effective December 21, 2015, the USCG adjusted the limits of OPA liability for a tank vessel, other than a single-hull tank vessel, over 3,000 gross tons liability to the greater of \$2,200 per gross ton or \$18,796,800 (subject to periodic adjustment for inflation). Effective December 21, 2015, the USCG adjusted the limits of OPA liability for non-tank vessels, edible oil tank vessels, and any oil spill response vessels, to the greater of \$1,100 per gross ton or \$939,800 (subject to periodic adjustment for inflation). These limits of liability do not apply if an incident was proximately caused by the violation of an applicable U.S. federal safety, construction or operating regulation by a responsible party (or its agent, employee or a person acting pursuant to a contractual relationship), or a responsible party's gross negligence or willful misconduct. The limitation on liability similarly does not apply if the responsible party fails or refuses to (i) report the incident where the responsible party knows or has reason to know of the incident; (ii) reasonably cooperate and assist as requested in connection with oil removal activities; or (iii) without sufficient cause, comply with an order issued under the Federal Water Pollution Act (Section 311 (c), (e)) or the Intervention on the High Seas Act.

CERCLA contains a similar liability regime whereby owners and operators of vessels are liable for cleanup, removal and remedial costs, as well as damages for injury to, or destruction or loss of, natural resources, including the reasonable costs associated with assessing the same, and health assessments or health effects studies. There is no liability if the discharge of a hazardous substance results solely from the act or omission of a third party, an act of God or an act of war. Liability under CERCLA is limited to the greater of \$300 per gross ton or \$5.0 million for vessels carrying a hazardous substance as cargo and the greater of \$300 per gross ton or \$500,000 for any other vessel. These limits do not apply (rendering the responsible person liable for the total cost of response and damages) if the release or threat of release of a hazardous substance resulted from willful misconduct or negligence, or the primary cause of the release was a violation of applicable safety, construction or operating standards or regulations. The limitation on liability also does not apply if the responsible person fails or refused to provide all reasonable cooperation and assistance as requested in connection with response activities where the vessel is subject to OPA.

OPA and CERCLA each preserve the right to recover damages under existing law, including maritime tort law. OPA and CERCLA both require owners and operators of vessels to establish and maintain with the USCG evidence of financial responsibility sufficient to meet the maximum amount of liability to which the particular responsible person may be subject. Vessel owners and operators may satisfy their financial responsibility obligations by providing a proof of insurance, a surety bond, qualification as a self-insurer or a guarantee. We comply and plan to comply with the USCG's financial responsibility regulations by providing applicable certificates of financial responsibility.

The 2010 Deepwater Horizon oil spill in the Gulf of Mexico resulted in additional regulatory initiatives or statutes, including higher liability caps under OPA, new regulations regarding offshore oil and gas drilling, and a pilot inspection program for offshore facilities. However, several of these initiatives and regulations have been or may be revised. For example, the U.S. Bureau of Safety and Environmental Enforcement's ("BSEE") revised Production Safety Systems Rule ("PSSR"), effective December 27, 2018, modified and relaxed certain environmental and safety protections under the 2016 PSSR. Additionally, the BSEE released proposed changes to the Well Control Rule, which could roll back certain reforms regarding the safety of drilling operations, and the U.S. President proposed leasing new sections of U.S. waters to oil and gas companies for offshore drilling, expanding the U.S. waters that are available for such activity over the next five years. The effects of these proposals are currently unknown. Compliance with any new requirements of OPA and future legislation or regulations applicable to the operation of our vessels could impact the cost of our operations and adversely affect our business.

OPA specifically permits individual states to impose their own liability regimes with regard to oil pollution incidents occurring within their boundaries, provided they accept, at a minimum, the levels of liability established under OPA and some states have enacted legislation providing for unlimited liability for oil spills. Many U.S. states that border a navigable waterway have enacted environmental pollution laws that impose strict liability on a person for removal costs and damages resulting from a discharge of oil or a release of a hazardous substance. These laws may be more stringent than U.S. federal law. Moreover, some states have enacted legislation providing for unlimited liability for discharge of pollutants within their waters, although in some cases, states which have enacted this type of legislation have not yet issued implementing regulations defining vessel owners' responsibilities under these laws. The Company intends to comply with all applicable state regulations in the ports where the Company's vessels call.

We currently maintain pollution liability coverage insurance in the amount of \$1 billion per incident for each of our vessels. If the damages from a catastrophic spill were to exceed our insurance coverage, it could have an adverse effect on our business and results of operation.

#### Other United States Environmental Initiatives

The U.S. Clean Air Act of 1970 (including its amendments of 1977 and 1990) ("CAA") requires the EPA to promulgate standards applicable to emissions of volatile organic compounds and other air contaminants. Our vessels are subject to vapor control and recovery requirements for certain cargoes when loading, unloading, ballasting, cleaning and conducting other operations in regulated port areas. The CAA also requires states to draft State Implementation Plans, or SIPs, designed to attain national health-based air quality standards in each state. Although state-specific, SIPs may include regulations concerning emissions resulting from vessel loading and unloading operations by requiring the installation of vapor control equipment. Our vessels operating in such regulated port areas with restricted cargoes are equipped with vapor recovery systems that satisfy these existing requirements.

The U.S. Clean Water Act ("CWA") prohibits the discharge of oil, hazardous substances and ballast water in U.S. navigable waters unless authorized by a duly-issued permit or exemption, and imposes strict liability in the form of penalties for any unauthorized discharges. The CWA also imposes substantial liability for the costs of removal, remediation and damages and complements the remedies available under OPA and CERCLA. In 2015, the EPA expanded the definition of "waters of the United States" ("WOTUS"), thereby expanding federal authority under the CWA. Following litigation on the revised WOTUS rule, in December 2018, the EPA and Department of the Army proposed a revised, limited definition of "waters of the United States." The effect of this proposal on U.S. environmental regulations is still unknown.

The EPA and the USCG have also enacted rules relating to ballast water discharge, compliance with which requires the installation of equipment on our vessels to treat ballast water before it is discharged or the implementation of other port facility disposal arrangements or procedures at potentially substantial costs, and/or otherwise restrict our vessels from entering U.S. Waters.



The EPA will regulate these ballast water discharges and other discharges incidental to the normal operation of certain vessels within United States waters pursuant to the Vessel Incidental Discharge Act (“VIDA”), which was signed into law on December 4, 2018 and will replace the 2013 Vessel General Permit (“VGP”) program (which authorizes discharges incidental to operations of commercial vessels and contains numeric ballast water discharge limits for most vessels to reduce the risk of invasive species in U.S. waters, stringent requirements for exhaust gas scrubbers, and requirements for the use of environmentally acceptable lubricants) and current Coast Guard ballast water management regulations adopted under the U.S. National Invasive Species Act (“NISA”), such as mid-ocean ballast exchange programs and installation of approved USCG technology for all vessels equipped with ballast water tanks bound for U.S. ports or entering U.S. waters. VIDA establishes a new framework for the regulation of vessel incidental discharges under Clean Water Act (CWA), requires the EPA to develop performance standards for those discharges within two years of enactment, and requires the U.S. Coast Guard to develop implementation, compliance, and enforcement regulations within two years of EPA’s promulgation of standards. Under VIDA, all provisions of the 2013 VGP and USCG regulations regarding ballast water treatment remain in force and effect until the EPA and U.S. Coast Guard regulations are finalized. Non-military, non-recreational vessels greater than 79 feet in length must continue to comply with the requirements of the VGP, including submission of a Notice of Intent (“NOI”) or retention of a PARI form and submission of annual reports. We have submitted NOIs for our vessels where required. Compliance with the EPA, U.S. Coast Guard and state regulations could require the installation of ballast water treatment equipment on our vessels or the implementation of other port facility disposal procedures at potentially substantial cost, or may otherwise restrict our vessels from entering U.S. waters.

#### European Union Regulations

In October 2009, the European Union amended a directive to impose criminal sanctions for illicit ship-source discharges of polluting substances, including minor discharges, if committed with intent, recklessly or with serious negligence and the discharges individually or in the aggregate result in deterioration of the quality of water. Aiding and abetting the discharge of a polluting substance may also lead to criminal penalties. The directive applies to all types of vessels, irrespective of their flag, but certain exceptions apply to warships or where human safety or that of the ship is in danger. Criminal liability for pollution may result in substantial penalties or fines and increased civil liability claims. Regulation (EU) 2015/757 of the European Parliament and of the Council of 29 April 2015 (amending EU Directive 2009/16/EC) governs the monitoring, reporting and verification of carbon dioxide emissions from maritime transport, and, subject to some exclusions, requires companies with ships over 5,000 gross tonnage to monitor and report carbon dioxide emissions annually starting on January 1, 2018, which may cause us to incur additional expenses.

The European Union has adopted several regulations and directives requiring, among other things, more frequent inspections of high-risk ships, as determined by type, age, and flag as well as the number of times the ship has been detained. The European Union also adopted and extended a ban on substandard ships and enacted a minimum ban period and a definitive ban for repeated offenses. The regulation also provided the European Union with greater authority and control over classification societies, by imposing more requirements on classification societies and providing for fines or penalty payments for organizations that failed to comply. Furthermore, the EU has implemented regulations requiring vessels to use reduced sulfur content fuel for their main and auxiliary engines. The EU Directive 2005/33/EC (amending Directive 1999/32/EC) introduced requirements parallel to those in Annex VI relating to the sulfur content of marine fuels. In addition, the EU imposed a 0.1% maximum sulfur requirement for fuel used by ships at berth in EU ports.

#### Greenhouse Gas Regulation

Currently, the emissions of greenhouse gases from international shipping are not subject to the Kyoto Protocol to the United Nations Framework Convention on Climate Change, which entered into force in 2005 and pursuant to which adopting countries have been required to implement national programs to reduce greenhouse gas emissions with targets extended through 2020. International negotiations are continuing with respect to a successor to the Kyoto Protocol, and restrictions on shipping emissions may be included in any new treaty. In December 2009, more than 27 nations, including the U.S. and China, signed the Copenhagen Accord, which includes a non-binding commitment to

reduce greenhouse gas emissions. The 2015 United Nations Climate Change Conference in Paris resulted in the Paris Agreement, which entered into force on November 4, 2016 and does not directly limit greenhouse gas emissions from ships. On June 1, 2017, the U.S. President announced that the United States intends to withdraw from the Paris Agreement. The timing and effect of such action has yet to be determined, but the Paris Agreement provides for a four-year exit process.

At MEPC 70 and MEPC 71, a draft outline of the structure of the initial strategy for developing a comprehensive IMO strategy on reduction of greenhouse gas emissions from ships was approved. In accordance with this roadmap, in April 2018, nations at the MEPC 72 adopted an initial strategy to reduce greenhouse gas emissions from ships. The initial strategy identifies “levels of ambition” to reducing greenhouse gas emissions, including (1) decreasing the carbon intensity from ships through implementation

of further phases of the EEDI for new ships; (2) reducing carbon dioxide emissions per transport work, as an average across international shipping, by at least 40% by 2030, pursuing efforts towards 70% by 2050, compared to 2008 emission levels; and (3) reducing the total annual greenhouse emissions by at least 50% by 2050 compared to 2008 while pursuing efforts towards phasing them out entirely. The initial strategy notes that technological innovation, alternative fuels and/or energy sources for international shipping will be integral to achieve the overall ambition. These regulations could cause us to incur additional substantial expenses.

The EU made a unilateral commitment to reduce overall greenhouse gas emissions from its member states from 20% of 1990 levels by 2020. The EU also committed to reduce its emissions by 20% under the Kyoto Protocol's second period from 2013 to 2020. Starting in January 2018, large ships calling at EU ports are required to collect and publish data on carbon dioxide emissions and other information.

In the United States, the EPA issued a finding that greenhouse gases endanger the public health and safety, adopted regulations to limit greenhouse gas emissions from certain mobile sources, and proposed regulations to limit greenhouse gas emissions from large stationary sources. However, in March 2017, the U.S. President signed an executive order to review and possibly eliminate the EPA's plan to cut greenhouse gas emissions. The EPA or individual U.S. states could enact environmental regulations that would affect our operations.

Any passage of climate control legislation or other regulatory initiatives by the IMO, the EU, the U.S. or other countries where we operate, or any treaty adopted at the international level to succeed the Kyoto Protocol or Paris Agreement, that restricts emissions of greenhouse gases could require us to make significant financial expenditures which we cannot predict with certainty at this time. Even in the absence of climate control legislation, our business may be indirectly affected to the extent that climate change may result in sea level changes or certain weather events.

#### International Labour Organization

The International Labour Organization (the "ILO") is a specialized agency of the UN that has adopted the Maritime Labour Convention 2006 ("MLC 2006"). A Maritime Labour Certificate and a Declaration of Maritime Labour Compliance is required to ensure compliance with the MLC 2006 for all ships above 500 gross tons in international trade. We believe that all our vessels are in substantial compliance with and are certified to meet MLC 2006.

#### Vessel Security Regulations

Since the terrorist attacks of September 11, 2001 in the United States, there have been a variety of initiatives intended to enhance vessel security such as the U.S. Maritime Transportation Security Act of 2002 ("MTSA"). To implement certain portions of the MTSA, the USCG issued regulations requiring the implementation of certain security requirements aboard vessels operating in waters subject to the jurisdiction of the United States and at certain ports and facilities, some of which are regulated by the EPA.

Similarly, Chapter XI-2 of the SOLAS Convention imposes detailed security obligations on vessels and port authorities and mandates compliance with the International Ship and Port Facilities Security Code ("the ISPS Code"). The ISPS Code is designed to enhance the security of ports and ships against terrorism. To trade internationally, a vessel must attain an International Ship Security Certificate ("ISSC") from a recognized security organization approved by the vessel's flag state. Ships operating without a valid certificate may be detained, expelled from, or refused entry at port until they obtain an ISSC. The various requirements, some of which are found in the SOLAS Convention, include, for example:

- on-board installation of automatic identification systems to provide a means for the automatic transmission of safety-related information from among similarly equipped ships and shore stations, including information on a ship's identity, position, course, speed and navigational status;
- on-board installation of ship security alert systems, which do not sound on the vessel but only alert the authorities on shore;

- the development of vessel security plans;
- ship identification number to be permanently marked on a vessel's hull;
- a continuous synopsis record kept onboard showing a vessel's history including the name of the ship, the state whose flag the ship is entitled to fly, the date on which the ship was registered with that state, the ship's identification number, the port at which the ship is registered and the name of the registered owner(s) and their registered address;
- and
- compliance with flag state security certification requirements.

The USCG regulations, intended to align with international maritime security standards, exempt non-U.S. vessels from MTSA vessel security measures, provided such vessels have on board a valid ISSC that attests to the vessel's compliance with the SOLAS Convention security requirements and the ISPS Code. Future security measures could have a significant financial impact on us. We intend to comply with the various security measures addressed by MTSA, the SOLAS Convention and the ISPS Code.

The cost of vessel security measures has also been affected by the escalation in the frequency of acts of piracy against ships, notably off the coast of Somalia, including the Gulf of Aden and Arabian Sea area. Substantial loss of revenue and other costs may be incurred as a result of detention of a vessel or additional security measures, and the risk of uninsured losses could significantly affect our business. Costs are incurred in taking additional security measures in accordance with Best Management Practices to Deter Piracy, notably those contained in the BMP4 industry standard.

#### Offshore Drilling Regulations

Our offshore drilling units are subject to many of the above environmental laws and regulations relating to vessels, but are also subject to laws and regulations focused on offshore drilling operations. We may incur costs to comply with these revised standards.

Rigs must comply with applicable MARPOL limits on sulfur oxide and nitrogen oxide emissions, chlorofluorocarbons, and the discharge of other air pollutants, and also with the Bunker Convention's strict liability for pollution damage caused by discharges of bunker fuel in jurisdictional waters of ratifying states. We believe that all of our drilling units are currently compliant in all material respects with these regulations.

Furthermore, any drilling units that we may operate in U.S. waters, including the U.S. territorial sea and the 200 nautical mile exclusive economic zone around the United States, would have to comply with OPA and CERCLA requirements, among others, that impose liability (unless the spill results solely from the act or omission of a third party, an act of God or an act of war) for all containment and clean-up costs and other damages arising from discharges of oil or other hazardous substances.

The U.S. Bureau of Ocean Energy Management, or BOEM, periodically issues guidelines for rig fitness requirements in the Gulf of Mexico and may take other steps that could increase the cost of operations or reduce the area of operations for our units, thus reducing their marketability. Implementation of BOEM guidelines or regulations may subject us to increased costs or limit the operational capabilities of our units, and could materially and adversely affect our operations and financial condition.

In addition to the MARPOL, OPA and CERCLA requirements described above, our international offshore drilling operations are subject to various laws and regulations in countries in which we operate, including laws and regulations relating to the importation of and operation of drilling units and equipment, currency conversions and repatriation, oil and gas exploration and development, environmental protection, taxation of offshore earnings and earnings of expatriate personnel, the use of local employees and suppliers by foreign contractors, and duties on the importation and exportation of drilling units and other equipment. New environmental or safety laws and regulations could be enacted, which could adversely affect our ability to operate in certain jurisdictions. Governments in some countries have become increasingly active in regulating and controlling the ownership of concessions and companies holding concessions, the exploration for oil and gas, and other aspects of the oil and gas industries in their countries. In some areas of the world, this governmental activity has adversely affected the amount of exploration and development work done by major oil and gas companies and may continue to do so. For example, on December 20, 2016, the U.S. President invoked a law that banned offshore oil and gas drilling in large areas of the Arctic and the Atlantic Seaboard. However, a recent executive order has called for review of that legislation, and it is unclear whether drilling will soon be permitted in those areas. The government of Canada simultaneously banned new drilling in Canadian Arctic waters. Operations in less developed countries can be subject to legal systems that are not as mature or predictable as those in more developed countries, which can lead to greater uncertainty in legal matters and proceedings. Implementation of new environmental laws or regulations that may apply to ultra-deepwater drilling units may subject us to increased costs or limit the operational capabilities of our drilling units and could materially and adversely affect our operations and financial condition.



### Inspection by Classification Societies

The hull and machinery of every commercial vessel must be classed by a classification society authorized by its country of registry. The classification society certifies that a vessel is safe and seaworthy in accordance with the applicable rules and regulations of the country of registry of the vessel and SOLAS. Most insurance underwriters make it a condition for insurance coverage and lending that a vessel be certified “in class” by a classification society which is a member of the International Association of Classification Societies, the IACS. The IACS has adopted harmonized Common Structural Rules, or the Rules, which apply to oil tankers and bulk carriers constructed on or after July 1, 2015. The Rules attempt to create a level of consistency between IACS Societies. All of our vessels are certified as being “in class” by all the applicable Classification Societies (e.g., American Bureau of Shipping, Lloyd's Register of Shipping).

A vessel must undergo annual surveys, intermediate surveys, drydockings and special surveys. In lieu of a special survey, a vessel's machinery may be on a continuous survey cycle, under which the machinery would be surveyed periodically over a five-year period. Every vessel is also required to be drydocked every 30 to 36 months for inspection of the underwater parts of the vessel. If any vessel does not maintain its class and/or fails any annual survey, intermediate survey, drydocking or special survey, the vessel will be unable to carry cargo between ports and will be unemployable and uninsurable which could cause us to be in violation of certain covenants in our loan agreements. Any such inability to carry cargo or be employed, or any such violation of covenants, could have a material adverse impact on our financial condition and results of operations.

### 100% Container Screening

On August 3, 2007, the United States signed into law the Implementing Recommendations of the 9/11 Commission Act of 2007 (or the 9/11 Commission Act). The 9/11 Commission Act amends the SAFE Port Act of 2006 to require that all containers being loaded at foreign ports onto vessels destined for the United States be scanned by nonintrusive imaging equipment and radiation detection equipment before loading.

As a result of the 100% scanning requirements added to the SAFE Port Act of 2006, ports that ship to the United States may need to install new x-ray machines and make infrastructure changes in order to accommodate the screening requirements. Such implementation requirements may change which ports are able to ship to the United States and shipping companies may incur significant increased costs. It is impossible to predict how this requirement will affect the industry as a whole, but changes and additional costs can be reasonably expected.

### Risk of Loss and Liability Insurance

#### General

The operation of any cargo vessel includes risks such as mechanical failure, physical damage, collision, property loss, cargo loss or damage and business interruption due to political circumstances in foreign countries, piracy incidents, hostilities and labor strikes. In addition, there is always an inherent possibility of marine disaster, including oil spills and other environmental mishaps, and the liabilities arising from owning and operating vessels in international trade. OPA, which imposes virtually unlimited liability upon shipowners, operators and bareboat charterers of any vessel trading in the exclusive economic zone of the United States for certain oil pollution accidents in the United States, has made liability insurance more expensive for shipowners and operators trading in the United States market. We carry insurance coverage as customary in the shipping industry. However, not all risks can be insured, specific claims may be rejected, and we might not be always able to obtain adequate insurance coverage at reasonable rates.

#### Hull and Machinery Insurance

We procure hull and machinery insurance, protection and indemnity insurance, which includes environmental damage and pollution insurance and war risk insurance and freight, demurrage and defense insurance for our fleet. We generally do not maintain insurance against loss of hire (except for certain charters for which we consider it appropriate), which covers business interruptions that result in the loss of use of a vessel.

#### Protection and Indemnity Insurance

The insurance of our vessels which are chartered on a bareboat basis or on a time charter basis to Frontline Shipping and the Golden Ocean Charterer is the responsibility of the bareboat charterers, Frontline Management or Golden Ocean Management, respectively, who arrange insurance in line with standard industry practice. We are responsible for the insurance of our other time chartered and voyage chartered vessels. In accordance with standard practice, we maintain marine hull and machinery and war



risks insurance, which include the risk of actual or constructive total loss, and protection and indemnity insurance with mutual assurance associations. From time to time we carry insurance covering the loss of hire resulting from marine casualties in respect of some of our vessels. Currently, the amount of coverage for liability for pollution, spillage and leakage available to us on commercially reasonable terms through protection and indemnity associations and providers of excess coverage is up to \$1 billion per vessel per occurrence. Protection and indemnity associations are mutual marine indemnity associations formed by shipowners to provide protection from large financial loss to one member by contribution towards that loss by all members.

We believe that our current insurance coverage is adequate to protect us against the accident-related risks involved in the conduct of our business and that we maintain appropriate levels of environmental damage and pollution insurance coverage, consistent with standard industry practice. However, there is no assurance that all risks are adequately insured against, that any particular claims will be paid, or that we will be able to procure adequate insurance coverage at commercially reasonable rates in the future.

#### Seasonality

A large part of our vessels are chartered at fixed rates on a long-term basis and seasonal factors do not have a significant direct effect on our business. Our tankers on charter to Frontline Shipping, our dry bulk carriers on charter to the Golden Ocean Charterer and our offshore supply vessels on charter to the Solstad Charterer are subject to profit sharing agreements and to the extent that seasonal factors affect the profits of the charterers of these vessels we will also be affected. We also have nine dry bulk carriers, two Suezmax tankers and two car carriers trading in the spot or short term time charter market, and the effects of seasonality may affect the earnings of these vessels.

#### C. ORGANIZATIONAL STRUCTURE

See Exhibit 8.1 for a list of our significant subsidiaries.

## D. PROPERTY, PLANTS AND EQUIPMENT

We own a substantially modern fleet of vessels. The following table sets forth the fleet that we own or charter-in as of March 26, 2019. All of the VLCCs, Suezmax tankers, product tankers and chemical tankers are double-hull vessels.

| Vessel                             | Approximate<br>Built | Dwt.    | Flag | Lease<br>Classification | Charter<br>Termination<br>Date |     |
|------------------------------------|----------------------|---------|------|-------------------------|--------------------------------|-----|
| <b>VLCCs</b>                       |                      |         |      |                         |                                |     |
| Front Hakata                       | 2002                 | 298,500 | BA   | Direct Financing        | 2025                           |     |
| Front Energy                       | 2004                 | 305,000 | MI   | Direct Financing        | 2027                           |     |
| Front Force                        | 2004                 | 305,000 | MI   | Direct Financing        | 2027                           |     |
| <b>Suezmaxes</b>                   |                      |         |      |                         |                                |     |
| Glorycrown                         | 2009                 | 156,000 | MI   | n/a                     | n/a                            | (4) |
| Everbright                         | 2010                 | 156,000 | MI   | n/a                     | n/a                            | (4) |
| <b>Capesize Dry Bulk Carriers</b>  |                      |         |      |                         |                                |     |
| Belgravia                          | 2009                 | 170,000 | MI   | Operating               | 2025                           | (1) |
| Battersea                          | 2009                 | 170,000 | MI   | Operating               | 2025                           | (1) |
| Golden Magnum                      | 2009                 | 180,000 | HK   | Operating               | 2025                           | (1) |
| Golden Beijing                     | 2010                 | 176,000 | HK   | Operating               | 2025                           | (1) |
| Golden Future                      | 2010                 | 176,000 | HK   | Operating               | 2025                           | (1) |
| Golden Zhejiang                    | 2010                 | 176,000 | HK   | Operating               | 2025                           | (1) |
| Golden Zhoushan                    | 2011                 | 176,000 | HK   | Operating               | 2025                           | (1) |
| KSL China                          | 2013                 | 180,000 | MI   | Operating               | 2025                           | (1) |
| <b>Kamsarmax Dry Bulk Carriers</b> |                      |         |      |                         |                                |     |
| Sinochart Beijing                  | 2012                 | 82,000  | HK   | Operating               | 2022                           |     |
| Min Sheng 1                        | 2012                 | 82,000  | HK   | Operating               | 2022                           |     |
| <b>Handysize Dry Bulk Carriers</b> |                      |         |      |                         |                                |     |
| SFL Spey                           | 2011                 | 34,000  | HK   | n/a                     | n/a                            | (4) |
| SFL Medway                         | 2011                 | 34,000  | HK   | n/a                     | n/a                            | (4) |
| SFL Trent                          | 2012                 | 34,000  | HK   | n/a                     | n/a                            | (4) |
| SFL Kent                           | 2012                 | 34,000  | HK   | n/a                     | n/a                            | (4) |
| SFL Tyne                           | 2012                 | 32,000  | HK   | n/a                     | n/a                            | (4) |
| SFL Clyde                          | 2012                 | 32,000  | HK   | n/a                     | n/a                            | (4) |
| SFL Dee                            | 2013                 | 32,000  | HK   | n/a                     | n/a                            | (4) |
| <b>Product Tankers</b>             |                      |         |      |                         |                                |     |
| SFL Trinity                        | 2017                 | 114,000 | MI   | Operating               | 2024                           |     |
| SFL Sabine                         | 2017                 | 114,000 | MI   | Operating               | 2024                           |     |
| <b>Chemical Tankers</b>            |                      |         |      |                         |                                |     |
| Maria Victoria V                   | 2008                 | 17,000  | PAN  | Operating               | 2021                           | (1) |
| SC Guangzhou                       | 2008                 | 17,000  | PAN  | Operating               | 2021                           | (1) |



## Container vessels

|                  |      |            |     |                  |             |
|------------------|------|------------|-----|------------------|-------------|
| MSC Margarita    | 2001 | 5,800 TEU  | LIB | Direct Financing | 2024(1) (7) |
| MSC Vidhi        | 2002 | 5,800 TEU  | LIB | Direct Financing | 2024(1) (7) |
| MSC Vaishnavi R. | 2002 | 4,100 TEU  | LIB | Operating        | 2021(1) (7) |
| MSC Julia R.     | 2002 | 4,100 TEU  | LIB | Operating        | 2021(1) (7) |
| MSC Arushi R.    | 2002 | 4,100 TEU  | LIB | Operating        | 2021(1) (7) |
| MSC Katya R.     | 2002 | 4,100 TEU  | LIB | Operating        | 2021(1) (7) |
| MSC Anisha R.    | 2002 | 4,100 TEU  | LIB | Operating        | 2020(1)     |
| MSC Vidisha R.   | 2002 | 4,100 TEU  | LIB | Operating        | 2020(1)     |
| MSC Zlata R.     | 2002 | 4,100 TEU  | LIB | Operating        | 2020(1)     |
| MSC Alice        | 2003 | 1,700 TEU  | MI  | Sales Type       | 2022(1)     |
| Heung-A Green    | 2005 | 1,700 TEU  | MAL | Operating        | 2020(1)     |
| Green Ace        | 2005 | 1,700 TEU  | MAL | Operating        | 2020(1)     |
| San Felipe       | 2014 | 8,700 TEU  | MI  | Operating        | 2021        |
| San Felix        | 2014 | 8,700 TEU  | MI  | Operating        | 2021        |
| San Fernando     | 2015 | 8,700 TEU  | MI  | Operating        | 2022        |
| San Francisca    | 2015 | 8,700 TEU  | MI  | Operating        | 2022        |
| Maersk Sarat     | 2015 | 9,500 TEU  | LIB | Operating        | 2020        |
| Maersk Skarstind | 2016 | 9,500 TEU  | LIB | Operating        | 2021        |
| Maersk Shivling  | 2016 | 9,300 TEU  | LIB | Operating        | 2021        |
| MSC Anna         | 2016 | 19,200 TEU | LIB | Direct Financing | 2031(1) (5) |
| MSC Viviana      | 2017 | 19,200 TEU | LIB | Direct Financing | 2032(1) (5) |
| MSC Alabama      | 1996 | 3,424 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Alyssa       | 2001 | 4,354 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Belle        | 1998 | 1,098 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Caitlin      | 1998 | 1,733 TEU  | LIB | Direct Financing | 2025(1)     |
| MSC Edith        | 1998 | 1,733 TEU  | LIB | Direct Financing | 2025(1)     |
| MSC Erminia      | 1993 | 3,720 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Giannina     | 1997 | 2,061 TEU  | PT  | Direct Financing | 2025(1)     |
| MSC Himanshi     | 1997 | 2,072 TEU  | LIB | Direct Financing | 2025(1)     |
| MSC Japan        | 1996 | 3,424 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Jemima       | 1994 | 2,394 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Korea        | 1996 | 3,424 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Mandy        | 1993 | 3,007 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Nilgun       | 1994 | 2,394 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Rossella     | 1993 | 3,502 TEU  | PAN | Direct Financing | 2025(1)     |
| MSC Santhya      | 1991 | 3,005 TEU  | PAN | Direct Financing | 2025(1)     |
| Thalassa Axia    | 2014 | 13,800 TEU | LIB | Operating        | 2024(6)     |
| Thalassa Doxa    | 2014 | 13,800 TEU | LIB | Operating        | 2024(6)     |
| Thalassa Mana    | 2014 | 13,800 TEU | LIB | Operating        | 2024(6)     |
| Thalassa Tyhi    | 2014 | 13,800 TEU | LIB | Operating        | 2024(6)     |
| Cap San Vincent  | 2015 | 10,600 TEU | MI  | Operating        | 2024(1) (6) |
| Cap San Lazaro   | 2015 | 10,600 TEU | MI  | Operating        | 2024(1) (6) |
| Cap San Juan     | 2015 | 10,600 TEU | MI  | Operating        | 2024(1) (6) |
| MSC Erica        | 2016 | 19,400 TEU | LIB | Direct Financing | 2033(1) (5) |
| MSC Reef         | 2016 | 19,400 TEU | LIB | Direct Financing | 2033(1) (5) |

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|                             |      |           |        |                  |         |
|-----------------------------|------|-----------|--------|------------------|---------|
| Car Carriers                |      |           |        |                  |         |
| Composer                    | 2005 | 6,500 CEU | HK     | n/a              | n/a (4) |
| Conductor                   | 2006 | 6,500 CEU | PAN    | n/a              | n/a (4) |
| Jack-Up Drilling Rigs       |      |           |        |                  |         |
| West Linus                  | 2014 | 450 ft    | NOR    | Direct Financing | 2029(1) |
| Ultra-Deepwater Drill Units |      |           |        |                  |         |
| West Hercules               | 2008 | 10,000 ft | PAN    | Direct Financing | 2024(1) |
| West Taurus                 | 2008 | 10,000 ft | PAN    | Direct Financing | 2024(1) |
| Supramax Dry Bulk Carriers  |      |           |        |                  |         |
| SFL Hudson                  | 2009 | 57,000    | MI     | Operating        | 2020    |
| SFL Yukon                   | 2010 | 57,000    | HK     | n/a              | n/a (4) |
| SFL Sara                    | 2011 | 57,000    | HK     | n/a              | n/a (4) |
| SFL Kate                    | 2011 | 57,000    | HK     | Operating        | 2021    |
| SFL Humber                  | 2012 | 57,000    | HK     | Operating        | 2022    |
| Offshore support vessels    |      |           |        |                  |         |
| Sea Leopard                 | 1998 | AHTS      | (2)CYP | Direct Financing | 2027    |
| Sea Cheetah                 | 2007 | AHTS      | (2)CYP | Operating        | 2027    |
| Sea Jaguar                  | 2007 | AHTS      | (2)CYP | Operating        | 2027    |
| Sea Halibut                 | 2007 | PSV       | (3)CYP | Operating        | 2027    |
| Sea Pike                    | 2007 | PSV       | (3)CYP | Operating        | 2027    |

Key to Flags: BA – Bahamas, CYP – Cyprus, HK – Hong Kong, LIB – Liberia, MAL – Malta, MI – Marshall Islands, PAN – Panama, PT – Portugal, NOR – Norway.

Notes:

- (1) Charterer has purchase options or obligations during the term or at the end of the charter.
- (2) Anchor handling tug supply vessel (AHTS).
- (3) Platform supply vessel (PSV).
- (4) Currently employed on a short-term charter or trading in the spot market.
- (5) Vessel chartered-in and out on direct financing leases
- (6) Vessel chartered-in as capital leases and out as operating leases
- (7) Extended in 2019. Lease assessment is preliminary and may change.

Substantially, all of our owned vessels and rigs are pledged under mortgages, excluding three of the 1,700 TEU container vessels, two 6,500 CEU car carriers and two chemical tankers.

Other than our interests in the vessels and drilling units described above, we do not own any material physical properties. We lease office space in Oslo from Seatankers Management Norway AS and in London from Frontline Corporate Services Ltd, both related parties.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.



## ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion should be read in conjunction with Item 3. "Selected Financial Data", Item 4. "Information on the Company" and our audited consolidated financial statements and notes thereto included herein.

## A. OPERATING RESULTS

## Overview

Following our spin-off from Frontline and the purchase of our original fleet in 2004, we have established ourselves as a leading international maritime asset-owning company with a large and diverse asset base across the maritime and offshore industries. A full fleet list is provided in Item 4.D "Information on the Company" showing the assets that we currently own and charter to our customers.

## Fleet Development

The following table summarizes the development of our active fleet of vessels, including four chartered-in container vessels and seven container vessels financed through sale and leaseback transactions:

| Vessel type                 | Total<br>fleet       | Additions/<br>Disposals | Total<br>fleet       | Additions/<br>Disposals | Total<br>fleet       |    |    |
|-----------------------------|----------------------|-------------------------|----------------------|-------------------------|----------------------|----|----|
|                             | December<br>31, 2016 | 2017                    | December<br>31, 2017 | 2018                    | December<br>31, 2018 |    |    |
| Oil Tankers                 | 15                   | -4                      | 11                   | -6                      | 5                    |    |    |
| Chemical tankers            | 2                    |                         | 2                    |                         | 2                    |    |    |
| Dry bulk carriers           | 22                   |                         | 22                   |                         | 22                   |    |    |
| Container vessels           | 21                   | +1                      | 22                   | +24                     | -1                   | 45 |    |
| Car carriers                | 2                    |                         | 2                    |                         | 2                    |    |    |
| Jack-up drilling rigs       | 2                    |                         | 2                    | -1                      | 1                    |    |    |
| Ultra-deepwater drill units | 2                    |                         | 2                    |                         | 2                    |    |    |
| Offshore support vessels    | 5                    |                         | 5                    |                         | 5                    |    |    |
| Product tankers             | —                    | +2                      | 2                    |                         | 2                    |    |    |
| Total Active Fleet          | 71                   | +3                      | -4                   | 70                      | +24                  | -8 | 86 |

There have not been any deliveries that have taken place or are scheduled to take place between year ended December 31, 2018 and filing date.

## Factors Affecting Our Current and Future Results

Principal factors that have affected our results since 2004, and are expected to affect our future results of operations and financial position, include:

- the earnings of our vessels under time charters and bareboat charters to Frontline Shipping, the Seadrill Charterers, the Golden Ocean Charterer and other charterers;
- the amount we receive under the profit sharing arrangements with Frontline Shipping, the Golden Ocean Charterer and the Solstad Charterer;
- the earnings and expenses related to any additional vessels that we acquire;
- earnings from the sale of assets and termination of charters;

- vessel management fees and operating expenses;
- administrative expenses;
- interest expenses; and
- mark-to-market adjustments to the valuation of our interest rate swaps and other derivative financial instruments.



## Revenues

As discussed above, Frontline Shipping was our principal customer when we were spun-off from Frontline in 2004. Since then we have increased our customer base from one to more than 10 customers including related parties Frontline Shipping, Seadrill and Golden Ocean. In the year ended December 31, 2018, Frontline Shipping accounted for approximately 8% of our consolidated operating revenues (2017: 15%, 2016: 28%). In the year ended December 31, 2018, the Company had eight Capesize dry bulk carriers leased to a subsidiary of Golden Ocean which accounted for approximately 13% of our consolidated operating revenues (2017: 14%, 2016: 12%).

In the year ended December 31, 2018, the Company had 29 container vessels on long-term bareboat charters to MSC, an unrelated party, which accounted for approximately 11% of our consolidated operating revenues in the year ended December 31, 2018 (2017: 10%, 2016: 4%). Following the acquisition of Hamburg Süd by Maersk in November 2017, the Company had 10 container vessels on long-term time charters to Maersk at December 31, 2018, which accounted for approximately 27% of our consolidated operating revenues (2017: 14%; 2016: 9%).

Our revenues arise primarily from our long-term, fixed-rate charters and as shown in Results of Operations below the majority of our income is derived from time charter income, however we also have finance lease interest and service income, and bareboat charter income from operating leases.

Our future earnings are dependent upon the continuation of existing lease arrangements and our continued investment in new lease arrangements. Future earnings may be significantly affected by the sale of vessels or a default by counterparties under our chartering agreements. Investments and sales which have affected our earnings since January 1, 2018, are listed in Item 4 above under acquisitions and disposals. Some of our lease arrangements contain purchase options which, if exercised by our charterers, will affect our future leasing revenues.

In 2013, we began to derive income from voyage charters. Currently, we have nine dry bulk carriers, two car carriers and two suezmax tankers trading in the spot or short term time charter market, where the effects of seasonality may affect the earnings of these vessels.

We have profit sharing agreements with some of our charterers, in particular with Frontline Shipping, the Golden Ocean Charterer, and the Solstad Charterer. Revenues received under profit sharing agreements depend upon the returns generated by the charterers from the deployment of our vessels. These returns are subject to market conditions which have historically been subject to significant volatility. Our main profit share income has arisen from our tankers chartered to Frontline Shipping. The profit sharing percentage with Frontline Shipping is 50% of earnings above time-charter rates, payable on a quarterly basis. In addition to the tankers chartered to Frontline Shipping, our eight Capesize dry bulk carriers on long-term charter to the Golden Ocean Charterer and our five offshore support vessels on long-term charter to the Solstad Charterer include profit sharing arrangements whereby we earn, respectively, a 33% or 50% share of profits earned by the vessels above threshold levels.

## Vessel Management and Operating Expenses

Our vessel-owning subsidiaries with vessels on charter to Frontline Shipping have entered into fixed rate management agreements with Frontline Management, under which Frontline Management is responsible for all technical management of the vessels. These subsidiaries each pay Frontline Management a fixed fee of \$9,000 per day per vessel for these services. An exception to this arrangement is for any vessel chartered to Frontline Shipping which is sub-chartered by them on a bareboat basis, for which no management fee is payable for the duration of bareboat sub-charter. Similarly, the vessels on time-charter to the Golden Ocean Charterer pay a fixed fee of \$7,000 per day per vessel to Golden Ocean Management, a wholly-owned subsidiary of Golden Ocean, for all technical management of

the vessels.

In addition to the three vessels on charter to Frontline Shipping and the eight vessels on charter to Golden Ocean Charterer, we also have 14 container vessels, five dry bulk carriers and two product tankers employed on time charters, and two Suezmax tankers, nine dry bulk carriers and two car carriers employed in the spot or short term time charter market. We have outsourced the technical management for these vessels and we pay operating expenses for the vessels as they are incurred. Operating expenses include mainly crew costs, repairs and maintenance, spares and supplies, insurance, management fees and drydocking.

The remaining vessels we own that have charters attached to them are employed on bareboat charters, where the charterer pays all operating expenses, including maintenance, drydocking and insurance.

### Administrative Expenses

Administrative expenses consist of general corporate overhead expenses, including personnel costs, property costs, legal and professional fees, and other administrative expenses. Personnel costs include, among other things, salaries, pension costs, fringe benefits, travel costs and health insurance. We have entered into administrative services agreements with Frontline Management and Seatankers Management Co. Ltd., or Seatankers, under which they provide us with certain administrative support services, and have agreed to reimburse them for reasonable third party costs, if any, advanced on our behalf. Some of the compensation paid to Frontline Management and Seatankers is based on cost sharing for the services rendered, based on actual incurred costs plus a margin.

### Mark-to-Market Adjustments

In order to hedge against fluctuations in interest rates, we have entered into interest rate swaps which effectively fix the interest payable on a portion of our floating rate debt. We have also entered into interest/currency swaps in order to fix both the interest and exchange rates applicable to the payment of interest and eventual settlement on our floating rate NOK bonds. Although the intention is to hold such financial instruments until maturity, US GAAP requires us to record them at market valuation in our financial statements. Adjustments to the mark-to-market valuation of these derivative financial instruments, which are caused by variations in interest and exchange rates, are reflected in results of operations and other comprehensive income. Accordingly, our financial results may be affected by fluctuations in interest and exchange rates.

### Interest Expenses

Other than the interest expense associated with our senior unsecured convertible bonds, and our senior unsecured NOK bonds, the amount of our interest expense will be dependent on our overall borrowing levels and may significantly increase when we acquire vessels or on the delivery of newbuildings. Interest incurred during the construction of a newbuilding is capitalized in the cost of the newbuilding. Interest expense may also change with prevailing interest rates, although the effect of these changes may be reduced by interest rate swaps or other derivative instruments that we enter into.

### Equity in earnings of associated companies

Our income earned from Seadrill is through three wholly owned subsidiaries which are accounted for using the equity method, that lease drilling units to subsidiaries of Seadrill. In the year ended December 31, 2018, income from associated companies accounted for 39.1% of our net income (2017: 38.6%, 2016: 31.7%). The Company and these three wholly owned subsidiaries, agreed to the Restructuring Plan announced by Seadrill in September 2017. As part of the agreement, Ship Finance and these subsidiaries agreed to reduce the contractual charter hire payable by the relevant Seadrill subsidiaries by approximately 29% for five years starting in 2018, with the reduced amounts added back in the period thereafter.

### Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements in accordance with US GAAP requires management to make estimates and assumptions affecting the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our financial statements, and the reported amounts of revenues and expenses during the

reporting period. The following is a discussion of the accounting policies we apply that are considered to involve a higher degree of judgment in their application. For details of all our material accounting policies, see Note 2 to our consolidated financial statements.

#### Revenue Recognition

Effective from January 1, 2018, we adopted the new accounting standard ASC, Topic 606 "Revenue from Contracts with Customers" using the modified retrospective method, which resulted in no adjustment to our retained earnings on adoption and comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The Company generates its revenues from the charter hire of its vessels and offshore related assets, and freight billings. Revenues are generated from time charter hire, bareboat charter hire, direct financing lease interest income, sales-type lease interest income, finance lease service revenues, profit sharing arrangements, voyage charters and other freight billings.

In a time charter voyage, the vessel is hired by the charterer for a specified period of time in exchange for consideration which is based on a daily hire rate. Generally, the charterer has the discretion over the ports visited, shipping routes and vessel speed. The contract/charter party generally provides typical warranties regarding the speed and performance of the vessel. The charter party generally has some owner protective restrictions such that the vessel is sent only to safe ports by the charterer and carries only lawful or non hazardous cargo. In a time charter contract, we are responsible for all the costs incurred for running the vessel such as crew costs, vessel insurance, repairs and maintenance and lubes. The charterer bears the voyage related costs such as bunker expenses, port charges, canal tolls during the hire period. The performance obligations in a time charter contract are satisfied over the term of the contract beginning when the vessel is delivered to the charterer until it is redelivered back to us. The charterer generally pays the charter hire in advance of the upcoming contract period. The time charter contracts are either operating or direct financing or sales type leases. Where time charters and bareboat charters are considered operating leases revenues are recorded over the term of the charter as a service is provided. When a time charter contract is linked to an index, we recognize revenue for the applicable period based on the actual index for that period.

Rental payments from direct financing and sales-type leases are allocated between lease service revenues, if applicable, lease interest income and repayment of net investment in leases. The amount allocated to lease service revenue is based on the estimated fair value, at the time of entering the lease agreement, of the services provided which consist of ship management and operating services.

In a voyage charter contract, the charterer hires the vessel to transport a specific agreed-upon cargo for a single voyage. The consideration in such a contract is determined on the basis of a freight rate per metric ton of cargo carried or occasionally on a lump sum basis. The charterer is responsible for any short loading of cargo or "dead" freight. The voyage charter party generally has standard payment terms with freight paid on completion of discharge. The voyage charter party generally has a "demurrage" clause. As per this clause, the charterer reimburses us for any potential delays exceeding the allowed laytime as per the charter party clause at the ports visited, which is recorded as voyage revenue. Estimates and judgments are required in ascertaining the most likely outcome of a particular voyage and actual outcomes may differ from estimates. Such estimate is reviewed and updated over the term of the voyage charter contract. In a voyage charter contract, the performance obligations begin to be satisfied once the vessel begins loading the cargo.

We have determined that our voyage charter contracts consist of a single performance obligation of transporting the cargo within a specified time period. Therefore, the performance obligation is met evenly as the voyage progresses, and the revenue is recognized on a straight line basis over the voyage days from the commencement of loading to completion of discharge. Contract assets with regards to voyage revenues are reported as "Voyages in progress" as the performance obligation is satisfied over time. Voyage revenues typically become billable and due for payment on completion of the voyage and discharge of the cargo, at which point the receivable is recognized as "Trade accounts receivable, net".

In a voyage contract, the Company bears all voyage related costs such as fuel costs, port charges and canal tolls. To recognize costs incurred to fulfill a contract as an asset, the following criteria shall be met: (i) the costs relate directly to the contract, (ii) the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future and (iii) the costs are expected to be recovered. The costs incurred during the period prior to commencement of loading the cargo, primarily bunkers, are deferred as they represent setup costs and recorded as a current asset and are subsequently amortized on a straight-line basis as we satisfy the performance obligations under the contract. Costs incurred to obtain a contract, such as commissions, are also deferred and expensed over the same period.

For our vessels operating under revenue sharing agreements, or in pools, revenues and voyage expenses are pooled and allocated to each pool's participants in accordance with an agreed-upon formula. Revenues generated through

revenue sharing agreements are presented gross when we are considered the principal under the charter parties with the net income allocated under the revenue sharing agreement presented as within voyage charter income. For revenue sharing agreements that meet the definition of a lease, we account for such contracts as variable rate operating leases and recognize revenue for the applicable period based on the actual net revenue distributed by the pool.

Any contingent elements of rental income, such as profit share or interest rate adjustments, are recognized when the contingent conditions have materialized.

Frontline Shipping pays the Company a profit sharing rate of 50% of their earnings above average threshold charter rates on a time-charter equivalent basis from their use of the Company's fleet each quarter. For each profit sharing period, the threshold is calculated as the number of days in the period multiplied by the daily threshold TCE rates for the applicable vessels. The 50% profit sharing agreement with Frontline Shipping is payable on a quarterly basis.

In 2015, we acquired eight Capesize dry bulk carriers from subsidiaries of Golden Ocean and immediately upon delivery each vessel commenced a ten year time-charter to the Golden Ocean Charterer. The terms of the charters provide that we will receive a profit sharing rate of 33% of their earnings above average threshold charter rates, calculated quarterly on a time-charter equivalent basis.

In 2016, the charter agreements relating to five offshore support vessels chartered to the Solstad Charterer on a bareboat basis were amended and restated, including provisions whereby we will receive a profit sharing rate of 50% of each vessel's earnings above average threshold charter rates, calculated on a time-charter equivalent basis.

In the past, we have also received a 50% share of profits earned by some our dry bulk carriers operating on short-term time charters to United Freight Carriers, or UFC, a related party. All profit sharing revenues are recorded when earned and realizable.

#### Investment in Debt and Equity Securities

Investments in debt and equity securities include share investments and interest-earning listed and unlisted corporate bonds. Any premium paid on their acquisition is amortized over the life of the bond. Investments in debt securities are recorded at fair value, with unrealized gains and losses recorded as a separate component of other comprehensive income. Investments in equity securities are recorded at fair value, with unrealized gains and losses recorded in the consolidated statement of operations. If circumstances arise which lead the Company to believe that the issuer of a corporate bond may be unable meet its payment obligations in full, or that the fair value at acquisition of the share investment or corporate bond may otherwise not be fully recoverable, then to the extent that a loss is expected to arise that unrealized loss is recorded as an impairment in the statement of operations, with an adjustment if necessary to any unrealized gains or losses previously recorded in other comprehensive income. In determining whether the Company has an other-than-temporary impairment in its investment in bonds, in addition to the Company's intention and ability to hold the investments until the market recovers, the Company considers the period of decline, the amount and the severity of the decline and the ability of the investment to recover in the near to medium term. The Company also evaluates if the underlying security provided by the bonds is sufficient to ensure that the decline in fair value of these bonds did not result in an other-than-temporary impairment.

The cost of disposals or reclassifications from other comprehensive income is calculated on an average cost basis, where applicable.

The fair value of unlisted corporate bonds is determined from an analysis of projected cash flows, based on factors including the terms, provisions and other characteristics of the bonds, credit ratings and default risk of the issuing entity, the fundamental financial and other characteristics of that entity, and the current economic environment and trading activity in the debt market.

#### Vessels and Depreciation (including operating lease assets)

The cost of vessels and rigs less estimated residual value are depreciated on a straight line basis over their estimated remaining economic useful lives. The estimated economic useful life of our offshore assets, including drilling rigs and drillships, is 30 years and for all other vessels it is 25 years. These are common life expectancies applied in the shipping and offshore industries.

If the estimated economic useful life or estimated residual value of a particular vessel is incorrect, or circumstances change and the estimated economic useful life and/or residual value have to be revised, an impairment loss could result in future periods. We monitor the carrying values of our vessels, including direct financing lease assets, and revise the estimated useful lives and residual values of any vessels where appropriate, particularly when new regulations are implemented.

#### Vessels and Equipment under Capital Lease

The Company charters-in certain vessels and equipment under leasing agreements. Leases of vessels and equipment, where the Company has substantially all the risks and rewards of ownership, are classified as capital lease assets, with corresponding capital lease obligations recorded. Capital lease assets are capitalized at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments.

For sale and lease back transactions, when the asset sold is for more or less than its carrying amount, any indicated loss or gain on the sale is in substance a prepayment of rent or unearned rent, respectively, and thus, in accordance with ASC 840-40-35-4, the Company defers this prepaid or unearned rental and amortizes it over the lease term. In case the fair value of the asset sold is less than its carrying amount, any indicated loss on the sale is recognized in the consolidated statement of income as incurred.



Depreciation of vessels and equipment under capital lease is included within "Depreciation" in the consolidated statement of operations. Vessels and equipment under capital lease are depreciated on a straight-line basis over the vessels' remaining economic useful lives or on a straight-line basis over the term of the lease. The method applied is determined by the criteria by which the lease has been assessed to be a capital lease.

#### Investment in Direct Financing and Sales-Type Leases

Leases (charters) of our vessels where we are the lessor are classified as either direct financing or sales-type leases or operating leases, based on an assessment of the terms of the lease. For charters classified as direct financing leases, the minimum lease payments (reduced in the case of time-chartered vessels by projected vessel operating costs) plus the estimated residual value of the vessel are recorded as the gross investment in the capital lease.

For direct financing leases, the difference between the gross investment in the lease and the carrying value of the vessel is recorded as unearned lease interest income. The net investment in the lease consists of the gross investment less the unearned income. Over the period of the lease each charter payment received, net of vessel operating costs if applicable, is allocated between "lease interest income" and "repayment of investment in lease" in such a way as to produce a constant percentage rate of return on the balance of the net investment in the direct financing lease. Thus, as the balance of the net investment in each direct financing lease decreases, a lower proportion of each lease payment received is allocated to lease interest income and a greater proportion is allocated to lease repayment. For direct financing leases relating to time chartered vessels, the portion of each time charter payment received that relates to vessel operating costs is classified as "lease service revenue".

The implicit rate of return for each of the Company's direct financing leases is derived in accordance with Accounting Standards Codification, or ASC, Topic 840 "Leases" using the fair value of the asset at the lease inception, the minimum contractual lease payments and the estimated residual values.

For sales-type leases, the difference between the gross investment in the lease and the present value of its components, i.e. the minimum lease payments and the estimated residual value, is recorded as unearned lease interest income. The discount rate used in determining the present values is the interest rate implicit in the lease. The present value of the minimum lease payments, computed using the interest rate implicit in the lease, is recorded as the sales price, from which the carrying value of the vessel at the commencement of the lease is deducted in order to determine the profit or loss on sale. As is the case for direct financing leases, the unearned lease interest income is amortized to income over the period of the lease so as to produce a constant periodic rate of return on the net investment in the lease. In addition, in the case of a sales-type lease, the difference between the fair value (or sales price) and the carrying value (or cost) of the asset is recognized as "profit on sale" in the period in which the lease commences.

We estimate the unguaranteed residual value of our direct financing lease assets at the end of the lease period by calculating depreciation in accordance with our accounting policies over the estimated useful life of the asset. Residual values are reviewed at least annually to ensure that original estimates remain appropriate.

There is a degree of uncertainty involved in the estimation of the unguaranteed residual values of assets leased under both operating and direct financing or sales-type leases. Global effects of supply and demand for oil and other cargoes, and changes in international government regulations cause volatility in the spot market for second-hand vessels. Where assets are held until the end of their useful lives the unguaranteed residual value (i.e. scrap value) will fluctuate with the price of steel and any changes in laws related to the ship scrapping process, commonly known as ship breaking.

Classification of a lease involves the use of estimates or assumptions about fair values of leased vessels and expected future values of vessels. We generally base our estimates of fair value on independent broker valuations of each of

our vessels. Our estimates of expected future values of vessels are based on current fair values amortized in accordance with our standard depreciation policy for owned vessels.

#### Fixed Price Purchase Options

Where an asset is subject to an operating lease that includes fixed price purchase options, the projected net book value of the asset is compared to the option price at the various option dates. If any option price is less than the projected net book value at an option date, the initial depreciation schedule is amended so that the carrying value of the asset is written down on a straight line basis to the option price at the option date. If the option is not exercised, this process is repeated so as to amortize the remaining carrying value, on a straight line basis, to the estimated scrap value or the option price at the next option date, as appropriate.

Similarly, where a direct financing or sales-type lease relates to a charter arrangement containing fixed price purchase options, the projected carrying value of the net investment in the lease is compared to the option price at the various option dates. If any option price is less than the projected net investment in the lease at an option date, the rate of amortization of unearned finance lease interest income is adjusted to reduce the net investment in the lease to the option price at the option date. If the option is not exercised, this process is repeated so as to reduce the net investment in the lease to the un-guaranteed residual value or the option price at the next option date, as appropriate.

Thus, for operating assets and direct financing and sales-type lease assets, if an option is exercised there will either be (a) no gain or loss on the exercise of the option or (b) in the event that an option is exercised at a price in excess of the net book value of the asset or the net investment in the lease, as appropriate, at the option date, a gain will be reported in the statement of operations at the date of delivery to the new owners.

#### Impairment of Long-Lived Assets

The vessels and rigs held and used by us are reviewed for impairment on a quarterly basis and whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment charge would be recognized if the estimate of future undiscounted cash flows expected to result from the use of the vessel or rig and its eventual disposal is less than its carrying amount. When testing for impairment, we consider daily rates currently in effect for existing charters, the possibility of any medium or long-term charter arrangements being terminated early and, using historical trends, estimated daily rates for each vessel or rig for its remaining useful life not covered by existing charters. In assessing the recoverability of carrying amounts, we must make assumptions regarding estimated future cash flows. These assumptions include assumptions about spot market rates, operating costs and the estimated economic useful life of these assets. In making these assumptions we refer to five-year and ten-year historical trends and performance, as well as any known future factors. Factors we consider important which could affect recoverability and trigger impairment include significant underperformance relative to expected operating results, new regulations that change the estimated useful economic lives of our vessels and rigs, and significant negative industry or economic trends.

In the year ended December 31, 2016, reviews of the carrying value of long-lived assets indicated that one VLCC classified as held for sale and one container vessel were impaired, and charges were taken against these assets. In 2017, the reviews of the carrying value of long-lived assets resulted in no impairment charge being required. In 2018, reviews of the carrying value of long-lived assets indicated that five offshore support vessels and four VLCCs were impaired, and charges were taken against these assets.

#### Vessel Market Values

As we obtain information from various industry and other sources, our estimates of vessel market values are inherently uncertain. In addition, charter-free market values are highly volatile and any estimate of market value may not be indicative of the current or future basic market value of our vessels or prices that we could achieve if we were to sell them. Moreover, we are not holding our vessels for sale, except as otherwise noted in this report, and most of our vessels are currently employed under long-term charters or leases or other arrangements. There is not a ready liquid market for vessels that are subject to such arrangements.

During the past few years, the charter-free market values of vessels have experienced particular volatility, with substantial declines in many vessel classes. As a result, the charter-free market values of many of our vessels have declined below those vessels' carrying value. However, we would not impair those vessels' carrying value under our accounting impairment policy, if we expect future cash flows receivable from the vessels over their remaining useful lives, including existing charters, to exceed the carrying values of such vessels.

At December 31, 2018, we owned 75 vessels and rigs. Including the two ultra-deepwater drilling units and the harsh-environment jack-up drilling rig which are owned by equity accounted subsidiaries, the aggregate carrying value of these 75 assets at December 31, 2018, was \$2.8 billion, as summarized in the table below. The table is presented in the context of the markets in which the vessels operate, with crude oil tankers, oil product tankers and chemical tankers grouped together under "Tanker vessels", container vessels and car carriers grouped together under "Liners" and jack-up drilling rigs, ultra-deepwater drilling units and offshore support vessels grouped together under "Offshore units".

|                       | Number of<br>owned vessels | Aggregate carrying value at<br>December 31, 2018<br>(\$ millions) |
|-----------------------|----------------------------|---|
| Tanker vessels (1)    | 9                          | 340   |
| Dry bulk carriers (2) | 22                         | 539   |
| Liners (3)            | 36                         | 856   |
| Offshore units (4)    | 8                          | 1,063   |
|                       | 75                         | 2,798   |

(1) Includes nine vessels with an aggregate carrying value of \$340 million, which we believe exceeds their aggregate charter-free market value by approximately \$68 million.

(2) Includes 14 vessels with an aggregate carrying value of \$321 million, which we believe exceeds their aggregate charter-free market value by approximately \$133 million and eight vessels with an aggregate carrying value of \$218 million, which we believe is approximately \$23 million less than their aggregate charter-free market value.

(3) Includes nine vessels with an aggregate carrying value of \$357 million, which we believe exceeds their aggregate charter-free market value by approximately \$47 million, and 27 vessels with an aggregate carrying value of \$500 million, which we believe is approximately \$40 million less than their aggregate charter-free market value.

(4) Includes five vessels with an aggregate net carrying value of \$43 million, which we believe does not exceed their aggregate charter-free market value following their impairment at December 31, 2018, and three vessels with an aggregate carrying value of \$1,020 million, which we believe is approximately \$174 million less than their aggregate charter-free market value.

The above aggregate carrying value of \$2.8 billion at December 31, 2018, is made up of (a) \$221 million investments in direct finance leases (excluding the chartered-in container vessels MSC Anna, MSC Vivianna, MSC Erica and MSC Reef), (b) \$1,556 million vessels and equipment (excluding vessels and equipment under capital lease), (c) \$1,020 million carrying value of two ultra-deepwater drilling units and one jack-up drilling rig owned by equity accounted subsidiaries.

#### Obligations under Capital Lease

The Company charters-in certain vessels and equipment under leasing agreements. Leases of vessels and equipment, where the Company has substantially all the risks and rewards of ownership, are classified as capital lease assets, with corresponding capital lease obligations recorded. Capital lease assets are capitalized at the commencement of the lease at the lower between the fair value of the leased asset and the present value of the minimum lease payments. Each lease payment is allocated between liability and finance charges to achieve a constant rate on the capital balance outstanding. The interest element of the capital cost is charged to the Consolidated Statement of Operations over the lease period.

#### Convertible Bonds

The Company accounts for debt instruments with convertible features in accordance with the details and substance of the instruments at the time of their issuance. For convertible debt instruments issued at a substantial premium to equivalent instruments without conversion features, or those that may be settled in cash upon conversion, it is presumed that the premium or cash conversion option represents an equity component. Accordingly, the Company determines the carrying amounts of the liability and equity components of such convertible debt instruments by first determining the carrying amount of the liability component by measuring the fair value of a similar liability that does not have an equity component. The carrying amount of the equity component representing the embedded conversion option is then determined by deducting the fair value of the liability component from the total proceeds from the issue.

The resulting equity component is recorded, with a corresponding offset to debt discount which is subsequently amortized to interest cost using the effective interest method over the period the debt is expected to be outstanding as an additional non-cash interest expense. Transaction costs associated with the instrument are allocated pro-rata between the debt and equity components.

#### Mark-to-Market Valuation of Financial Instruments

The Company enters into interest rate and currency swap transactions, total return bond swaps and total return equity swaps. As required by ASC Topic 815 "Derivatives and Hedging", the mark-to-market valuations of these transactions are recognized as assets or liabilities, with changes in their fair value recognized in the consolidated statements of operations or, in the case of swaps designated as hedges to underlying loans, in other comprehensive income. To determine the market valuation of these instruments, we use a variety of assumptions that are based on market conditions and risks existing at each balance sheet date. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

#### Variable Interest Entities

A variable interest entity is defined in ASC Topic 810 "Consolidation" ("ASC 810") as a legal entity where either (a) the total equity at risk is not sufficient to permit the entity to finance its activities without additional subordinated support; (b) equity interest holders as a group lack either i) the power to direct the activities of the entity that most significantly impact on its economic success, ii) the obligation to absorb the expected losses of the entity, or iii) the right to receive the expected residual returns of the entity; or (c) the voting rights of some investors in the entity are not proportional to their economic interests and the activities of the entity involve or are conducted on behalf of an investor with a disproportionately small voting interest.

ASC 810 requires a variable interest entity to be consolidated by its primary beneficiary, being the interest holder, if any, which has both (1) the power to direct the activities of the entity which most significantly impact on the entity's economic performance, and (2) the right to receive benefits or the obligation to absorb losses from the entity which could potentially be significant to the entity.

In applying the provisions of ASC 810, we must make assessments in respect of, but not limited to, the sufficiency of the equity investment in the underlying entity and the extent to which interest holders have the power to direct activities. These assessments include assumptions about future revenues and operating costs, fair values of assets, and estimated economic useful lives of assets of the underlying entity.

#### Recent accounting pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02 "Leases" to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 creates a new Accounting Standards Codification Topic 842 "Leases" to replace the previous Topic 840 "Leases." ASU 2016-02 affects both lessees and lessors, although for the latter the provisions are similar to the previous model, but updated to align with certain changes to the lessee model and also the new revenue recognition provisions contained in Topic 606. ASU 2016-02 is effective for fiscal years and interim periods beginning after December 15, 2018. Early adoption is permitted. Accounting Standards Codification ("ASC") 842 provides a group of practical expedients that allows entities to not (i) reassess whether any expired or existing contracts are considered or contain leases; (ii) reassess the lease classification for any expired or existing leases; and (iii) reassess initial direct costs for any existing leases. The Company plans to adopt ASC 842 on January 1, 2019 and has elected the use of the practical expedients. Due to this election, the Company has determined the adoption of ASC 842 will not have a material impact on the consolidated financial statements.

In December 2018, the FASB issued ASU No. 2018-20 "Leases (Topic 842): Narrow-Scope Improvements for Lessors" to address issues facing lessors when applying the leases standard. The amendments addresses the following issues; (i) Sales taxes and other similar taxes collected from lessees, which permits lessors, as an accounting policy election, to not evaluate whether certain sales taxes and other similar taxes are lessor costs or lessee costs. Instead, those lessors will account for those costs as if they are lessee costs and exclude the costs from being reported as lease revenue with an associated expense. (ii) Certain lessor costs paid directly by lessees, whereby certain lessor costs require lessors to exclude from variable payments, and therefore revenue, lessor costs paid by lessees directly to third parties. The amendments also require lessors to account for costs excluded from the consideration of a contract that are paid by the lessor and reimbursed by the lessee as variable payments. A lessor will record those reimbursed costs as revenue. (iii) Recognition of variable payments for contracts with lease and non-lease components. The amendments relate to recognizing variable payments for contracts with lease and non-lease components require lessors to allocate (rather than recognize as currently required in the new leases standard) certain variable payments to the lease and non-lease components when the changes in facts and circumstances on which the variable payment is based occur. After the allocation, the amount of variable



payments allocated to the lease components will be recognized as income in profit or loss in accordance with the new leasing guidance, while the amount of variable payments allocated to non-lease components will be recognized in accordance with other accounting guidance, such as revenue from contracts with customers. ASU 2018-20 is effective for fiscal years and interim periods beginning after December 15, 2018. The Company has evaluated the adoption of ASU 2018-20 will not have a material impact on the consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13 "Financial Instruments - Credit Losses" to introduce new guidance for the accounting for credit losses on instruments within its scope. ASU 2016-13 requires among other things, the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable supportable forecasts. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for fiscal years and interim periods beginning after December 15, 2019. Early adoption is permitted. The Company is currently assessing the impact of ASU 2016-13 on its consolidated financial position, results of operations and cash flows.

In March 2017, the FASB issued ASU 2017-08 "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities" to amend the amortization period for certain purchased callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. ASU 2017-08 is effective for fiscal years and interim periods beginning after December 15, 2018. Early adoption is permitted. The impact on the consolidated financial statements of the Company will depend on the facts and circumstances of any specific future transactions.

In August 2017, the FASB issued ASU 2017-12 "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities" to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The amendments also simplify the application of hedge accounting in certain situations. ASU 2017-12 is effective for fiscal years and interim periods beginning after December 15, 2018. The Company has not elected to early adopt. The effect of the adoption of ASU 2017-12 will be that \$34.4 thousand of hedge ineffectiveness losses will be reclassified from retained earnings to other comprehensive income.

In July 2018, the FASB issued ASU 2018-10 "Codification Improvements to Topic 842, Leases" to provide amendments that affect narrow aspects of the guidance issued in the amendments in ASU 2016-02 including those regarding residual value guarantees, rate implicit in the lease, lessee reassessment of lease classification, lessor reassessment of lease term and purchase option, variable lease payments that depend on an index or a rate, investment tax credits, lease term and purchase option, transition guidance for amounts previously recognized in business combinations, certain transition adjustments, transition guidance for leases previously classified as capital leases under Topic 840, transition guidance for modifications to leases previously classified as direct financing or sales-type leases under Topic 840, transition guidance for sale and leaseback transactions, impairment of net investment in the lease, unguaranteed residual asset, effect of initial direct costs on rate implicit in the lease, and failed sale and leaseback transactions. ASU 2018-10 is effective for fiscal years and interim periods beginning after December 15, 2018. The Company does not expect that the adoption of ASU 2018-10 will have a material effect on the consolidated financial statements.

In October 2018, the FASB issued ASU No. 2018-16 "Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes." In the United States, eligible benchmark interest rates under Topic 815 are interest rates on

direct Treasury obligations of the U.S. government (UST), the London Interbank Offered Rate (LIBOR) swap rate, and the Overnight Index Swap (OIS) Rate based on the Fed Funds Effective Rate. When the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, in August 2017, it introduced the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate as the fourth permissible U.S. benchmark rate. The new ASU adds the OIS rate based on SOFR as a U.S. benchmark interest rate to facilitate the LIBOR to SOFR transition and provide sufficient lead time for entities to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes. ASU 2018-16 is effective for fiscal years and interim periods beginning after December 15, 2019. The Company is currently assessing the impact of ASU 2018-16 on the consolidated financial statements.

In November 2018, the FASB issued ASU No. 2018-18 "Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606", which defines a collaborative arrangement as a contractual arrangement under which two or more parties actively participate in a joint operating activity and are exposed to significant risks and rewards that depend on the activity's commercial success. The ASU provides guidance on how to assess whether certain transactions between collaborative arrangement participants should be accounted for within the revenue recognition standard.

The ASU also provides more comparability in the presentation of revenue for certain transactions between collaborative arrangement participants. It accomplishes this by allowing organizations to only present units of account in collaborative arrangements that are within the scope of the revenue recognition standard together with revenue accounted for under the revenue recognition standard. The parts of the collaborative arrangement that are not in the scope of the revenue recognition standard should be presented separately from revenue accounted for under the revenue recognition standard. ASU 2018-18 is effective for fiscal years and interim periods beginning after December 15, 2019. The Company does not expect that the adoption of ASU 2018-18 will have a material effect on the consolidated financial statements.

Also in November 2018, the FASB issued ASU No. 2018-19 "Codification Improvements to Topic 326, Financial Instruments-Credit Losses" to provide new guidance to mitigate the transition complexity by requiring entities other than public business entities, including not-for-profit organizations and certain employee benefit plans, to implement the credit losses standard issued in 2016, for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. This aligns the implementation date for their annual financial statements with the implementation date for their interim financial statements. The guidance also clarifies that receivables arising from operating leases are not within the scope of the credit losses standard, but rather, should be accounted for in accordance with the leases standard. ASU 2018-19 is effective for fiscal years and interim periods beginning after December 15, 2019. The Company is currently assessing the impact of ASU 2018-19 on the consolidated financial statements.

## Market Overview

### The Oil Tanker Market

According to industry sources, the tanker freight rates experienced an increase in 2014 and 2015 from the low levels in 2013. This increase was abruptly halted in 2016. Spot charter rates for VLCCs averaged \$41,488 per day in 2016, down from an average spot charter rate in 2015 of \$64,486 per day. A further decrease in rates was seen in 2017, where rates averaged \$17,794 per day for the full year. In the current year, the rates started out with a downward momentum, reaching a low of \$3,185 per day in May. The market strengthened significantly during the second half of 2018, peaking at average rates of \$45,317 in November. Suezmax tanker spot rates also saw an increase year on year from \$16,749 in December 2017 to \$42,108 in December 2018.

Overall, tonnage demand for tankers has increased by more than 2% in 2018, compared to a 4.7% growth in 2017. However, on the supply side, crude oil tanker capacity remained flat at 0.3% in 2018, compared to a growth of 5.4% in 2017.

This decrease in capacity relative to demand resulted in an increase in TCE rates for modern VLCCs and Suezmax tankers in the later part of 2018, reaching approximately \$33,000 and \$24,000 per day respectively.

The increase in rates during the second half of 2018 is partly attributable to total tanker demolition reaching 21m dwt in 2018, which is the highest level recorded since 1985. According to industry sources, at the end of 2018 the total order book for new VLCCs and Suezmax tankers consisted, respectively, of 99 vessels and 64 vessels, representing approximately 13% and 12% of the existing fleet.

### The Dry Bulk Shipping Market

According to industry sources, the dry bulk shipping market experienced a relatively positive year across all sectors of the drybulk market, following a good 2017. Fleet capacity increased nearly 3%, while tonnage demand increased by nearly 2.5%. However in the last quarter of the year, average bulker earnings fell by 10% on a year-on-year basis, representing the first decline since the end of 2016. While the overall supply-demand outlook currently seems balanced for the sector, a number uncertain risk factors are a cause for concern, such as global trade war, economic concerns and the uncertainty for Chinese imports.

The average one-year time charter rates for Capesize, Supramax and Handysize dry bulk carriers were, respectively, \$19,100 per day, \$12,800 per day and \$10,200 per day, representing increases from 2017 of 26%, 30% and 26%, respectively.

During the year, contracting for newbuilding dry bulk carriers decreased to 30.9 million dwt from 36.2 million dwt in 2017, while deliveries of new vessels amounted to 28 million dwt and scrapping removed some 4 million dwt. Thus, fleet capacity increased by 24 million dwt, equivalent to approximately 3% of the total fleet size. At the end of 2018, the total order book for new dry bulk carriers was 88.5 million dwt, equivalent to 11% of the existing fleet.

The Capesize spot rates for 2018 remained typically volatile, averaging \$15,614 per day in December compared with \$23,737 per day in December 2017. To further demonstrate the volatility in the sector, there was a 15% decrease in rates between September to December. However, overall, the Capesize sector saw an increase in average rates year-on-year of 4%, its highest level since 2011.

#### The Freight Liner Market (Containerships and Car Carriers)

According to industry sources, the container charter market saw broad improvements in 2018 compared to 2017. Charter rates improved on a full year average basis, while box freight rates on a whole were relatively flat. Throughout the year supply outgrew the demand expansion, softening the market fundamentals.

Global container trade is estimated to have grown by 4.3% in 2018, on the back of firm growth on the transpacific trade route.

Containership fleet capacity in 2018 expanded by a total of 5.6%, which was largely accounted for by the growth of 15,000+ TEU vessels that resulted in a 34% fleet increase in 2018. Containerships delivered in the full year 2018, totaled 168 vessels of 1.3 million TEU comparing to 148 vessels of 1.1 million TEU in 2017. Contracting for the segment stood at 190 vessels of 1.2 million TEU at 2018 year end and at the start of 2019, the order book amounted to 428 vessels, however deliveries are expected to slow for 0.9 million TEU in 2019 and 1.1 million TEU in 2020. At the same time recycling activity is projected to increase.

The ongoing changes in environmental and regulatory requirements continue to play an important role in the sector, with 266 container vessels, including delivered newbuildings, of 2.2 million TEU fitted or are due to be fitted with Sulfur Oxide, or SOx scrubbers at the start of 2019. Furthermore, consolidation within the sector continues to remain a key theme between a number of liner companies.

According to industry sources, seaborne car trade continued to grow in 2018 following an expansion in 2017, with volumes estimated to have risen by 6% in 2017, and are projected to grow by more than 3% in 2018 to 22.3 million cars (excluding intra-EU trade) in the full year. Historically, seaborne car trade had been one of the faster growing parts of seaborne trade, but expansion had been very limited in recent years. In 2016, seaborne car trade fell by 1% to 20.3 million cars, 2% lower than trade in 2013, with volumes also still below the 2007 peak. The low commodity price environment significantly undermined consumer demand in many developing countries in 2016 with 21.1 million cars shipped. Global seaborne trade is expected to slow in 2019 to 2.4%, with forecasted volumes to reach 22.9 million cars. Rising consumer demand is expected to drive continued growth in imports into South America and Africa. Sales in alternative energy vehicles, such as hybrid and electric cars are expected to continue to rise, particularly in European, Chinese and emerging markets.

#### The Offshore Drilling Market

According to industry sources, the price of oil (Brent crude spot) averaged around \$110 from 2011 to 2013, which was attractive to oil and gas companies and prompted them to substantially increase their investment in offshore exploration and development activity, resulting in full utilization and record high day rates for mobile offshore drilling units in 2013. However, over the course of 2014 the oil price fell to below \$50 per barrel in December 2014 and the fall continued to under \$30 per barrel in January 2016, although this recovered to an average of \$43 per barrel by the end of 2016. As a consequence of this fall in oil prices, oil and gas companies have significantly reduced their exploration and development activities, resulting in decidedly weaker demand in the offshore drilling market. However, the last two years has seen an increase to an average of \$54 per barrel in 2017, and a further increase to \$71 per barrel in 2018. According to industry sources, the demand for Ultra Deepwater drilling units stands at 29 Semis and 65 drill ships, totaling 94. The active supply amounts to 40 Semis and 80 Drill ships, corresponding to an active

utilization of 78.3% for the segment. There is still a total of 41 Ultra Deepwater drilling units cold stacked.

There is currently a total worldwide demand for harsh environment jack ups totaling 41 units, with a supply of 51 units, amounting to a utilization of 80.4%. There are four harsh environment jack ups that are still cold stacked on a worldwide basis.

### The Offshore Support Vessel ("OSV") Market

According to industry sources, the OSV market remains one of the most severely affected by the offshore downturn. During 2018, the OSV market remained depressed with several owners leaving this market during the year.

The OSV market has suffered due to significant debt and oversupply of vessels. During 2018, the market saw an overall number of 150 vessels being recycled, compared to the record-breaking year of 2017 which saw 143 vessels sold for recycling. Despite the market moving slowly, indications show that developments are moving in the right direction. Activity in both the Platform Supply ("PSV") and Anchor Handling Tug Supply ("AHTS") sector saw continuous growth in 2018, up 7% from the bottom seen during the first half of 2017. There are significant differences in regions, with positive signs in rates and utilization seen in the North Sea and in Brazil, with US Gulf and South East Asia seeing very little movement compared to market conditions at the end of 2017.

The above overviews of the various sectors in which we operate are based on current market conditions. However, market developments cannot always be predicted and may differ from our current expectations.

### Inflation

Most of our time chartered vessels are subject to operating and management agreements that have the charges for these services fixed for the term of the charter. Thus, although inflation has a moderate impact on our corporate overheads and our vessel operating expenses, we do not consider inflation to be a significant risk to direct costs in the current and foreseeable economic environment. In addition, in a shipping downturn, costs subject to inflation can usually be controlled because shipping companies typically monitor costs to preserve liquidity and encourage suppliers and service providers to lower rates and prices in the event of a downturn.

## Results of Operations

Year ended December 31, 2018, compared with year ended December 31, 2017

Net income for the year ended December 31, 2018, was \$73.6 million, a decrease of 27.3% from the year ended December 31, 2017.

| (in thousands of \$)                                      | 2018      | 2017      |
|---|-----------|-----------|
| Total operating revenues                                  | 418,712   | 380,878   |
| Gain/(loss) on sale of assets and termination of charters | (2,578 )  | 1,124     |
| Gain/(loss) on sale of subsidiaries and disposal groups   | 7,613     | —         |
| Total operating expenses                                  | 306,132   | 227,376   |
| Net operating income                                      | 117,615   | 154,626   |
| Interest income   | 17,951    | 19,330    |
| Interest expense  | (113,886) | (90,414 ) |
| Gain/(loss) on purchase of bonds                          | 1,146     | (2,305 )  |
| Other non-operating items (net)                           | 36,161    | (3,794 )  |
| Equity in earnings of associated companies                | 14,635    | 23,766    |
| Net income  | 73,622    | 101,209   |

Net operating income for the year ended December 31, 2018, was \$117.6 million, compared with \$154.6 million for the year ended December 31, 2017. The decrease was principally due to vessel impairment charges recorded against four VLCCs and five offshore supply vessels and a net loss on disposal of seven vessels offset by a gain on disposal of the subsidiary owning the jack-up rig Soehanah. Overall net income for 2018 decreased by \$27.6 million compared with 2017 mainly due to the decrease in net operating income, an increase in interest expense and lower earnings from equity accounted associated companies. This was offset by an increase in mark-to market gain on equity securities and gains on the divestment of bonds and shares in Golden Close.

Three ultra-deepwater drilling units were accounted for under the equity method during 2018 and 2017. The operating revenues of the wholly-owned subsidiaries owning these assets are included under "equity in earnings of associated companies", where they are reported net of operating and non-operating expenses.

| Operating revenues<br>(in thousands of \$) | 2018    | 2017    |
|--|---------|---------|
| Direct financing lease interest income     | 39,678  | 38,265  |
| Finance lease service revenues             | 22,095  | 35,010  |
| Profit sharing revenues                    | 1,779   | 5,814   |
| Time charter revenues                      | 292,726 | 238,409 |
| Bareboat charter revenues                  | 36,222  | 40,596  |
| Voyage charter revenues                    | 24,339  | 21,037  |
| Other operating income                     | 1,873   | 1,747   |
| Total operating revenues                   | 418,712 | 380,878 |

Total operating revenues increased by 9.9% in the year ended December 31, 2018, compared with the year ended December 31, 2017.



Direct financing and sales-type lease interest income arises on the Company's crude oil tankers on charter to Frontline Shipping, one offshore support vessel on charter to the Solstad Charterer and 20 container vessels on charter to MSC. In general, direct financing lease interest income reduces over the terms of our leases, as progressively a lesser proportion of the lease rental payment is allocated to interest income and a greater proportion is treated as repayment on the lease. The \$1.4 million increase in direct finance lease interest income from 2017 to 2018 is mainly a result of the addition of 15 second hand feeder size container vessels acquired in 2018. In addition two 19,400 TEU container vessels delivered in December 2018 on long-term charter to MSC contributed marginally to the increase. The increase was offset by the disposal of two Suezmax tankers in May 2017 and August 2017 and the sale of eight VLCC tankers between March 2017 and December 2018, and a reduction in lease income for one offshore supply vessel on charter to the Solstad Charterer following agreements to restructure and defer charterhire.

The \$12.9 million reduction in finance lease service revenue arose as a result of the sale of the eight VLCCs and two Suezmax tankers previously on charter to Frontline Shipping.

We have a profit sharing arrangement with Frontline Shipping whereby the Company earns a 50% share of profits earned by the vessels above threshold levels. The Company earned and recognized profit sharing revenue under this arrangement of \$1.5 million in the year ended December 31, 2018 compared with \$5.6 million in 2017. The decrease is attributable to a less favorable tanker market in 2018 and also fewer vessels on charter to Frontline Shipping. In addition, the Company has eight dry bulk carriers operating on time-charters to the Golden Ocean Charterer, which includes profit sharing arrangements whereby the Company earns a 33% share of profits earned by the vessels above threshold levels. In the year ended December 31, 2018, the Company earned \$0.2 million income under this arrangement compared with \$0.2 million profit share in 2017.

In addition, we had a profit sharing agreement on one of our two Suezmax tankers trading in a pool together with two tankers owned by Frontline, which earned us nil profit share income in 2018 compared with \$0.1 million in 2017.

Following amendments made to agreements in 2016, we also have a profit share arrangement relating to the five offshore supply vessels on charter to the Solstad Charterer, whereby the Company is entitled to a 50% profit share above the base charter rates, calculated and paid on a quarterly basis on a vessel by vessel basis. No profit share revenue was earned by the vessels in 2018 or in 2017 as all five vessels are in lay-up.

During 2018, time charter revenues were earned by 15 container vessels, two car carriers, 22 dry bulk carriers, one Suezmax tanker and two oil product tankers. The \$54.3 million increase in time charter revenues in 2018 compared with 2017, was mainly due to the addition of three 10,600 TEU container vessels in September and October 2018, four 13,800 TEU container vessels in May 2018, as well as the addition of two oil product tankers delivered from the shipyard in August 2017. These increases to time charter revenues were partly offset by the Suezmax, Everbright earning time charter revenue for the full year 2017 but only partially in the same period in 2018 due to the return of the vessel to voyage chartering following the expiry of a two-year time charter contract in February 2018.

Bareboat charter revenues are earned by our vessels and rigs which are leased under operating leases on a bareboat basis. In 2018 and 2017, these consisted of four offshore support vessels, two chemical tankers, one jack-up drilling rig, two 1,700 TEU container vessels, two 5,800 TEU container vessels and seven 4,100 TEU container vessels. The \$4.4 million decrease in bareboat charter revenues is mainly due to decrease in bareboat charter revenues was mainly due to lower revenues recorded for the four offshore support vessels. The decrease in bareboat charter revenue was partially offset by the jack-up drilling rig Soehanah, which earned \$3.6 million in bareboat revenue in 2018 compared to \$1.9 million in 2017. The rig was sold on December 31, 2018.

Two of our vessels, the Suezmax tankers Everbright and Glorycrown, and four Handysize dry bulk carriers operated on a voyage charter basis during 2018. In 2017, five Handysize dry bulk carriers and one of the Suezmax tankers operated on a voyage charter basis. The \$3.3 million increase in voyage charter revenues from 2017 to 2018 is mainly attributable to the trading patterns of the two Suezmax tankers trading in a pool together with two tankers owned by

Frontline. During the year ended December 31, 2018, there was an increase in voyage charter revenue from Everbright, which returned to voyage chartering during the year as described above. The Everbright increase was partly offset by a slight decrease in voyage charter income from Glorycrown. The 2018 increase in voyage charter revenues, compared to 2017, was also partially offset by a decrease resulting from the trading patterns of certain Handysize dry bulk carriers which earned more time charter revenues than voyages charter revenues.

## Cash flows arising from direct financing leases

The following table analyzes our cash flows from the direct financing leases with Frontline Shipping, the Solstad charterer, and MSC during 2018 and 2017, and shows how they are accounted for:

| (in thousands of \$)  | 2018   | 2017    |
|---|--------|---------|
| Charterhire payments accounted for as:                        |        |         |
| Direct financing and sales-type lease interest income         | 39,678 | 38,265  |
| Finance lease service revenues                                | 22,095 | 35,010  |
| Direct financing lease repayments                             | 33,486 | 31,929  |
| Total direct financing and sales-type lease payments received | 95,259 | 105,204 |

## Gain/(loss) on sale of assets and termination of charters

In 2018, a net loss of \$2.6 million was recorded, arising from the disposals of six crude oil tankers previously on charter to Frontline Shipping, and one container vessel, SFL Avon, sold in May 2018. In 2017, a net gain of \$1.1 million was recorded, arising from the disposals of four crude oil tankers, the commencement of a sales-type lease for the 1,700 TEU container vessel MSC Alice and the early termination of the previous charter for the jack-up drilling rig Soehanah. (see Note 8: Gain/(loss) on sale of assets and termination of charters).

## Gain/(loss) on sale of subsidiaries and disposal groups

In December 2018, the Company entered into an agreement to sell 100% of the share capital of Rig Finance Limited ("Rig Finance"), a wholly owned subsidiary, to an unrelated third party. Rig Finance owned the jack-up drilling rig Soehanah resulting in a net gain of \$7.6 million on the sale.

## Operating expenses

| (in thousands of \$)      | 2018    | 2017    |
|---------------------------|---------|---------|
| Vessel operating expenses | 128,548 | 131,794 |
| Depreciation              | 104,079 | 88,150  |
| Vessel impairment charge  | 64,338  | —       |
| Administrative expenses   | 9,167   | 7,432   |
|                           | 306,132 | 227,376 |

Vessel operating expenses include operating and occasional voyage expenses for the container vessels, dry bulk carriers, product tankers and car carriers operated on a time charter basis and managed by related and unrelated parties, and also voyage expenses from our two Suezmax tankers trading in a pool together with two tankers owned by Frontline and certain Handysize dry bulk carriers operating in the spot market during 2018. In addition, vessel operating expenses include payments to Frontline Management of \$9,000 per day for each vessel chartered to Frontline Shipping and also payments to Golden Ocean Management of \$7,000 per day for each vessel chartered the Golden Ocean Charterer, in accordance with the vessel management agreements.

Vessel operating expenses decreased by \$3.2 million in 2018, compared with 2017. The decrease is mainly due to the disposal of two Suezmax tankers in May 2017 and August 2017 and the sale of eight VLCC tankers between March 2017 and December 2018, as described above, from the fleet of crude oil tankers on charter to Frontline Shipping. The decrease was partly offset by the two oil product tankers delivered from the shipyard in August 2017 and the increases in expenses from the addition of three 10,600 TEU container vessels in September and October 2018, four 13,800 TEU container vessels in May 2018.

Depreciation expenses relate to the vessels on charters accounted for as operating leases and on voyage charters. The increase in depreciation by \$15.9 million for 2018 compared with 2017, was mainly due to the addition of the two product tankers, SFL Trinity and SFL Sabine delivered to the Company in August 2017, the acquisition of four 13,800

TEU container vessels in May 2018 and the addition of three 10,600 TEU container vessels in September and October 2018. The increase was partially offset by a decrease in depreciation for the jack-up drilling rig Soehanah, following the termination of its previous bareboat charter agreement. The basis of the previous higher depreciation was an amortization to an option price within the terminated agreement.

During 2018, a review of the carrying value of long-lived assets indicated that the carrying values of four of our VLCCs and five of our offshore supply vessels were other than temporarily impaired, resulting in an impairment charge of \$64.3 million recorded against their carrying values. In 2017, no vessel impairment charge was recorded. The 23% increase in administrative expenses for 2018, compared with 2017, is mainly due to increased salary costs due to increased headcount. Increases in professional fees, registration and travel activities also contributed to the higher administrative expenses.

#### Interest income

Interest income decreased from \$19.3 million in 2017 to \$18.0 million in 2018, mainly due to lower interest income from long term loans to associated companies as well as interest received on debt securities. This decrease was partly offset by increased interest income from short term deposits.

#### Interest expense

| (in thousands of \$)                              | 2018    | 2017   |
|---|---------|--------|
| Interest on US\$ floating rate loans              | 51,357  | 33,466 |
| Interest on NOK 600M floating rate bonds due 2017 | —       | 2,082  |
| Interest on NOK 900M floating rate bonds due 2019 | 4,597   | 4,691  |
| Interest on NOK 500M floating rate bonds due 2020 | 3,531   | 1,852  |
| Interest on NOK 600M floating rate bonds due 2023 | 1,232   | —      |
| Interest on 3.25% convertible bonds due 2018      | 171     | 5,107  |
| Interest on 5.75% convertible bonds due 2021      | 12,926  | 12,866 |
| Interest on 4.875% convertible bonds due 2023     | 5,448   | —      |
| Swap interest                                     | 2,661   | 5,328  |
| Interest on capital lease obligation              | 21,775  | 15,982 |
| Other interest                                    | —       | 26     |
| Amortization of deferred charges                  | 10,188  | 9,014  |
|   | 113,886 | 90,414 |

At December 31, 2018, the Company, including its consolidated subsidiaries, had total debt principal outstanding of \$1.5 billion (2017: \$1.5 billion), comprising \$77.7 million (NOK672 million) outstanding principal amount of NOK floating rate bonds due 2019 (2017: \$92.5 million, NOK758 million), \$57.8 million (NOK500 million) outstanding principal amount of NOK floating rate bonds due 2020 (2017: \$61.0 million, NOK 500 million), \$69.4 million (NOK600 million) outstanding principal amount of NOK floating rate bonds due 2023 (2017: \$nil, NOKnil), \$nil outstanding principal amount of 3.25% convertible bonds due 2018 (2017: \$63.2 million), \$212.2 million outstanding principal amount of 5.75% convertible bonds due 2021 (2017: \$225.0 million), \$151.7 million outstanding principal amount of 4.875% convertible bonds due 2023 (2017: \$nil), and \$0.9 billion under floating rate secured long term credit facilities (2017: \$1.1 billion). In addition, the Company, including its consolidated subsidiaries, had total capital lease debt obligations outstanding of \$1.2 billion (2017: \$0.2 billion).

The average three-month US\$ London Interbank Offered Rate, or LIBOR, was 2.30% in 2018 and 1.26% in 2017. The increase in interest expense associated with our floating rate debt for 2018, compared with 2017, is mainly due to the increase in LIBOR for the period and increases in loans.

The decrease in interest payable on the 3.25% convertible bonds due 2018 and the NOK 600 million floating rate bonds due 2017 is due to their redemption in February 2018 and July 2017, respectively. The increase in interest payable on the 4.875% convertible bonds and NOK 600 million floating rate bonds due 2023 is due to their issuance in April 2018 and September 2018, respectively.

At December 31, 2018, the Company and its consolidated subsidiaries were party to interest rate swap contracts, which effectively fixed our interest rates on \$0.9 billion of floating rate debt at a weighted average rate excluding margin of 2.92% per annum (2017: \$1.1 billion of floating rate debt fixed at a weighted average rate excluding margin of 2.85% per annum).

The above capital lease interest expense represents the interest portion of our capital lease obligations from four (2017: two) chartered-in 19,200 TEU and 19,400 TEU container vessels and from four (2017: nil) 13,800 TEU container vessels acquired in

May 2018 and three (2017: nil) 10,600 TEU vessels that were re-financed through Japanese Operating Leases with Call Option sale and leaseback financing ("JOLCO financing") (see Note: 21: Capital lease obligations and other long-term liabilities).

As reported above, two ultra-deepwater drilling units and one harsh environment jack-up drilling rig were accounted for under the equity method in 2018 and 2017. Their non-operating expenses, including interest expenses, are not included above, but are reflected in "Equity in earnings of associated companies" below.

#### Other non-operating items

In 2018, other non-operating items amounted to a net gain of \$36.2 million, compared to a net loss of \$3.8 million in 2017. The net gain of \$36.2 million for 2018 arose mainly from a gain on the disposal of bonds and shares in Golden Close of \$13.5 million, a gain of \$12.3 million from the mark-to-market of equity investments, \$13.9 million fair value increase in non-designated derivatives offset by \$0.7 million of net cash payments on non-designated derivatives and a net loss of \$2.0 million arising from foreign currency translation (see Note 10: Other financial items).

The net loss of \$3.8 million for 2017 arose mainly from \$5.1 million of net cash payments on non-designated interest rate swaps, an impairment loss recorded against available for sale investments of \$4.4 million and \$4.5 million of foreign exchange losses resulting mainly from the translation of de-designated NOK bonds. This expense was partly offset by a gain of \$8.1 million from positive mark-to-market adjustments to financial instruments and \$3.3 million dividend income received on the Frontline shares (see Note 24: Related party transactions).

#### Equity in earnings of associated companies

During 2018 and 2017, the Company had certain wholly-owned subsidiaries accounted for under the equity method, as discussed in the consolidated financial statements included herein (Note 17: Investment in associated companies). The total equity in earnings of associated companies in 2018 was \$9.1 million lower than in the comparative period in 2017 mainly due to the reduction in finance lease interest income recorded by the ultra-deepwater drilling units West Taurus and West Hercules and the harsh environment jack-up drilling rig West Linus. This is due to the amendments undertaken to the charter contracts for these rigs in connection with the Seadrill Restructuring Plan. Under the terms of the Restructuring Plan, the Company agreed to reduce the contractual charter hire for each of the three drilling units on charter to the Seadrill Charterers by approximately 29% for a period of five years with economic effect from January 2018, with the reduced amounts added back in the period thereafter. The term of the charters for West Hercules and West Taurus was also extended by 13 months until December 2024. In addition, the purchase obligations in the case of West Hercules and West Taurus and the put option in the case of West Linus at expiry of the charters were amended.

#### Year ended December 31, 2017, compared with year ended December 31, 2016

Net income for the year ended December 31, 2017, was \$101.2 million, a decrease of 30.9% from the year ended December 31, 2016.

| (in thousands of \$)                                      | 2017      | 2016      |
|---|-----------|-----------|
| Total operating revenues                                  | 380,878   | 412,951   |
| Gain/(loss) on sale of assets and termination of charters | 1,124     | (167 )    |
| Total operating expenses                                  | (227,376) | (244,695) |
| Net operating income                                      | 154,626   | 168,089   |
| Interest income   | 19,330    | 21,736    |
| Interest expense  | (90,414 ) | (71,843 ) |

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|  |          |          |
|--|----------|----------|
| Loss/(gain) on purchase of bonds           | (2,305 ) | (8,802 ) |
| Other non-operating items (net)            | (3,794 ) | 9,461    |
| Equity in earnings of associated companies | 23,766   | 27,765   |
| Net income                                 | 101,209  | 146,406  |

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Net operating income for the year ended December 31, 2017, was \$154.6 million, compared with \$168.1 million for the year ended December 31, 2016. The decrease was principally due to lower profit sharing revenues. Overall net income for 2017 decreased by \$45.2 million compared with 2016 mainly due to the decrease in net operating income and an increase in interest expense. In addition, lower interest and dividend income from investments, exchange losses and costs arising from the redemption of bonds and impairment charges for certain investments included in other non-operating items all contributed to the decrease in overall net income. This was partly offset by an increase in income from the mark-to-market of derivatives.

Three ultra-deepwater drilling units were accounted for under the equity method during 2017 and 2016. The operating revenues of the wholly-owned subsidiaries owning these assets are included under "equity in earnings of associated companies", where they are reported net of operating and non-operating expenses.

|  |         |         |
|--|---------|---------|
| Operating revenues                     |         |         |
| (in thousands of \$)                   | 2017    | 2016    |
| Direct financing lease interest income | 38,265  | 23,181  |
| Finance lease service revenues         | 35,010  | 44,523  |
| Profit sharing revenues                | 5,814   | 51,544  |
| Time charter revenues                  | 238,409 | 226,748 |
| Bareboat charter revenues              | 40,596  | 45,039  |
| Voyage charter revenues                | 21,037  | 19,329  |
| Other operating income                 | 1,747   | 2,587   |
| Total operating revenues               | 380,878 | 412,951 |

Total operating revenues decreased by 7.8% in the year ended December 31, 2017, compared with the year ended December 31, 2016.

Direct financing and sales-type lease interest income arises on most of our crude oil tankers on charter to Frontline Shipping, one offshore support vessel on charter to the Solstad Charterer and three container vessels on long term charter to MSC. In general, direct financing lease interest income reduces over the terms of our leases, as progressively a lesser proportion of the lease rental payment is allocated to interest income and a greater proportion is treated as repayment on the lease. The \$15.1 million increase in direct finance lease interest income from 2016 to 2017 is mainly a result of the addition of the three container vessels on long-term charter to MSC. Two of the vessels are chartered-in 19,200 TEU container vessels, accounted for as finance lease assets, which were delivered in December 2016 and March 2017, respectively. The third one, a 1,700 TEU container vessel which was previously an operating lease asset, is now accounted for as a sales-type lease following the commencement of a five-year bareboat charter to MSC in April 2017. The increase in direct finance lease interest income was partly offset by the sale of two Suezmax tankers in May 2017 and August 2017, respectively, in addition to the sale of three VLCC tankers in July 2016, March 2017 and June 2017, respectively, and one offshore support vessel in February 2016, all of which were accounted for as direct financing lease assets.

The \$9.5 million reduction in finance lease service revenue arose as a result of the sale of the three VLCCs and two Suezmax tankers.

We have a profit sharing arrangement with Frontline Shipping whereby the Company earns a 50% share of profits earned by the vessels above threshold levels. The Company earned and recognized profit sharing revenue under this arrangement of \$5.6 million in the year ended December 31, 2017 compared with \$50.9 million in 2016. The decrease is attributable to a less favourable tanker market in 2017 and also fewer vessels on charter to Frontline Shipping. In addition, the Company has eight dry bulk carriers operating on time-charters to the Golden Ocean Charterer, which

includes profit sharing arrangements whereby the Company earns a 33% share of profits earned by the vessels above threshold levels. In the year ended December 31, 2017, the Company earned \$0.2 million income under this arrangement compared with no profit share in 2016. We also had a profit sharing agreement relating to dry bulk carriers chartered to UFC in 2016, which earned us \$0.6 million in 2016. In 2017, we did not have any vessels on charter to UFC.

In addition, we had a profit sharing agreement on one of our two Suezmax tankers trading in a pool together with two tankers owned by Frontline, which earned us \$0.1 million in 2017 compared with \$0.1 million in 2016.

Following amendments made to agreements in 2016, we also have a profit share arrangement relating to the five offshore supply vessels on charter to the Solstad Charterer, whereby the Company is entitled to a 50% profit share above the base charter rates, calculated and paid on a quarterly basis on a vessel by vessel basis. No profit share revenue was earned by the vessels in 2017 or in 2016 as all five vessels are in lay-up.

During 2017, time charter revenues were earned by eight container vessels, two car carriers, 22 dry bulk carriers, one Suezmax tanker and two oil product tankers. The \$11.7 million increase in time charter revenues in 2017 compared with 2016, was mainly due to the addition of the two product tankers delivered from the shipyard in August 2017 and also due to a full year of earnings in 2017 from two of the three 9,300 - 9,500 TEU container vessels that commenced time charter contracts in February 2016 and May 2016, respectively. These increases to time charter revenues were partly offset by the 1,700 TEU container vessel, MSC Alice earning time charter revenue in 2016 but none in the same period in 2017.

Bareboat charter revenues are earned by our vessels and rigs which are leased under operating leases on a bareboat basis. In 2017 and 2016, these consisted of four offshore support vessels, two chemical tankers, one jack-up drilling rig, two 1,700 TEU container vessels, two 5,800 TEU container vessels and seven 4,100 TEU container vessels. The \$4.4 million decrease in bareboat charter revenues is mainly due to the jack-up drilling rig Soehanah, which earned \$1.8 million lower bareboat revenue in 2017 compared with 2016. The rig received no charter hires during the first quarter of 2017 and was redelivered to us in April 2017, following a full 10-year special survey paid for by the previous charterer. In June 2017, the rig commenced a drilling contract with a national oil company in Asia for a period of 12 months, with an option to extend the charter by an additional 12 months. In addition, amendments to the charter agreements of the offshore support vessels on charter to the Solstad Charterer, which were effective from June 2016 and July 2017, respectively, also resulted in a reduction in bareboat charter revenue.

Two of our vessels, the Suezmax tankers Everbright and Glorycrown, and four Handysize dry bulk carriers operated on a voyage charter basis during 2016. In 2017, five Handysize dry bulk carriers and one of the Suezmax tankers operated on a voyage charter basis. The \$1.7 million increase in voyage charter revenues from 2016 to 2017 is predominantly due to the additional Handysize dry bulk carriers commencing trading on a voyage charter basis in 2017 partly offset by one of the two Suezmax tankers previously trading on a voyage charter basis commencing a time charter contract part way through 2016.

#### Cash flows arising from direct financing leases

The following table analyzes our cash flows from the direct financing leases with Frontline Shipping, the Solstad charterer, and MSC during 2017 and 2016, and shows how they are accounted for:

| (in thousands of \$)  | 2017    | 2016   |
|---|---------|--------|
| Charterhire payments accounted for as:                        |         |        |
| Direct financing and sales-type lease interest income         | 38,265  | 23,181 |
| Finance lease service revenues                                | 35,010  | 44,523 |
| Direct financing lease repayments                             | 31,929  | 30,410 |
| Total direct financing and sales-type lease payments received | 105,204 | 98,114 |

The vessels chartered on direct financing leases to Frontline Shipping, are leased on time-charter terms, where we are responsible for the management and operation of such vessels. This has been effected by entering into fixed price agreements with Frontline Management whereby we pay them management fees of \$9,000 per day for each vessel chartered to Frontline Shipping. Accordingly, \$9,000 per day is allocated from each time charter payment received from Frontline Shipping to cover lease executory costs, and this is classified as "finance lease service revenue". If any vessel chartered on a direct financing lease to Frontline Shipping is sub-chartered on a bareboat basis, then the charter payments for that vessel are reduced by \$9,000 per day for the duration of the bareboat sub-charter.

Gain/(loss) on sale of assets and termination of charters

In 2017, a net gain of \$1.1 million was recorded, arising from the disposals of four crude oil tankers, the commencement of a sales-type lease for the 1,700 TEU container vessel MSC Alice and the early termination of the previous charter for the jack-up drilling rig Soehanah. (see Note 8: Gain/(loss) on sale of assets and termination of charters). In 2016, a loss of \$0.2 million was recorded on the disposals of the offshore supply vessel Sea Bear, sold in February 2016 and the VLCC Front Vanguard in July 2016.

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|                           |         |         |
|---------------------------|---------|---------|
| Operating expenses        |         |         |
| (in thousands of \$)      | 2017    | 2016    |
| Vessel operating expenses | 131,794 | 136,016 |
| Depreciation              | 88,150  | 94,293  |
| Vessel impairment charge  | —       | 5,314   |
| Administrative expenses   | 7,432   | 9,072   |
|                           | 227,376 | 244,695 |

Vessel operating expenses consist of payments to Frontline Management of \$9,000 per day for each vessel chartered to Frontline Shipping and also payments to Golden Ocean Management of \$7,000 per day for each vessel chartered to Golden Ocean Charterer, in accordance with the vessel management agreements. In addition, vessel operating expenses include operating and occasional voyage expenses for the container vessels, dry bulk carriers, product tankers and car carriers operated on a time charter basis and managed by related and unrelated parties, and also voyage expenses from our two Suezmax tankers trading in a pool together with two tankers owned by Frontline and certain Handysize dry bulk carriers operating in the spot market during 2017.

Vessel operating expenses decreased by \$4.2 million in 2017, compared with 2016. The decrease is mainly due to the sale of five tankers between July 2016 and August 2017, described above, from the fleet of crude oil tankers on charter to Frontline Shipping. The decrease was partly offset by the two product tankers delivered from the shipyard in August 2017 and the increases in voyage expenses from the net additional increase in Handysize dry bulk carriers that commenced trading on a voyage charter basis during the period.

Depreciation expenses relate to the vessels on charters accounted for as operating leases and on voyage charters. The decrease in depreciation by \$11.5 million for 2017 compared with 2016, is mainly due to a lower depreciation charge on the jack-up drilling rig Soehanah, following the termination of its previous bareboat charter agreement. The basis of the previous higher depreciation was an amortization to an option price within the terminated agreement.

During 2016, a review of the carrying value of long-lived assets indicated that the carrying values of one of our VLCCs, the sale of which was agreed in 2016 and which was delivered to its new owner in March 2017, and one of our 1,700 TEU container vessels were impaired and an impairment charge was taken. In 2017, no vessel impairment charge was recorded.

The 18% decrease in administrative expenses for 2017, compared with 2016, is mainly due to reduced salary costs, office costs, marketing and investor relations costs and service administration fees.

#### Interest income

Interest income decreased from \$21.7 million in 2016 to \$19.3 million in 2017, due to lower interest income from long term loans to associated companies. The decrease in the interest income from associates was partly offset by increased interest income from corporate bonds held as available-for-sale securities and interest income from short term deposits.

|  |        |        |
|--|--------|--------|
| Interest expense<br>(in thousands of \$)     | 2017   | 2016   |
| Interest on US\$ floating rate loans         | 33,466 | 29,032 |
| Interest on NOK floating rate bonds due 2017 | 2,082  | 4,152  |
| Interest on NOK floating rate bonds due 2019 | 4,691  | 4,697  |
| Interest on NOK floating rate bonds due 2020 | 1,852  | —      |
| Interest on 3.75% convertible bonds due 2016 | —      | 329    |
| Interest on 3.25% convertible bonds due 2018 | 5,107  | 10,093 |
| Interest on 5.75% convertible bonds due 2021 | 12,866 | 3,127  |
| Swap interest                                | 5,328  | 9,165  |
| Interest on capital lease obligation         | 15,982 | 246    |
| Other interest                               | 26     | 30     |
| Amortization of deferred charges             | 9,014  | 10,972 |
|  | 90,414 | 71,843 |

At December 31, 2017, the Company, including its consolidated subsidiaries, had total debt principal outstanding of \$1.5 billion (2016: \$1.6 billion), comprising \$92.5 million (NOK758 million) outstanding principal amount of NOK floating rate bonds due 2019 (2016: \$87.8 million, NOK758 million), \$61.0 million (NOK 500 million) outstanding principal amount of NOK floating rate bonds due 2020 (2016: \$nil, NOKnil), \$63.2 million outstanding principal amount of 3.25% convertible bonds due 2018 (2016: \$184.2 million), \$225.0 million outstanding principal amount of 5.75% convertible bonds due 2021 (2016: \$225.0 million), and \$1.1 billion under floating rate secured long term credit facilities (2016: \$1.0 billion).

The average three-month US\$ London Interbank Offered Rate, or LIBOR, was 1.26% in 2017 and 0.74% in 2016. The increase in interest expense associated with our floating rate debt for 2017, compared with 2016, is mainly due to the increase in LIBOR for the period.

The decrease in interest payable on the 3.75% convertible bonds and the NOK600 million floating rate bonds due 2017 is due to their redemption in February 2016 and July 2017, respectively. The decrease in interest payable on the 3.25% convertible bonds is due to repurchases in October 2016 and partial conversion in October 2017. The increase in interest payable on the 5.75% convertible bonds and NOK 500 million senior secured bonds is due to their issuance in October 2016 and June 2017, respectively.

At December 31, 2017, the Company and its consolidated subsidiaries were party to interest rate swap contracts, which effectively fix our interest rates on \$1.1 billion of floating rate debt at a weighted average rate excluding margin of 2.85% per annum (2016: \$1.2 billion of floating rate debt fixed at a weighted average rate excluding margin of 2.74% per annum).

In October 2015, we entered into agreements to charter in two 19,200 TEU container vessels on a bareboat basis, each for a period of 15 years from delivery by the shipyard, and to charter out each vessel for the same 15 year period. The first of these vessels was delivered in December 2016 and the second one was delivered in March 2017. These vessels are accounted for as direct financing lease assets. The above capital lease interest expense represents the interest portion of our capital lease obligations from chartering-in these vessels from their third party owners.

As reported above, two ultra-deepwater drilling units and one harsh environment jack-up drilling rig were accounted for under the equity method in 2017 and 2016. Their non-operating expenses, including interest expenses, are not included above, but are reflected in "Equity in earnings of associated companies" below.

#### Other non-operating items

In 2017, other non-operating items amounted to a net loss of \$3.8 million, compared to a net gain of \$9.5 million in 2016. The net loss of \$3.8 million for 2017 arose mainly from \$5.1 million of net cash payments on non-designated interest rate swaps, an impairment loss recorded against available for sale investments of \$4.4 million and \$4.5 million of foreign exchange losses resulting mainly from the translation of de-designated NOK bonds. This expense was partly offset by a gain of \$8.1 million from positive mark-to-market adjustments to financial instruments and \$3.3 million dividend income received on the Frontline shares (see Note 24: Related party transactions).

The net gain of \$9.5 million in 2016 mainly consists of a gain of \$3.9 million from mark-to-market adjustments to financial instruments and \$11.6 million dividend income received on the Frontline shares. The net gain was partly offset by \$4.9 million cash payments on non-designated interest rate swaps.

#### Equity in earnings of associated companies

During 2017 and 2016, the Company had certain wholly-owned subsidiaries accounted for under the equity method, as discussed in the consolidated financial statements included herein (Note 17: Investment in associated companies). The total equity in earnings of associated companies in 2017 was \$4.0 million lower than in the comparative period in 2016 mainly due to the reduction in finance lease interest income recorded by the ultra-deepwater drilling units West Taurus and West Hercules and the harsh environment jack-up drilling rig West Linus.

## B. LIQUIDITY AND CAPITAL RESOURCES

We operate in a capital intensive industry. Our purchase of the tankers in the initial transaction with Frontline was financed through a combination of debt issuances, a deemed equity contribution from Frontline and borrowings from commercial banks. Our subsequent acquisitions have been financed through a combination of our own equity and term loans, lease financing and revolving credit facilities from commercial banks. Providers of such borrowings generally require that the loans be secured by mortgages against the assets being acquired, and at December 31, 2018, substantially all of our vessels and drilling units are pledged as security or are held as capital leases. However, in common with many other companies, we also have unsecured borrowings as shown below. Providers of unsecured financing do so on the basis of the Company's assets and liabilities, cash flows, operating results and other factors, all of which affect the terms on which such unsecured financing is available. In general, unsecured financing is more expensive than borrowings secured against collateral.

Our liquidity requirements relate to servicing our debt, funding the equity portion of investments in vessels, funding working capital requirements and maintaining cash reserves against fluctuations in operating cash flows. Revenues from our time charters and bareboat charters are received 15 days in advance, monthly in advance, or monthly in arrears. Vessel management and operating fees are payable monthly in advance for vessels chartered to Frontline Shipping and the Golden Ocean Charterer, and as incurred for other time-chartered vessels.

Our funding and treasury activities are conducted within corporate policies to maximize investment returns while maintaining appropriate liquidity for both our short and long-term needs. This includes arranging borrowing facilities on a cost-effective basis. Cash and cash equivalents are held primarily in U.S. dollars, with minimal amounts held in Norwegian Kroner and Pound Sterling.

Surplus funds may be deployed to acquire equity or debt interests in other companies, with the aim of generating competitive returns. Such investments may also utilize credit facilities arranged specifically to facilitate such investment.

Our short-term liquidity requirements relate to servicing our debt and funding working capital requirements, including required payments under our management agreements and administrative services agreements. Sources of short-term liquidity include cash balances, short-term investments, available amounts under revolving credit facilities and receipts from our charters. We believe that our cash flow from the charters will be sufficient to fund our anticipated debt service and working capital requirements for the short and medium term.

Our long-term liquidity requirements include funding the equity portion of investments in new vessels, and repayment of long-term debt balances, including those relating to the following loan agreements of the Company and its consolidated subsidiaries as at 31 December 2018:



- NOK900 million senior unsecured bonds due 2019
- NOK500 million senior unsecured bonds due 2020
- 5.75% senior unsecured convertible bonds due 2021
- NOK600 million senior unsecured bonds due 2023
- 4.875% senior unsecured convertible bonds due 2023
- \$17.5 million secured term loan facility due 2023
- \$45 million secured term loan and revolving credit facility due 2019
- \$75 million secured term loan facility due 2019
- \$20 million secured term loan facility due 2019
- \$43 million secured term loan facility due 2019
- \$43 million secured term loan facility due 2020
- \$101 million secured term loan facility due 2023
- \$128 million secured term loan facility due 2021
- \$210 million secured term loan facility due 2021
- \$128 million secured term loan facility due 2022
- \$171 million secured loan facility due 2023
- \$39 million secured term loan facility due 2022
- \$166 million secured term loan facility due 2022
- \$76 million secured term loan facility due 2024
- \$50 million secured term credit facility due 2025

Our long-term liquidity requirements also include repayment of the following long-term loan agreements of our equity-accounted subsidiaries:

- \$390 million secured term loan and revolving credit facility due 2022
- \$375 million secured term loan and revolving credit facility due 2023
- \$475 million secured term loan and revolving credit facility due 2023

The above long-term loan agreements in our equity accounted subsidiaries relate to the three drilling units on charter to the Seadrill Charterers.

The main security provided under the secured credit facilities include (i) guarantees from subsidiaries, as well as instances where the Company guarantees all or part of the loans, (ii) a first priority pledge over all shares of the relevant asset owning subsidiaries and (iii) a first priority mortgage over the relevant collateral assets which includes substantially all of the vessels and the drilling units that are currently owned by the Company as at December 31, 2018, excluding three 1,700 TEU container vessels, two car carriers, two chemical tankers and three VLCCs.

At December 31, 2018, the Company had no commitments under contracts to acquire newbuilding vessels (2017: \$nil).

As at December 31, 2018, the Company had committed \$3.4 million towards the procurement of exhaust gas cleaning systems ("EGCS") on four of its oil tankers (2017: \$nil). There were no other material contractual commitments as at December 31, 2018.

In addition, 11 (2017: two) subsidiaries had lease liabilities totaling \$1,172.1 million at December 31, 2018 (2017: \$239.6 million) related to the charter-in of 11 (2017: two) container vessels, nine of which were delivered during 2018.

We expect that we will require additional borrowings or issuances of equity in the long term to meet our capital requirements.

As of December 31, 2018, we had cash and cash equivalents of \$211.4 million (2017: \$153.1 million). In addition, we had \$nil net available to draw under secured revolving credit facilities as of December 31, 2018. The availability of such amounts under the secured revolving credit facilities, is subject to compliance with the loan covenants under the relevant agreements at the time of drawdown. Although we were in compliance with such loan covenants as of December 31, 2018, we cannot guarantee that we will be in compliance in the future, and the amounts may therefore not be available to draw, reducing our available liquidity. In the year ended December 31, 2018, we generated cash of \$201.0 million net from operations, used \$866.6 million net in investing activities and generated \$724.9 million net from financing activities.

Cash flows provided by operating activities for 2018 increased to \$201.0 million, from \$177.8 million for 2017, mainly due to changes in net operating income and timing of charter hire, profit share and other related receivables. Investing activities used \$866.6 million in 2018, compared with \$48.4 million generated in 2017. The higher cash used in investing activities is mainly due to \$1,137.7 million of vessels purchased in 2018 compared with \$81.7 million spent on the acquisition of newbuildings in 2017. In addition, \$24.2 million was paid to associated companies in 2018 to prepay two of the loans compared with \$27.3 million received from associated companies in 2017. The current year increase in cash used in investing activities was partly offset by higher proceeds from the sale of assets and charter terminations by \$70.9 million in 2018 compared with 2017 and net cash proceeds of \$83.5 million received from the sale of the subsidiary owing the jack-up drilling rig Soehanah.

Net cash provided by financing activities for 2018 was \$724.9 million, compared to \$135.5 million net cash used in 2017. The \$860.4 million difference in cash provided by financing activities was primarily due to \$944.1 million financing received from the sale and leaseback of nine vessels. This was partially offset by \$75.5 million less proceeds from issuance of debt net of repayments. In 2018, the Company repurchased and redeemed \$97.2 million of our NOK and convertible bonds compared with \$68.4 million in 2017. In addition, \$29.2 million was paid in 2017 in connection with the settlement of the cross currency swap following its repurchase compared with no settlements in 2018.

During the year ended December 31, 2018, we paid four dividends totaling \$1.40 per common share (2017: four dividends totaling \$1.60 per common share), or a total of \$149 million (2017: \$153 million). All dividends paid in 2018 and 2017 were cash payments.

## Borrowings

As of December 31, 2018, we had total short-term and long-term debt outstanding of \$1.5 billion (2017: \$1.5 billion). In addition, as of December 31, 2018, our wholly-owned equity accounted subsidiaries SFL Deepwater Ltd., or SFL Deepwater, SFL Hercules Ltd., or SFL Hercules, and SFL Linus Ltd., or SFL Linus, had long term debt of \$204 million, \$210 million, and \$241 million, respectively (2017: \$226 million, \$251 million and \$309 million, respectively). These three subsidiaries are accounted for using the equity method, and their outstanding long-term debt is not included in the long-term debt shown on our consolidated balance sheet.

The following table presents an overall summary of our borrowings as at December 31, 2018:

| (in millions of \$)                                | December 31, 2018           |                              |
|--|-----------------------------|------------------------------|
|  | Outstanding balance on loan | Net amount available to draw |
| Unsecured borrowings:                              |                             |                              |
| NOK900 million bonds due 2019                      | 77.7                        | —                            |
| NOK500 million bonds due 2020                      | 57.8                        | —                            |
| 5.75% convertible bonds due 2021                   | 212.2                       | —                            |
| NOK600 million bonds due 2023                      | 69.4                        | —                            |
| 4.875% senior unsecured convertible bonds due 2023 | 151.7                       | —                            |

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|   |         |   |
|---|---------|---|
| Total unsecured borrowings  | 568.8   | — |
| U.S. dollar denominated floating rate debt due through 2025                               | 891.5   | — |
| Total borrowings of Company and consolidated subsidiaries                                 | 1,460.3 | — |
| Equity accounted subsidiaries: Loan facilities secured with mortgages on vessels and rigs | 655.2   | — |
| Total borrowings  | 2,115.5 | — |

As of December 31, 2018, there was no net available funds to draw under secured revolving credit facilities. The availability of such amounts under the secured revolving credit facilities, is subject to compliance with the loan covenants under the relevant agreements at the time of drawdown. Although we were in compliance with such loan covenants as of December 31, 2018, we cannot guarantee that we will be in compliance in the future, and the amounts may therefore not be available to draw, reducing our available liquidity.

In February 2010, a subsidiary entered into a \$43 million secured term loan facility with a bank. The proceeds of the facility were used to partially finance the Suezmax tanker Glorycrown. At December 31, 2018, the amount outstanding under the facility was \$17.8 million. The facility bears interest of LIBOR plus a margin and originally had a term of approximately five years. In November 2014, the terms of the loan were amended and restated, and the facility now matures in November 2019. The facility is secured by the subsidiary's assets and a guarantee from Ship Finance International Limited. The facility contains a minimum value covenant and covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In March 2010, a subsidiary entered into a \$43 million secured term loan facility with a bank. The proceeds of the facility were used to partially finance the Suezmax tanker Everbright. At December 31, 2018, the amount outstanding under this facility was \$17.8 million. The facility bears interest of LIBOR plus a margin and originally had a term of five years. In March 2015, the terms of the loan were amended and restated, and the facility now matures in March 2020. The facility is secured by the subsidiary's assets and a guarantee from Ship Finance International Limited. The facility contains a minimum value covenant and covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In March 2011, three subsidiaries entered into a \$75 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund the acquisition of three Supramax dry bulk carriers. At December 31, 2018, the amount outstanding under this facility was \$32.7 million. The facility bears interest at LIBOR plus a margin and has a term of approximately eight years. The facility is secured against the subsidiaries' assets and a limited guarantee from Ship Finance International Limited. The facility contains a minimum value covenant, which is only applicable if there is a default under the charters attached to the vessels or one year prior to expiry of the charters, whichever falls earlier. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In May 2011, eight subsidiaries entered into a \$171 million secured loan facility with a syndicate of banks. The facility is supported by China Export & Credit Insurance Corporation, or SINOSURE, which has provided an insurance policy in favor of the banks for part of the outstanding loan. The facility is secured by seven Handysize dry bulk carriers. At December 31, 2018, the amount outstanding under this facility was \$73.7 million. The facility bears interest at LIBOR plus a margin and has a term of approximately ten years from delivery of each vessel. The facility is secured against the subsidiaries' assets and a guarantee from Ship Finance International Limited.

In March 2014, we issued NOK900 million senior unsecured bonds. The bonds bear interest at NIBOR plus a margin and are redeemable in full in March 2019. Subsequent to the issue of the bonds, we have made net purchases of bonds with principal amounts totaling NOK142 million, which are being held as treasury bonds. At December 31, 2018, the amount outstanding was NOK672.0 million, equivalent to \$77.7 million. The bonds may, in their entirety, be redeemed at our option from September 19, 2018, upon giving bondholders at least 30 business days' notice and paying 100.50% of par value plus accrued interest. The bond agreement contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In June 2014, seven subsidiaries entered into a \$45 million secured term loan and revolving credit facility with a bank. The proceeds of the facility were used to partly fund the acquisition of seven 4,100 TEU container vessels. At December 31, 2018, the amount outstanding under this facility was \$45.0 million, and the available amount under the

revolving part of the facility was \$nil. The facility bears interest at LIBOR plus a margin and has a term of five years. The facility is secured against the subsidiaries' assets and a guarantee from Ship Finance International Limited. The facility contains a minimum value covenant, which is only applicable if there is an early termination of any of the charters attached to the vessels, or six months prior to expiry of the charters, whichever falls earlier. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In August 2014, six subsidiaries entered into a \$101 million secured term loan facility, secured against six offshore support vessels. At December 31, 2018, the amount outstanding under this facility is \$44.1 million. The facility bears interest at LIBOR plus a margin and has a term of approximately five years. In October 2017, certain amendments were made to the agreement, including an extension of the final maturity date until January 2023. The facility contains a minimum value covenant, which is applicable from January 2021, and covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios. The facility also contains covenants that require Solship (formerly Deep Sea) to maintain certain minimum levels of liquidity and working capital. One of the vessels was sold in February 2016 and the facility is now secured against the remaining five vessels and a limited guarantee from Ship Finance International Limited.

In September 2014, two subsidiaries entered into a \$20 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund the acquisition of two 5,800 TEU container vessels. At December 31, 2018, the amount outstanding under this facility was \$20.0 million. The facility bears interest at LIBOR plus a margin and has a term of five years. The facility is secured against the subsidiaries' assets and a guarantee from Ship Finance International Limited. The facility contains a minimum value covenant, which is only applicable if there is an early termination of any of the charters attached to the vessels. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In September 2014, two subsidiaries entered into a \$128 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund the acquisition of two newbuilding 8,700 TEU container vessels, which were delivered in 2014. At December 31, 2018, the amount outstanding under this facility was \$92.4 million. The facility bears interest at LIBOR plus a margin and has a term of seven years. The facility is secured against the subsidiaries' assets and a limited guarantee from Ship Finance International Limited. The facility contains a minimum value covenant, which is only applicable if there is a default under any of the charters attached to the vessels, or from the fifth anniversary of the drawdown under the facility, whichever falls earlier. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In November 2014, two subsidiaries entered into a \$128 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund the acquisition of two newbuilding 8,700 TEU container vessels, which were delivered in January 2015. At December 31, 2018, the amount outstanding under this facility was \$95.6 million. The facility bears interest at LIBOR plus a margin and has a term of seven years. The facility is secured against the subsidiaries' assets and a limited guarantee from Ship Finance International Limited. The facility contains a minimum value covenant, which is only applicable if there is a default under any of the charters attached to the vessels, or six months prior to expiry of the charters, whichever falls earlier. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In December 2014, two subsidiaries entered into a \$39 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund the acquisition of two Kamsarmax dry bulk carriers. At December 31, 2018, the amount outstanding under this facility was \$26.7 million. The facility bears interest at LIBOR plus a margin and has a term of approximately eight years. The facility is secured against the subsidiaries' assets and a limited guarantee from Ship Finance International Limited. The facility contains a minimum value covenant, which is only applicable if there is a default under any of the charters attached to the vessels, or 12 months prior to expiry of the charters, whichever falls earlier. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In June 2015, 17 wholly-owned subsidiaries entered into a \$250 million secured revolving credit facility with a syndicate of banks, secured against 17 tankers chartered to Frontline Shipping and a guarantee from Ship Finance International Limited. Fourteen of the tankers were sold and delivered to their new owners before December 31, 2018, and the facility was secured against the remaining three tankers before repayment in December 2018. At December 31, 2018, the amount outstanding under this facility was \$nil, and the amount available to draw was \$nil. The facility bore interest at LIBOR plus a margin and contained minimum value covenants and also covenants that required us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios. In February 2019, this facility was refinanced with a \$50 million secured term loan facility secured against the three remaining tankers.

In July 2015, eight subsidiaries entered into a \$166 million secured term loan facility with a syndicate of banks. The proceeds of the facility were used to partly fund the acquisition of eight Capesize dry bulk carriers. At December 31, 2018, the amount outstanding under this facility was \$117.9 million. The facility bears interest at LIBOR plus a margin and has a term of approximately seven years. The facility is secured against the subsidiaries' assets and a limited guarantee from Ship Finance International Limited. The facility contains minimum value covenants and also covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In November 2015, three subsidiaries entered into a \$210 million secured term loan facility with a syndicate of banks, to partly fund the acquisition of three newbuilding container vessels. One of the vessels was delivered in November 2015, and the remaining two were delivered in 2016. At December 31, 2018, the amount outstanding under this facility was \$173.9 million. The facility bears interest at LIBOR plus a margin and has a term of five years from the delivery of each vessel. The facility is secured against the subsidiaries' assets and a limited guarantee from Ship Finance International Limited. The facility contains a minimum value covenant, which is only applicable if there is a default under any of the charters attached to the vessels, or six months prior to expiry of the charters, whichever falls earlier. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In October 2016, we issued \$225 million senior unsecured convertible bonds. In December 2018, we made net purchases of bonds with principal amounts totaling \$12.8 million and at December 31, 2018, the amount outstanding under this facility was \$212.2 million. Interest on the bonds is fixed at 5.75% per annum. The bonds are convertible into our common shares and mature on October 15, 2021. The conversion rate at the time of issuance was 56.2596 common shares for each \$1,000 bond, equivalent to a conversion price of approximately \$17.7747 per share. The conversion rate will be adjusted for dividends in excess of \$0.225 per common share per quarter. Dividend distributions made since the issuance of the bonds have increased the conversion rate to 62.9233, equivalent to a conversion price of approximately \$15.8924 per share as at this report date. In conjunction with the bond issue, we have loaned up to 8,000,000 of our common shares to an affiliate of one of the underwriters of the issue, in order to assist investors in the bonds to hedge their positions. The shares that were lent by the Company were initially borrowed from Hemen, our largest shareholder. In November 2016, the Company issued 8,000,000 new shares to replace the shares borrowed from Hemen.



In June 2017, the Company issued a senior unsecured bond loan totaling NOK500 million in the Norwegian credit market. The bonds bear quarterly interest at NIBOR plus a margin and have a term of approximately three years. The net amount outstanding at December 31, 2018, was NOK500 million, equivalent to \$57.8 million. The bond agreement contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

In August 2017, two wholly-owned subsidiaries of the Company entered into a \$76.0 million secured term loan facility with a bank, secured against two product tanker vessels. The two vessels were delivered in August 2017. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of seven years. At December 31, 2018, the net amount outstanding was \$69.5 million. The facility contains a minimum value covenant, which is only applicable if there is a default under any of the charters attached to the vessels, or 12 months prior to the maturity date of the facility, whichever falls earlier. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

On April 23, 2018, the Company issued a senior unsecured convertible bond totaling \$150.0 million. Additional bonds were issued on May 4, 2018 at a principal amount of \$14.0 million. In December 2018, we made net purchases of bonds with principal amounts totaling \$12.3 million and at December 31, 2018, the amount outstanding under this facility was \$151.7 million. Interest on the bonds is fixed at 4.875% per annum and is payable in cash quarterly in arrears on February 1, May 1, August 1 and November 1. The bonds are convertible into Ship Finance International Limited common shares and mature on May 1, 2023. The initial conversion rate at the time of issuance was 52.8157 common shares per \$1,000 bond, equivalent to a conversion price of approximately \$18.93 per share. Since the issuance, dividend distributions have increased the conversion rate to 58.7171, equivalent to a conversion price of approximately \$17.03 per share. In conjunction with the bond issue, the Company agreed to loan up to 7,000,000 of its common shares to affiliates of the underwriters of the issue, in order to assist investors in the bonds to hedge their position. As at December 31, 2018, a total of 3,765,842 shares were issued from up to 7,000,000 shares issuable under a share lending arrangement.

In June 2018, 15 wholly-owned subsidiaries of the Company entered into a \$50.0 million secured term loan facility with a bank, secured against 15 feeder size container vessels. The 15 vessels were delivered in April 2018. The Company has provided a corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of seven years. The net amount outstanding at December 31, 2018, was \$46.9 million.

On September 13, 2018 the Company issued a senior unsecured bond totaling NOK600 million in the Norwegian credit market. The bonds bear quarterly interest at NIBOR plus a margin and are redeemable in full on September 13, 2023. The net amount outstanding at December 31, 2018, was NOK600 million, equivalent to \$69.4 million.

In December 2018, two subsidiaries entered into a \$17.5 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund two Supramax dry bulk carriers. At December 31, 2018, the amount outstanding under this facility was \$17.5 million. The facility bears interest at LIBOR plus a margin and has a term of approximately five years from delivery of the vessels. The facility is secured by the subsidiaries' assets and a limited guarantee from Ship Finance International Limited. The facility contains a minimum value covenant, which is only applicable if there is an early termination of any of the charters attached to the vessels. The facility also contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios.

#### Debt in Associated Companies

In May 2013, our equity-accounted subsidiary SFL Hercules entered into a \$375 million secured term loan and revolving credit facility with a syndicate of banks, secured against the ultra deepwater drilling rig West Hercules. At December 31, 2018, the amount outstanding under the facility was \$210.0 million, and the revolving part of the facility has been amalgamated with the term loan. The facility bears interest at LIBOR plus a margin, had a term of six years which during 2018 was extended by four years from the original maturity, and is secured against the assets of SFL Hercules. The lenders have limited recourse to Ship Finance International Limited as the holding company only guaranteed \$78.9 million of the debt at December 31, 2018. The facility contains covenants that require us to maintain

certain minimum levels of free cash, working capital and adjusted book equity ratios. The facility also has covenants that require Seadrill to maintain certain minimum levels of liquidity, current ratios, interest cover ratios and adjusted equity ratios and a maximum leverage ratio.

In October 2013, our equity-accounted subsidiary SFL Deepwater entered into a \$390 million secured term loan and revolving credit facility with a syndicate of banks, secured against the ultra deepwater drilling rig West Taurus. At December 31, 2018, the amount outstanding under the new facility was \$203.7 million, and the revolving part of the facility has been amalgamated with the term loan. The facility bears interest at LIBOR plus a margin, had a term of five years which during 2018 was extended by four years from the original maturity, and is secured against the assets of SFL Deepwater. The lenders have limited recourse to Ship Finance International Limited as the holding company only guaranteed \$84.7 million of the debt at December 31, 2018. The facility contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios. The facility also has covenants that require Seadrill to maintain certain minimum levels of liquidity, current ratios, interest cover ratios and adjusted equity ratios and a maximum leverage ratio.

In October 2013, our equity-accounted subsidiary SFL Linus entered into a \$475 million secured term loan and revolving credit facility with a syndicate of banks. The proceeds of the facility were used to finance the acquisition of the newbuilding harsh environment jack-up drilling rig West Linus, which was delivered in February 2014. At December 31, 2018, the amount outstanding under the facility was \$241.5 million, and the revolving part of the facility has been amalgamated with the term loan. The facility bears interest at LIBOR plus a margin, originally had a term of approximately five years which during 2018 was extended by four years from the original maturity, and is secured against the subsidiary's assets. The lenders have limited recourse to Ship Finance International Limited as the holding company only guaranteed \$102.5 million of the debt at December 31, 2018. The facility contains covenants that require us to maintain certain minimum levels of free cash, working capital and adjusted book equity ratios. The facility also has covenants that require Seadrill to maintain certain minimum levels of liquidity, current ratios, interest cover ratios and adjusted equity ratios and a maximum leverage ratio.

In connection with Seadrill's Restructuring Plan, certain amendments were agreed with the banks under the above three facilities in our equity account subsidiaries, including an extension of the final maturity date by four years, as mentioned above, and the minimum value clause not being applicable for the remaining life of the respective facilities. In addition, the minimum guarantee amounts were fixed at \$75 million for SFL Deepwater, \$70 million for SFL Hercules and \$90 million for SFL Linus, but increase by any net cash amounts received by the Company from the relevant subsidiaries. Further, the financial covenants on Seadrill were replaced by financial covenants on a newly established subsidiary of Seadrill, who also acts as guarantor for the obligations under the leases for the three drilling units, on a subordinated basis to the senior secured lenders in Seadrill and new secured notes.

We were in compliance with all loan covenants as at December 31, 2018. Solship and Seadrill were also in compliance with all applicable loan covenants in the facilities discussed above as at December 31, 2018. If Seadrill or Solship were to breach the loan covenants applicable to them, there is a risk that the Company will not be in compliance with the applicable loan covenants under the relevant agreement and the outstanding amounts applicable under the long-term debt facilities may become due and payable. At December 31, 2018, the three-month U.S. dollar LIBOR was 2.808% and the three-month Norwegian kroner NIBOR was 1.27%.

#### Minimum Value Covenants

Most of our loan facilities are secured with mortgages on vessels and rigs. At December 31, 2018, we had borrowings totaling \$0.9 billion with minimum value covenants which are tested on a regular basis, including \$0.7 billion borrowings in wholly-owned subsidiaries accounted for under the equity method. These borrowings were secured against 28 vessels and rigs which had combined charter-free market values totaling approximately \$1.6 billion. A reduction of 10% in charter-free market values in 2019 would not result in any material prepayments or reduction in availability on revolving credit facilities, after scheduled loan repayments and prepayments in the year.

In addition, at December 31, 2018, we had borrowings totaling \$0.6 billion with minimum value covenants which are tested if there is a default under the charter under which the relevant vessels are employed. These borrowings were secured against 25 vessels which had combined charter-free market values totaling approximately \$0.9 billion.

## Derivatives

We use financial instruments to reduce the risk associated with fluctuations in interest rates. At December 31, 2018, the Company and its consolidated subsidiaries had entered into interest rate swap contracts with a combined notional principal amount of \$721 million, whereby variable LIBOR interest rates excluding additional margins are swapped for fixed interest rates between 1.07% per annum and 2.93% per annum. We entered into interest rate/currency swap contracts, related to our bonds denominated in Norwegian kroner, with notional principal amounts of NOK100 million (\$17 million), NOK500 million (\$64 million) and NOK900 million (\$151 million), respectively, whereby variable NIBOR interest rates including additional margin are swapped for fixed interest rates of 6.03% per annum, 6.91% per annum and 6.03% per annum, respectively, and both the payment of interest and eventual settlement of the bonds will have an effective exchange rate of NOK5.94 = \$1, NOK7.81 = \$1 and NOK5.96 = \$1, respectively. We also entered into currency swap contracts, related to our NOK600 million bond denominated in Norwegian kroner, with notional principal amounts of NOK472 million (\$62 million), where the eventual settlement of the bonds will have an effective exchange rate of NOK7.60 = \$1. The overall effect of our swaps is to fix the interest rate on approximately \$0.9 billion of our floating rate debt, including equity accounted subsidiaries, at December 31, 2018, at a weighted average interest rate of 4.68% per annum including margin.

The effect of the above swap contracts is to substantially reduce our exposure to interest rate and exchange rate fluctuations, further analysis of which is presented in Item 11 "Quantitative and Qualitative Disclosures about Market Risk".

At the date of this report, we were not party to any other derivative contracts.

## Equity

In January 2013, we issued a senior unsecured convertible bond loan totaling \$350 million (see "Borrowings" above). As required by ASC 470-20 "Debt with conversion and Other Options", we calculated the equity component of the convertible bond, which was valued at \$20.7 million and recorded as "Additional paid-in capital". In October 2016, we purchased and canceled bonds with principal amounts totaling \$165.8 million. The equity component of the converted bonds in 2018 was valued at \$nil (2017: \$16.4 million for the purchased and canceled bonds) and this amount has been deducted from "Additional paid-in capital".

A reorganization of share capital was approved at the Annual General Meeting of the Company held in September 2016, in accordance with the Bermuda Companies Act. Following the reorganization, the Company's authorized share capital was adjusted to 150,000,000 shares of par value \$0.01 each, prior to which it had been 125,000,000 shares of par value \$1.00 each. As there were 93,504,575 shares issued and fully paid at the time of the reorganization, to reflect the decrease in the par value of each share from \$1.00 to \$0.01, \$92.6 million was transferred from share capital to contributed surplus. The shares of par value \$0.01 each rank pari passu in all respects with each other.

In October 2016, we issued a senior unsecured convertible bond totaling \$225 million (see "Borrowings" above). As required by ASC 470-20 "Debt with conversion and Other Options", we calculated the equity component of the convertible bond, which was valued at \$4.1 million and recorded as "Additional paid-in capital".

In November 2016, in conjunction with the Company's issue of senior unsecured convertible bonds totaling \$225 million (see below), we issued 8,000,000 new shares of par value \$0.01 each. The shares were issued at par value and have been loaned to an affiliate of one of the underwriters of the bond issue, in order to assist investors in the bonds to

hedge their position.

In November 2016, the Board of Directors renewed a share option scheme originally approved in November 2006, permitting the directors to grant options in the Company's shares to employees, officers and directors of the Company or its subsidiaries. The fair value cost of options granted is recognized in the statement of operations, with a corresponding amount credited to additional paid in capital. The additional paid-in capital arising from share options granted was \$0.5 million in 2018 (2017: \$0.4 million).

In October 2017, we issued a total of 9,418,798 new shares following separate privately negotiated transactions with certain holders of the 3.25% senior unsecured convertible bonds due 2018 for the conversion of a principal amount of \$121.0 million from the outstanding balance of the convertible bonds.

In 2018, we issued a total of no new shares of \$0.01 each following the exercise of share options (2017: 7,500 new shares of \$0.01 issued to satisfy options exercised).

In February 2018, the Company redeemed the full outstanding amount under the 3.25% senior unsecured convertible bonds due 2018. The remaining outstanding principal amount of \$63.2 million was paid in cash, and the premium settled in common shares with the issue of 651,365 new shares.

In April 2018, the Company issued a total of 3,765,842 new shares of par value \$0.01 each from up to 7,000,000 issuable under a share lending arrangement in relation with the Company's issuance of 4.875% senior unsecured convertible bonds in April and May 2018. The shares issued have been loaned to affiliates of the underwriters of the bond issue in order to assist investors in the bonds to hedge their position. The bonds are convertible into common shares and mature on May 1, 2023. As required by ASC 470-20 "Debt with conversion and Other Options", the Company calculated the equity component of the convertible bond, which was valued at 7.9 million at issue date and recorded as "Additional paid-in capital".

In May 2018, the Company issued a total of 4,024,984 new shares as part of the consideration paid for the acquisition of four 2014 built container vessels, each with approximately 13,800 TEU carrying capacity. The vessels are employed under long-term time-charters to an unrelated third party.

At the Annual General Meeting of the Company in September 2018, a resolution was passed to approve an increase of the Company's authorized share capital from \$1,500,000 divided into 150,000,000 common shares of \$0.01 par value each to \$2,000,000 divided into 200,000,000 common shares of \$0.01 par value each by the authorization of an additional 50,000,000 common shares of \$0.01 par value each.

Following the above transactions, as of December 31, 2018, our issued and fully paid share capital balance was \$1.2 million, our additional paid-in capital was \$469 million and our contributed surplus balance was \$681 million.

#### C. RESEARCH AND DEVELOPMENT, PATENTS AND LICENSES, ETC.

We do not undertake any significant expenditure on research and development, and have no significant interests in patents or licenses.

#### D. TREND INFORMATION

According to industry sources, vessel prices have generally declined since their peak in 2008, and newbuilding prices have increased over the last year. Prices for second-hand vessels have increased during 2018 from 2017 for modern second-hand tonnage, however still relatively low compared to historical standards.

The oil tanker market started a cyclical upturn in the second half of 2014, with spot charter rates in December 2015 reaching their highest levels since 2008. However, this trend was reversed in 2016, when the 6.5% increase in fleet capacity was not matched by a corresponding increase in demand. In 2018, crude tanker demand was at 2.5% and crude fleet growth remained flat at 0.3%.

Overall, 2018 ended on a positive note for the tanker market in all sectors. The year was characterized as a difficult market, while the end of the year saw positive rate development due to strong scrapping and an increase in demand. Demand for crude tankers is projected to grow by 3.8%, despite falling Iranian and Venezuelan exports and limited exports from OPEC members. The tanker trade is predicted to benefit from firm US exports and continued Chinese import growth, including refinery start-ups in South East Asia and increase in oil output from Brazil. The fleet of trading crude tankers is expected to see a growth of 3.6%, in line with expected demand growth. For the product



tanker fleet growth is expected to be 3%. For 2020, tanker deliveries are expected to fall by more than 25% to 23 million dwt, owing to the potential increase in scrapping resulting from the introduction of the global sulfur cap. The active supply growth across the tanker segment in 2019 and 2020 may be limited by due to vessels being out of service in order to retrofit abatement technology, and the potential variance in operating speeds. Introduction of the IMO 2020 sulfur cap is projected to have a positive impact on demand for tankers, especially from the second half of 2019 and into 2020, although there are a range of scenarios. Potential impacts include higher regional refinery outputs, supporting a 5% increase in crude tanker demand in 2020, with several logistical factors potentially impacting the demand growth.

Our tanker vessels on charter to Frontline Shipping are subject to long term charters that provide for both a fixed base charter-hire and profit sharing payments that apply once Frontline Shipping earns average daily rates from our vessels in the market that exceed the fixed base charter rates, calculated and payable on a quarterly basis. If rates for vessels chartered in the spot market increase, our profit sharing revenues, if any, will likewise increase for those vessels operated by Frontline Shipping in the spot market. We also have two Suezmax tankers currently employed in the spot market, which will benefit directly from any strengthening in spot charter rates.

According to industry sources, the dry bulk global trade was estimated to have expanded by 2.4% during 2018. This amounts to a total of 5.2 billion tonnes for the full year. In terms of tonne-miles, the growth stood at 2.8% on an overall level for the year. Industry sources indicate that the slower pace of growth in 2018 is a result of weaker Chinese iron ore imports due to increased use of scrap, as well as a disruption in trade flows due to the Chinese-US trade war. Projections of 2019 indicate that dry bulk trade may expand by 2.6% in terms of tonnes, 3.4% in terms of tonne-miles, although there are a range of likely scenarios. The fleet is expected to grow by 3% during 2019, which indicates that the fundamentals in the sector looks to be balanced. The downside risks are clear with the continued 'trade war', however the active supply growth could also be limited by the impact of the upcoming IMO 2020 sulfur cap with time out of service for retrofitting abatement technology expected to absorb an estimated 0.5% of the bulker fleet capacity in 2019. Looking ahead, initial projections indicate that bulk trade market could grow by approximately 2% and 3% if evaluating on a tonne-mile basis in 2020. Total fleet growth is projected to slow down, with an expected growth to come in below 2% in 2020. The impact of the IMO 2020 sulfur cap, the potential for increased recycling and lower operating speeds, is expected to provide room for further improvements in the dry bulk carrier sector.

According to industry sources, the containership charter market generally saw improvement during 2018, compared to 2017 however with mixed trends. Container vessel charter rates were up 28% in 2018 on a year on year basis, however during the second half of 2018, rates eased back. Spot rates for box freight were broadly flat during the year, with SCFI composite index averaging 833 points during 2018, up just 1% compared to 2017. The global seaborne container trade is estimated to have grown by 4.3% during 2018 to a total of 201 million TEU, following an expansion of 5.6% in 2017. Deliveries into the fleet totalled 168 units of 1.3 million TEU in the full year of 2018, which is up from the 1.2 million TEU growth seen in 2017. The demolition activity was however, reduced with a total of 64 vessels or 0.11 million TEU sold for recycling for the full year, an effect contributed to the improvements in charter market seen during the first half of 2018. Performance on the main lane trades during 2018 was relatively mixed. While the balance between supply and demand growth was relatively firmly in favour of supply side during 2018, projections for 2019 and 2020 remains positive, expecting rebalancing in the sector with moderate fleet capacity growth and healthy demand trends. Uncertainties around implementation of IMO 2020 regulations may have a positive effect on the sector going forward, with the continued risk to the demand outlook affected by the negative trends in the Chinese economy and the China-US 'trade-war', indicating a potential downside scenario.

The dramatic reduction in the oil price since 2014 has reduced demand for offshore drilling units, and day rates and utilizations have declined considerably in the four years to 2017, as many offshore exploration activities became inviable at low prices of between \$50 and \$55 per barrel. As a result, some owners/operators of drilling units have experienced financial difficulties in the past year, including breaching bank covenants and restructuring. According to some industry sources, there is an increasing sense that, 2018 may have marked the point at which the offshore market cycle "bottomed out", with rates seeing an upwards trend during the second half of 2019. However, while there are early signs of an upturn in several key indicators, there remains significant structural challenges to be overcome if offshore markets are to move towards balance.

Crude oil prices have trended upwards, from \$55 per barrel in September 2017 to approximately \$70 per barrel in January 2018. 2018 showed to be a volatile year for the oil market with significant factors affecting the price development, peaking higher than \$82 per barrel due to slowing production in Venezuela and new sanctions on Iranian oil. The last quarter, however saw the price of crude oil drop to levels well below \$60 per barrel, as global

growth estimates were lowered and OPEC, including Saudi production dropped approximately one mb/day from peak levels.

According to industry sources, the OSV market remains one of the most severely affected by the offshore downturn. 2018 saw record high recycling, following on from high 2017 levels, however the market is still seeing new deliveries and new orders, doing little to help the market balance.

Interest rates have been at historically at low levels since 2009, although interest rates have recently increased. We have effectively hedged a substantial portion of our interest exposure on our floating rate debt through swap agreements with banks, although interest rate rises will affect our future cost of debt. Several of our charter contracts also include interest adjustment clauses, whereby the charter rate is adjusted to reflect the actual interest paid on a deemed outstanding loan relating to the asset, effectively transferring the interest rate exposure to our counterparty under the charter contract.

The above overviews of the various sectors in which we operate are based on current market conditions. However, market developments cannot always be predicted and may differ from our current expectations.

#### E. OFF-BALANCE SHEET ARRANGEMENTS

At December 31, 2018, we were not party to any arrangements which may be considered to be off balance sheet arrangements.

#### F. TABULAR DISCLOSURE OF CONTRACTUAL OBLIGATIONS

##### Contractual Commitments

At December 31, 2018, we had the following contractual obligations and commitments:

|   | Payment due by period |              |              |                  | Total   |
|---|-----------------------|--------------|--------------|------------------|---------|
|   | Less than<br>1 year   | 1–3<br>years | 3–5<br>years | After<br>5 years |         |
|   | (in millions of \$)   |              |              |                  |         |
| NOK900 million senior unsecured bonds due 2019                  | 77.7                  | —            | —            | —                | 77.7    |
| NOK500 million senior unsecured bonds due 2020                  | —                     | 57.8         | —            | —                | 57.8    |
| 5.75% unsecured convertible bonds due 2021                      | —                     | 212.2        | —            | —                | 212.2   |
| NOK600 million senior unsecured bonds due 2023                  | —                     | —            | 69.4         | —                | 69.4    |
| 4.875% senior unsecured convertible bonds due 2023              | —                     | —            | 151.7        | —                | 151.7   |
| Floating rate long-term debt                                    | 189.4                 | 389.6        | 300.2        | 12.3             | 891.5   |
| Floating rate long-term debt in unconsolidated subsidiaries (1) | 33.2                  | 96.0         | 526.0        | —                | 655.2   |
| Total debt repayments   | 300.3                 | 755.6        | 1,047.3      | 12.3             | 2,115.5 |
| Total interest payments (2)                                     | 117.4                 | 203.1        | 121.4        | 10.5             | 452.4   |
| Capital lease obligations                                       | 67.4                  | 138.3        | 153.5        | 813.1            | 1,172.3 |
| Interest on capital lease obligations                           | 62.8                  | 115.3        | 99.9         | 163.7            | 441.7   |
| Total contractual cash obligations                              | 547.9                 | 1,212.3      | 1,422.1      | 999.6            | 4,181.9 |

(1) The floating rate long-term debt facilities in the unconsolidated subsidiaries relate to the three drilling units on charter to the Seadrill Charterers. In connection with Seadrill's Restructuring Plan, the loan facilities have been extended by four years, subject to court approval of the Restructuring Plan. The numbers in the above table assume that the Restructuring Plan is approved by the court.

(2) Interest payments are based on the existing borrowings of both fully consolidated and equity-accounted subsidiaries. It is assumed that no further refinancing of existing loans takes place and that there is no repayment on revolving credit facilities. Interest rate swaps have not been included in the calculation. The interest has been calculated using the five year U.S. dollar swap of 2.48%, the five year NOK swap of 1.81% and the exchange rate of NOK8.52 = \$1 as of March 19, 2019, plus agreed margins. Interest on fixed rate loans is calculated using the contracted interest rates.

#### G. SAFE HARBOR

Forward-looking information discussed in this Item 5 includes assumptions, expectations, projections, intentions and beliefs about future events. These statements are intended as "forward-looking statements." We caution that

assumptions, expectations, projections, intentions and beliefs about future events may and often do vary from actual results and the differences can be material. Please see "Cautionary Statement Regarding Forward-Looking Statements" in this report.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

The following table sets forth information regarding our directors and officers including the Chief Executive Officer and the Chief Financial Officer of our wholly owned subsidiary SFL Management AS, who are responsible for overseeing our management.

| Name                | Age | Position   |
|---------------------|-----|--|
| James O'Shaughnessy | 55  | Director of the Company and Chairperson of the Audit Committee |
| Harald Thorstein    | 39  | Director of the Company  |
| Bert Bekker         | 80  | Director of the Company  |
| Gary Vogel          | 53  | Director of the Company  |
| Keesjan Cordia      | 44  | Director of the Company  |
| Ole B. Hjertaker    | 52  | Chief Executive Officer of SFL Management AS                   |
| Aksel C. Olesen     | 42  | Chief Financial Officer of SFL Management AS                   |

Under our constituent documents, we are required to have at least one independent director on our Board of Directors whose consent will be required to file for bankruptcy, liquidate or dissolve, merge or sell all or substantially all of our assets.

Certain biographical information about each of our directors and officers is set forth below.

James O'Shaughnessy has been a Director of the Company since September 2018. Mr. O'Shaughnessy has been an Executive Vice President, Chief Accounting Officer and Corporate Controller of Axis Capital Holdings Limited since March 26, 2012. Prior to that Mr. O'Shaughnessy has amongst others served as Chief Financial Officer of Flagstone Reinsurance Holdings and as Chief Accounting Officer and Senior Vice President of Scottish Re Group Ltd., and Chief Financial Officer of XL Re Ltd. at XL Group plc. Mr. O'Shaughnessy received a Bachelor of Commerce degree from University College, Cork, Ireland in the year 1981 to 1985 and is both a Fellow of the Institute of Chartered Accountants of Ireland and an Associate Member of the Chartered Insurance Institute of the UK. Mr. O'Shaughnessy earned a Master's Degree in Accounting from University College Dublin in the year 1985 to 1986. Mr. O'Shaughnessy also serves as a director of Frontline, Golden Ocean, Northern Drilling Ltd, Archer Limited, Seadrill and Seadrill Partners LLC.

Harald Thorstein has served as a director of the Company since September 2011. Mr. Thorstein is currently employed by Seatankers Consultancy Services (UK) Limited in London, prior to which he was employed in the Corporate Finance division of DnB NOR Markets, specializing in the offshore and shipping sectors. Mr. Thorstein has an MSc in Industrial Economics and Technology Management from the Norwegian University of Science and Technology. Mr. Thorstein has served as a director of Seadrill Partners LLC since 2012, Seadrill since December 2017 and on the Board of Directors of Solstad Offshore ASA since June 2017.

Bert Bekker has served as a director of the Company since May 2015. Mr. Bekker has been in the heavy marine transport industry since 1978 when he co-founded Dock Express Shipping Rotterdam, the predecessor of Dockwise Transport. Mr. Bekker has served as a director of Wilh. Wilhelmsen Netherlands B.V. from July 2003 until the end of 2014. Mr. Bekker has also been serving as a director of Seadrill Partners LLC since September 2012.

Gary Vogel has served as a director of the Company since December 2016. Mr Vogel is the Chief Executive Officer and a director of Eagle Bulk Shipping Inc, a U.S. listed owner and operator of dry bulk vessels. He has worked

extensively both in the dry bulk market and private capital markets, and was previously the Chief Executive Officer of Clipper Group in Denmark.

Keesjan Cordia has been a Director of the Company since September 2018. Mr. Cordia is a private investor with a background in Economics and Business Administration. Mr. Cordia holds several board and advisory board positions in the Oil & Gas Industry, among which: board member of Workships group B.V (2006), board member of Combifloat B.V (2013) and board member of Kerrco Inc (2017). He recently became Chairman of the board of Oceanteam ASA (April 2018). From 2006-2014 he was CEO at Seafox (Offshore Services). Mr. Cordia is founder and Managing Partner of Invaco Management B.V., an investment firm based in Amsterdam. He is also an advisor to Parcom Capital and member of the investor committee of Connected Capital, both Private Equity firms. Mr. Cordia also serves as a director of Northern Drilling Ltd.

Ole B. Hjertaker has served SFL Management AS as Chief Executive Officer since July 2009, prior to which he served as Chief Financial Officer from September 2006. Mr. Hjertaker also served SFL Management AS as Interim Chief Financial Officer between July 2009 and January 2011. Prior to joining Ship Finance, Mr. Hjertaker was employed in the Corporate Finance division of DNB NOR Markets, a leading shipping and offshore bank. Mr. Hjertaker has extensive corporate and investment banking experience, mainly within the maritime/transportation industries, and holds a Master of Science degree from the Norwegian School of Economics and Business Administration. Mr. Hjertaker also serves as a director of NorAm Drilling Company AS, or NorAm Drilling.

Aksel C. Olesen joined SFL Management AS in January 2019 serving as Chief Financial Officer. Prior to joining SFL Management AS, he spent 12 years at Pareto Securities where he worked in various positions in the firm's investment banking division, including as Head of Investment Banking Asia in Singapore from 2011 to 2014 and most recent as Head of Shipping and Offshore Project Finance. Mr. Olesen started his career working for the shipping company Kristian Jebsens Rederi as part of the legal, business development and finance team. Mr. Olesen holds a Law Degree from the University of Bergen.

## B. COMPENSATION

During the year ended December 31, 2018, we paid to our directors and officers aggregate cash compensation of \$1.9 million, including an aggregate amount of \$0.04 million for pension and retirement benefits. We reimburse directors for reasonable out of pocket expenses incurred by them in connection with their service to us. In addition to cash compensation, during 2018 we also recognized an expense of \$0.2 million relating to directors' and officers' stock options.

## C. BOARD PRACTICES

In accordance with our Bye-laws, the number of directors shall be such number not less than two as we may by Ordinary Resolution determine from time to time, and each director shall hold office until the next annual general meeting following his election or until his successor is elected. We currently have five directors.

We currently have an Audit Committee, which is responsible for overseeing the quality and integrity of our financial statements and our accounting, auditing and financial reporting practices, our compliance with legal and regulatory requirements, the independent auditor's qualifications, independence and performance, and our internal audit function. James O'Shaughnessy is the Chairperson of the Audit Committee and the Audit Committee Financial Expert.

We currently have a Compensation Committee, which is responsible for establishing and reviewing the executive officers' and managements' compensation and benefits. Gary Vogel and Harald Thorstein are members of the Compensation Committee.

As a foreign private issuer, we are exempt from certain requirements of the NYSE that are applicable to U.S. listed companies. For a listing and further discussion of how our corporate governance practices differ from those required of U.S. companies listed on the NYSE, please see Item 16G or visit the corporate governance section of our website at [www.shipfinance.bm](http://www.shipfinance.bm).



Our officers are elected by our Board of Directors immediately following each Annual General Meeting and shall hold office for such period and on such terms as the Board of Directors may determine.

There are no service contracts between us and any of our directors providing for benefits upon termination of their employment or service.

## D. EMPLOYEES

We currently employ 11 persons on a full-time basis through our subsidiaries SFL Management AS and Ship Finance Management (UK) Ltd., and during the year ended December 31, 2018, employed 11 persons on a full-time basis. We have contracted with Frontline Management, Golden Ocean Management and other third parties for certain managerial responsibilities for our fleet, with Frontline Management for certain administrative services, including corporate services, and with Seatankers for certain advisory and support services.

## E. SHARE OWNERSHIP

The beneficial interests of our Directors and officers in our common shares as of March 26, 2019, are as follows:

| Director or Officer | Beneficial interest in Common Shares of \$0.01 each | Additional interest in options to acquire Common Shares which have vested | Percentage of Common Shares Outstanding |
|---------------------|---|---|---|
| James O'Shaughnessy | —   | —   | *                                       |
| Harald Thorstein    | —   | 17,500  | *                                       |
| Bert Bekker         | —   | 10,000  | *                                       |
| Gary Vogel          | —   | —   | *                                       |
| Keesjan Cordia      | —   | —   | *                                       |
| Ole B. Hjertaker    | 91,840  | 92,333  | *                                       |
| Aksel C. Olesen     | —   | —   | *                                       |

\* Less than one percent.

## Share Option Scheme

In November 2016, our Board of Directors renewed the Ship Finance International Limited Share Option Scheme originally approved in November 2006. Following the renewal in November 2016, the scheme will expire in November 2026. The subscription price for all options granted under the scheme will be reduced by the amount of all dividends declared by the Company per share in the period from the date of grant until the date the options are exercised.

In March 2016, 279,000 options were awarded to employees, officers and Directors pursuant to the Company's Share Option Scheme. The options vest over a three year period and have a five year term. The initial exercise price was \$14.38 per share and the first options were exercisable from March 2017.

In September 2017, 113,000 options were awarded to employees and officers pursuant to the Company's Share Option Scheme. The options vest over a three year period and have a five year term. The initial exercise price was \$14.30 per share and the first options will be exercisable from September 2018.

In April 2018, 83,000 options were awarded to employees and officers pursuant to the Company's Share Option Scheme. The options vest over a three year period and have a five year term. The initial exercise price was \$14.67 per share and the first options will be exercisable from April 2019.

In January 2019, 100,000 options were awarded to one officer pursuant to the Company's Share Option Scheme. The options vest over a three year period and have a five year term. The initial exercise price was \$11.50 per share and the first options will be exercisable from January 2020.

In March 2019, 425,000 options were awarded to employees, officers and Directors pursuant to the Company's Share Option Scheme. The options vest over a three year period and have a five year term. The initial exercise price was \$12.35 per share and the first options will be exercisable from March 2020.

Details of options to acquire common shares in the Company by our Directors and officers as of March 26, 2019, were as follows:

| Director or Officer | Number of options |        | Exercise price | Expiration Date |
|---------------------|-------------------|--------|----------------|-----------------|
|                     | Total             | Vested |                |                 |
| James O'Shaughnessy | 25,000            | —      | \$ 12.35       | March 2024      |
| Harald Thorstein    | 17,500            | 17,500 | \$ 9.68        | March 2021      |
| Harald Thorstein    | 25,000            | —      | \$ 12.35       | March 2024      |
| Bert Bekker         | 10,000            | 10,000 | \$ 9.68        | March 2021      |
| Bert Bekker         | 25,000            | —      | \$ 12.35       | March 2024      |
| Gary Vogel          | 25,000            | —      | \$ 12.35       | March 2024      |
| Keesjan Cordia      | 25,000            | —      | \$ 12.35       | March 2024      |
| Ole B. Hjertaker    | 79,000            | 79,000 | \$ 9.68        | March 2021      |
| Ole B. Hjertaker    | 40,000            | 13,333 | \$ 12.20       | September 2022  |
| Ole B. Hjertaker    | 30,000            | —      | \$ 13.27       | April 2023      |
| Ole B. Hjertaker    | 150,000           | —      | \$ 12.35       | March 2024      |
| Aksel C. Olesen     | 100,000           | —      | \$ 11.50       | January 2024    |

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY  
TRANSACTIONS

A. MAJOR SHAREHOLDERS

The following table presents certain information as at March 21, 2019, regarding the ownership of our Common Shares with respect to each shareholder whom we know to beneficially own five percent or more of our outstanding Common Shares.

| Owner                     | Number of Common Shares | Percent of Common Shares |
|---------------------------|-------------------------|--------------------------|
| Hemen Holding Limited (1) | 26,918,687              | 22.5%                    |

According to the Schedule 13D/A filed with the SEC on November 16, 2018, Hemen Holding Limited ("Hemen") is a Cyprus holding company, indirectly controlled by trusts established by Mr. John Fredriksen for the benefit of (1) his immediate family. Mr. Fredriksen disclaims beneficial ownership of the 26,918,687 shares of our common stock, except to the extent of his voting and dispositive interests in such shares of common stock and Mr. Fredriksen has no pecuniary interest in such shares.

A total of 119,375,525 common shares were outstanding as of March 21, 2019. In calculating the above percentages of common shares held by Hemen we have included 8,000,000 shares issued as part of a share lending arrangement relating to the October 2016 issue of 5.75% convertible notes and 3,765,842 shares issued in December 2018 as part of a share lending arrangement relating to the 4.875% convertible notes. These shares will be returned to the Company on or before the maturity of the bonds in 2021 and 2023 respectively.

The Company's major shareholders have the same voting rights as other shareholders of the Company.

As at March 21, 2019, the Company had 435 holders of record in the United States, including Cede & Co., which is the Depository Trust Company's nominee for holding shares on behalf of brokerage firms, as a single holder of record.

We are not aware of any arrangements, the operation of which may at a subsequent date result in a change in control.

## B. RELATED PARTY TRANSACTIONS

The Company, which was formed in 2003 as a wholly-owned subsidiary of Frontline, was partially spun-off in 2004 and its shares commenced trading on the NYSE in June 2004. A large part of our business continues to be transacted through contractual relationships between us and the following related parties, being companies in which Hemen and companies associated with Hemen have, or had, a significant direct or indirect interest:

- Frontline
- Frontline Shipping
- Seadrill
- Golden Ocean
- United Freight Carriers ("UFC" - which is a joint venture approximately 50% owned by Golden Ocean)
- Deep Sea Supply Plc. ("Deep Sea") (1)
- Seatankers Management Co. Ltd. ("Seatankers")
- NorAm Drilling
- Golden Close
- Sterna Finance
- ADS Crude Carriers Plc ("ADS")

(1) From October 2017, Deep Sea was determined to no longer be a related party (see below).

As of March 26, 2019 one of the Company's offshore support vessels (2017: one) accounted for as a direct financing lease and four of the Company's offshore support vessels (2017: four) accounted for as operating leases were employed under long term charters to a subsidiary of Deep Sea. In June 2017, Deep Sea completed a merger with Solstad Offshore ASA and Farstad Shipping ASA, creating Solstad Farstad which is listed on the Oslo Stock Exchange, with Hemen's shareholding in Solstad Farstad being below 20%. In October 2018, Solstad Farstad changed its name to Solstad Offshore ASA ("Solstad"). The Company determined that Solstad was not a related party as Hemen was deemed not to have significant influence over the new listed entity. Following the merger, Solship Invest 3 AS (formerly Deep Sea), a wholly owned subsidiary of Solstad acts as charter guarantor under the long term charter agreements.

As of March 26, 2019, we charter three vessels to Frontline Shipping under long-term direct financing leases, most of which were given economic effect from January 1, 2004. At December 31, 2018, the balance of net investments in direct financing leases to Frontline Shipping was \$115.0 million (2017: \$314.0 million) of which \$8.0 million (2017: \$22.3 million) represented short-term maturities.

Frontline Shipping is a wholly owned subsidiary of Frontline, but the performance under the leases is not guaranteed by Frontline following the amendments agreed in 2015. Frontline Shipping can only make distributions to its parent company if it can demonstrate it will have free cash of minimum of \$2 million per vessel both prior to and following (i) such distribution, (ii) the payment of the next hire due and any profit share accrued under the charters and (iii) the note issued to us must be fully repaid. Due to the current depressed tanker market, there is a risk that Frontline Shipping may not have sufficient funds to pay the agreed charter hires. However, the performance under the fixed price management agreements with Frontline Management whereby we pay management fees of \$9,000 per day for each vessel to cover all operating costs including drydocking costs, are guaranteed by Frontline.

As compensation for the amendments entered into in June 2015 we received 55 million ordinary shares in Frontline, the fair value of which amounted to \$150.2 million on the date of receipt. Following the amendments, from July 1, 2015, the leases were revised to reflect the compensation payment received and the reduction in future minimum lease payments to be received. In February 2016, Frontline enacted a 1-for-5 reverse stock split and our holding of Frontline now consists of 11 million ordinary shares. In the year ended December 31, 2018, the Company received dividend income totaling \$nil (2017: \$3.3 million) on these shares.

The amendments to the charter agreements made in June 2015, increased the profit sharing percentage to 50% for earnings above the new time-charter rates with effect from July 1, 2015. Following the amendments, the profit share is calculated and payable on a quarterly basis. We earned \$1.5 million under the 50% profit sharing agreement in 2018 (2017: \$5.6 million; 2016: \$50.9 million).

As of March 26, 2019, we charter two of our ultra deepwater drilling units to two of the Seadrill Charterers under long-term direct financing leases, these units are being owned by equity-accounted subsidiaries. At December 31, 2018, the balance of net investments in direct financing leases to the two Seadrill Charterers was \$623.3 million (2017: \$660.2 million), of which \$30.6 million (2017: \$36.9 million) represents short-term maturities.

As of March 26, 2019, we charter a harsh environment jack-up drilling rig to one of the Seadrill Charterers, which is a subsidiary of NADL, under a long-term direct financing lease, this rig being owned by an equity-accounted subsidiary. At December 31, 2018 the balance of the net investment in the direct financing lease to the subsidiary was \$396.7 million (2017: \$431.1 million) of which \$21.5 million (2017: \$34.5 million) represents short-term maturities. The obligations under the bareboat charter were originally guaranteed by NADL. In February 2015, amendments were made to the bareboat charter, whereby Seadrill replaced NADL as charter guarantor.

As of March 26, 2019, the Company had five offshore support vessels on long-term bareboat charters to a subsidiary of Deep Sea. In July 2016, the Company agreed to amend the terms of the charters, which were scheduled to end between September 2019 and January 2020. Under the amended agreements, the charter rates were temporarily reduced until May 2018, in exchange for extending the original charter periods by three years and introducing a 50% profit share on charter revenues earned by the vessels above the new base charter rates, calculated on a time-charter equivalent basis. The Company earned no profit share income under profit sharing arrangements in 2017 and 2016, during the period when Deep Sea was classified as a related party.

In the third quarter of 2015, we took delivery of eight Capesize dry bulk carriers from subsidiaries of Golden Ocean for a total cost of \$272.0 million. The vessels were immediately chartered back to a subsidiary of Golden Ocean on ten year time charters, at base charter rates of \$17,600 per day for the first seven years and \$14,900 per day thereafter. The charters also included an interest adjustment clause, whereby the base charter rates are adjusted based on the actual LIBOR compared to a base LIBOR. The performance under the charters is fully guaranteed by Golden Ocean. We will also receive a 33% profit share of revenues above the interest adjusted base charter rates, calculated and payable on a quarterly basis. In the year ended December 31, 2018, the Company earned \$0.2 million income under this arrangement (2017: \$0.2 million; 2016: \$nil). The charters for these vessels are classified as operating leases and at December 31, 2018, the net book value of these vessels was \$217.7 million (2017: \$233.7 million).

We pay Frontline Management a management fee of \$9,000 per day per vessel for all vessels chartered to Frontline Shipping, apart from certain vessels where the fee is suspended while they are sub-chartered on a bareboat basis. This daily fee has been payable since July 1, 2015, when amendments to the charter agreement became effective, before which the fixed daily fee was \$6,500 per day. As of March 26, 2019, we also have 15 container vessels, 14 dry bulk carriers, two Suezmax tankers, two car carriers and two product tankers operating on time charter or in the spot market, for which the supervision of the technical management is sub-contracted to Frontline Management. In the year ended December 31, 2018, management fees paid to Frontline Management amounted to \$24.0 million (2017: \$36.5 million; 2016: \$45.9 million). The management fees are classified as vessel operating expenses.

We pay Golden Ocean Management a management fee of \$7,000 per day per vessel for the eight vessels chartered to a subsidiary of Golden Ocean. As of March 26, 2019, we also have 15 container vessels and 14 dry bulk carriers operating on time-charters, for which part of the operating management is sub-contracted to Golden Ocean Management. In the year ended December 31, 2018, total management fees paid to Golden Ocean Management amounted to approximately \$21.2 million (2017: \$21.2 million; 2016: \$21.3 million).



In February 2018, July 2018, August 2018, September 2018 and October 2018, we sold the vessels Front Circassia, Front Page, Front Stratus, Front Serenade and Front Ariake, respectively, to unrelated third parties. A termination fee of \$8.9 million (with a fair value of \$4.4 million), was received in the form of a loan note from Frontline Shipping and \$3.4 million, \$3.4 million, \$3.4 million and \$3.4 million respectively, were received in the form of loan notes from Frontline as compensation for early termination of the charters.

In March 2017, May 2017, June 2017 and August 2017, Front Century, Front Brabant, Front Scilla and Front Ardenne on charter to Frontline Shipping were sold to unrelated third parties and their leases canceled, with agreed termination fees of \$4.1 million, \$3.6 million, \$6.5 million and \$4.8 million, respectively, received as compensation for the early termination of the charters.

In July 2016, the VLCC Front Vanguard on charter to Frontline Shipping was sold to an unrelated third party, with an agreed termination fee of \$0.3 million received as compensation for the early termination of the charter.

In February 2016, we sold the offshore support vessel Sea Bear to an unrelated third party and received compensation from Deep Sea for the early termination of the charter. The compensation was in the form of a loan note from Deep Sea, receivable over the approximately six remaining years of the canceled lease. The initial face value of the notes, on which interest at 7.25% is receivable, was \$14.6 million and their initial fair value was determined to be \$11.6 million. The Company received \$0.4 million interest on the loan note in 2017 up until it was no longer considered a related party receivable (2016: \$0.9 million).

On October 5, 2016, we issued a senior unsecured convertible bond loan totaling \$225 million. In conjunction with the bond issue, we loaned up to 8,000,000 of our common shares to an affiliate of one of the underwriters of the issue, in order to assist investors in the bonds to hedge their position. The shares that we lent were initially borrowed from Hemen, our largest shareholder, for a one-time loan fee of \$120,000. In November 2016, we issued 8,000,000 new shares, to replace the shares borrowed from Hemen, and received \$80,000 from Hemen.

In May 2018, four wholly-owned subsidiaries of the Company entered into a \$320.0 million unsecured loan facility provided by an affiliate of Hemen, Sterna Finance. The unsecured intermediary loan facility was entered into to partly fund the acquisition of four 13,800 TEU container vessels acquired in May 2018. The Company had provided a corporate guarantee for this loan facility, which had a fixed interest rate, was non-amortizing and had a term of 13 months from the drawdown date of the loan. Interest expense incurred on the loan in the year ended December 31, 2018 was \$6.4 million. The loan balance was prepaid in full in November 2018.

In August 2018, the Company acquired 4,031,800 shares in ADS, a newly formed company trading on the Oslo Merkur Market. The shares were purchased for \$10.0 million, and have a fair value of \$9.2 million at December 31, 2018. These shares, on which no dividend income was received in the year ended December 31, 2018, represent approximately 17.24% of the outstanding shares in the company.

In November 2016, we acquired approximately 12 million shares in NorAm Drilling for a consideration of approximately \$0.7 million. In November 2018 NorAm undertook a share consolidation of 20:1, resulting in a revised investment of 601,023 shares. On the same day NorAm participated in a rights issue, increasing the Company's investment in shares by 623,447 shares. In December 2018, the Company acquired an additional 41,756 shares bringing the total investment in NorAm to 1,266,226 shares with a fair value of \$3.9 million. This investment, on which \$nil dividend was received in the year ended December 31, 2018, is included in "Investments in Debt and Equity Securities" (Note 11) (2017: \$nil; 2016: \$nil).

The Company also holds within "Investments in Debt and Equity Securities" senior secured corporate bonds in NorAm Drilling due 2021. During the year ended December 31, 2018, the Company redeemed a total of 466,667 units at par value and recorded no gain or loss on redemption. This investment is included in Note 11: Investments in Debt and Equity Securities. Interest amounting to \$0.5 million was earned in the year ended December 31, 2018 (2017: \$0.5 million; 2016: \$0.5 million). In addition, the Company earned other income of \$nil in the year ended December 31, 2018, (2017: \$0.1 million; 2016: \$nil).

During the year ended December 31, 2018, Golden Close initiated liquidation proceedings. As a result of this, the Company received total proceeds of \$45.6 million in settlement of its total investment, resulting in an overall net gain of \$13.5 million. The Company earned interest income on the Golden Close notes up to the date of redemption of \$0.2 million in the year ended December 31, 2018 (2017: \$0.6 million; 2016: \$0.2 million). As at December 31, 2018, the net investment in Golden Close debt and equity securities is \$nil (2017: \$28.5 million).

During the year ended December 31, 2017, the Company received 8.9 million shares in Golden Close as part of a bond restructuring undertaken by Golden Close. These shares represented approximately 20% of the outstanding shares in the company when they were acquired.

In June 2017, the Company facilitated a performance guarantee in favour of an oil company relating to a new contract for the drillship Deepsea Metro 1, which is owned by Golden Close. The guarantee had a maximum liability limited to \$18.0 million, a maturity of up to six months, and was secured under a first lien mortgage over the drillship, ranking ahead of other secured claims. In the year ended December 31, 2017, the Company recorded net fee income of \$0.4 million for facilitating the guarantee. The performance guarantee agreement was terminated in September 2017.

SFL Deepwater, SFL Hercules and SFL Linus are wholly-owned subsidiaries of the Company, which are accounted for using the equity method. Ship Finance has agreements with SFL Deepwater, SFL Hercules and SFL Linus granting them loans of \$145.0 million, \$145.0 million and \$125.0 million, respectively. The loans carry a fixed interest rate and are repayable in full on October 1, 2023, October 1, 2023 and June 30, 2029, respectively, or earlier if the companies sell their drilling units. The outstanding loan balances as at December 31, 2018, were \$109.0 million, \$80.0 million, and \$121.0 million for SFL Deepwater, SFL Hercules and SFL Linus, respectively. Ship Finance is entitled to take excess cash from these companies, and such amounts are recorded within their current accounts with Ship Finance. The loan agreements specify that the balance on the current accounts will have no interest applied and will be settled by offset against the eventual repayments of the fixed interest loans. In the year ended December 31, 2018, the Company received interest income on these loans of \$5.1 million from SFL Deepwater (2017: \$5.4 million; 2016: \$6.5 million), \$3.6 million from SFL Hercules (2017: \$4.3 million; 2016: \$6.5 million) and \$5.4 million from SFL Linus (2017: \$5.5 million, 2016: \$5.6 million) totaling \$14.1 million. As at December 31, 2018, the combined bank borrowings of SFL Deepwater, SFL Hercules and SFL Linus amounted to \$655.2 million and the Company guaranteed \$266.1 million of this debt which is secured by first priority mortgages over the relevant rigs. In addition, the Company has assigned all claims it may have under secured loans granted by the Company to SFL Deepwater, SFL Hercules and SFL Linus, in favor of the lenders under the respective credit facilities.

#### C. INTERESTS OF EXPERTS AND COUNSEL

Not Applicable.

#### ITEM 8. FINANCIAL INFORMATION

##### A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

See Item 18.

##### Legal Proceedings

We and our ship-owning subsidiaries are routinely party, as plaintiff or defendant, to claims and lawsuits in various jurisdictions for demurrage, damages, off-hire and other claims and commercial disputes arising from the operation of their vessels, in the ordinary course of business or in connection with acquisition activities. We believe that resolution of such claims will not have a material adverse effect on our operations or financial conditions.

##### Dividend Policy

Our Board of Directors adopted a policy in May 2004 in connection with our public listing, whereby we seek to pay a regular quarterly dividend, the amount of which is based on our contracted revenues and growth prospects. Our goal is to increase our quarterly dividend as we grow the business, but the timing and amount of dividends, if any, is at the sole discretion of our Board of Directors and will depend upon our operating results, financial condition, cash requirements, restrictions in terms of financing arrangements and other relevant factors.

We have paid the following cash dividends in 2014, 2015, 2016, 2017 and 2018:

| Payment Date       | Amount<br>per<br>Share |
|--------------------|------------------------|
| 2014               |                        |
| March 28, 2014     | \$ 0.40                |
| June 30, 2014      | \$ 0.41                |
| September 30, 2014 | \$ 0.41                |
| December 30, 2014  | \$ 0.41                |
| 2015               |                        |
| March 27, 2015     | \$ 0.42                |
| June 30, 2015      | \$ 0.43                |
| September 30, 2015 | \$ 0.44                |
| December 30, 2015  | \$ 0.45                |
| 2016               |                        |
| March 30, 2016     | \$ 0.45                |
| June 29, 2016      | \$ 0.45                |
| September 29, 2016 | \$ 0.45                |
| December 29, 2016  | \$ 0.45                |
| 2017               |                        |
| March 30, 2017     | \$ 0.45                |
| June 30, 2017      | \$ 0.45                |
| September 29, 2017 | \$ 0.35                |
| December 29, 2017  | \$ 0.35                |
| 2018               |                        |
| March 27, 2018     | \$ 0.35                |
| June 29, 2018      | \$ 0.35                |
| September 27, 2018 | \$ 0.35                |
| December 28, 2018  | \$ 0.35                |

On February 26, 2019, our Board of Directors declared a dividend of \$0.35 per share which will be paid in cash on or around March 26, 2019.

#### B. SIGNIFICANT CHANGES

None.

ITEM 9. THE OFFER AND LISTING

Not applicable except for Item 9.A.4. and Item 9.C.

The Company's common shares were listed on the NYSE on June 15, 2004, and commenced trading on that date under the symbol "SFL".

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## ITEM 10. ADDITIONAL INFORMATION

### A. SHARE CAPITAL

Not Applicable.

### B. MEMORANDUM AND ARTICLES OF ASSOCIATION

The Memorandum of Association of the Company has previously been filed as Exhibit 3.1 to the Company's Registration Statement on Form F-4 (Registration No. 333-115705) filed with the SEC on May 25, 2004, and is hereby incorporated by reference into this Annual Report.

At our 2013 Annual General Meeting the shareholders voted to amend our Bye-laws, principally those governing General Meetings, proceedings of the Board of Directors and delegation of its powers. These amended Bye-laws of the Company as adopted by shareholders on September 20, 2013, have previously been filed as Exhibit 1.3 to the Company's annual report on Form 20-F for the year ended December 31, 2014, filed with the SEC on April 9, 2015 and are hereby incorporated by reference to this Annual Report.

At our 2016 Annual General Meeting the shareholders voted to amend our Bye-laws to change the quorum requirement for General Meetings to two Members present in person or by proxy and entitled to vote (whatever the number of shares held by them). These amended Bye-laws of the Company as adopted by shareholders on September 23, 2016, have previously been filed as Exhibit 1 to the Company's report on Form 6-K, filed with the SEC on September 29, 2016, and are hereby incorporated by reference to this Annual Report.

At our 2016 Annual General Meeting the shareholders approved the reorganization of the Company's share capital which resulted in a reduction of the par value of the Company's common shares from \$1.00 to \$0.01 and an increase in the number of authorized shares from 125,000,000 to 150,000,000.

At our 2018 Annual General Meeting, the shareholders approved the increase of the Company's authorized share capital from US\$1,500,000 divided into 150,000,000 common shares of US\$0.01 par value each to US\$2,000,000 divided into 200,000,000 common shares of US\$0.01 par value each by the authorization of an additional 50,000,000 common shares of US\$0.01 par value each.

The purposes and powers of the Company are set forth in Items 6(1) and 7(a) through (h) of our Memorandum of Association and in the Second Schedule of the Bermuda Companies Act of 1981, which is attached as an exhibit to our Memorandum of Association. These purposes include exploring, drilling, moving, transporting and refining petroleum and hydro-carbon products, including oil and oil products; the acquisition, ownership, chartering, selling, management and operation of ships and aircraft; the entering into of any guarantee, contract, indemnity or suretyship and to assure, support, secure, with or without the consideration or benefit, the performance of any obligations of any person or persons; and the borrowing and raising of money in any currency or currencies to secure or discharge any debt or obligation in any manner.

Bermuda law permits the Bye-laws of a Bermuda company to contain provisions excluding personal liability of a director, alternate director, officer, member of a committee authorized under Bye-law 98, resident representative or their respective heirs, executors or administrators to the company for any loss arising or liability attaching to him by virtue of any rule of law in respect of any negligence, default, breach of duty or breach of trust of which the officer or person may be guilty. Bermuda law also grants companies the power generally to indemnify directors, alternate directors and officers of the Company and any members of a committee authorized under Bye-law 98, resident representatives or their respective heirs, executors or administrators if any such person was or is a party or threatened to be made a party to a threatened, pending or completed action, suit or proceeding by reason of the fact that he or she

is or was a director, alternate director or officer of the Company or member of a committee authorized under Bye-law 98, resident representative or their respective heirs, executors or administrators or was serving in a similar capacity for another entity at the Company's request.

Our shareholders have no pre-emptive, subscription, redemption, conversion or sinking fund rights. Shareholders are entitled to one vote for each share held of record on all matters submitted to a vote of our shareholders. Shareholders have no cumulative voting rights. Shareholders are entitled to dividends if and when they are declared by our Board of Directors, subject to any preferred dividend right of holders of any preference shares. Directors to be elected by shareholder require a majority of votes cast at a meeting at which a quorum is present. For all other matters, unless a different majority is required by law or our Bye-laws, resolutions to be approved by shareholders require approval by a majority of votes cast at a meeting at which a quorum is present.



Upon our liquidation, dissolution or winding up, shareholders will be entitled to receive, ratably, our net assets available after the payment of all our debts and liabilities and any preference amount owed to any preference shareholders. The rights of shareholders, including the right to elect directors, are subject to the rights of any series of preference shares we may issue in the future.

Under our Bye-laws annual meetings of shareholders will be held each calendar year at a time and place selected by our Board of Directors (but never in the United Kingdom or Norway). Special meetings of shareholders may be called by our Board of Directors at any time and must be called at the request of shareholders holding at least 10% of our paid-up share capital carrying the right to vote at general meetings. Under our Bye-laws five days' notice of an annual meeting or any special meeting must be given to each shareholder entitled to vote at that meeting. Under Bermuda law accidental failure to give notice will not invalidate proceedings at a meeting. Our Board of Directors may set a record date at any time before or after any date on which such notice is dispatched.

Special rights attaching to any class of our shares may be altered or abrogated with the consent in writing of not less than 75% of the issued shares of that class or with the sanction of a resolution passed at a separate general meeting of the holders of such shares voting in person or by proxy.

Our Bye-laws do not prohibit a director from being a party to, or otherwise having an interest in, any transaction or arrangement with the Company or in which the Company is otherwise interested. Our Bye-laws provide our Board of Directors the authority to exercise all of the powers of the Company to borrow money and to mortgage or charge all or any part of our property and assets as collateral security for any debt, liability or obligation. Our directors are not required to retire because of their age, and our directors are not required to be holders of our common shares. Directors serve for one year terms, and shall serve until re-elected or until their successors are appointed at the next annual general meeting.

Our Bye-laws provide that no director, alternate director, officer, person or member of a committee, if any, resident representative, or his heirs, executors or administrators, which we refer to collectively as an indemnitee, is liable for the acts, receipts, neglects, or defaults of any other such person or any person involved in our formation, or for any loss or expense incurred by us through the insufficiency or deficiency of title to any property acquired by us, or for the insufficiency or deficiency of any security in or upon which any of our monies shall be invested, or for any loss or damage arising from the bankruptcy, insolvency, or tortious act of any person with whom any monies, securities, or effects shall be deposited, or for any loss occasioned by any error of judgment, omission, default, or oversight on his part, or for any other loss, damage or misfortune whatever which shall happen in relation to the execution of his duties, or supposed duties, to us or otherwise in relation thereto. Each indemnitee will be indemnified and held harmless out of our funds to the fullest extent permitted by Bermuda law against all liabilities, loss, damage or expense (including but not limited to liabilities under contract, tort and statute or any applicable foreign law or regulation and all reasonable legal and other costs and expenses properly payable) incurred or suffered by him as such director, alternate director, officer, person or committee member or resident representative (or in his reasonable belief that he is acting as any of the above). In addition, each indemnitee shall be indemnified against all liabilities incurred in defending any proceedings, whether civil or criminal, in which judgment is given in such indemnitee's favor, or in which he is acquitted. We are authorized to purchase insurance to cover any liability he may incur under the indemnification provisions of our Bye-laws.

### C. MATERIAL CONTRACTS

The Company has not entered into any new material contracts since January 1, 2018, other than those entered in the ordinary course of business or already attached in the exhibits.

Seadrill's Plan of Reorganization

On July 2, 2018, Seadrill emerged from Chapter 11 successfully completing its reorganization pursuant its plan of reorganization, or the Plan of Reorganization entered into in 2017. Under the terms of the Plan of Reorganization, the Company has agreed to reduce the contractual charter hire for each of the three drilling units on charter to the Seadrill Charterers by approximately 29% for a period of five years starting in 2018, with the reduced amounts added back in the period thereafter, as set out in the Restructuring Plan. The term of the charters for West Hercules and West Taurus were extended by 13 months until December 2024. The call options on behalf of the Seadrill Charterers under the relevant leases have also been amended as set out in the Restructuring Plan. In addition, the purchase obligations in the case of West Hercules and West Taurus and the put option in the case of West Linus at expiry of the charters have been amended as set out in the Restructuring Plan. The performance under the charters is guaranteed by Seadrill. The Restructuring Plan is an exhibit incorporated by reference to this annual report.

We also refer you to “Item 4. Information on the Company -A. History and Development of the Company,” “Item 5. Operating and Financial Review and Prospects -B. Liquidity and Capital Resources” and “Item 7. Major Shareholders and Related Party Transactions -B. Related Party Transactions” for a discussion of existing material agreements.

#### D. EXCHANGE CONTROLS

The Bermuda Monetary Authority, or the BMA, must give permission for all issuances and transfers of securities of a Bermuda exempted company like us. We have received a general permission from the BMA to issue any unissued common shares, and for the free transferability of the common shares as long as our common shares are listed on the NYSE. Our common shares may therefore be freely transferred among persons who are non-residents of Bermuda.

Although we are incorporated in Bermuda, we are classified as non-resident of Bermuda for exchange control purposes by the BMA. Other than transferring Bermuda Dollars out of Bermuda, there are no restrictions on our ability to transfer funds into and out of Bermuda or to pay dividends to U.S. residents who are holders of our common shares or other non-resident holders of our common shares in currency other than Bermuda Dollars.

#### E. TAXATION

##### U.S. Taxation

The following discussion is based upon the provisions of the U.S. Internal Revenue Code of 1986, as amended, or the Code, existing and proposed U.S. Treasury Department regulations, or the Treasury Regulations, administrative rulings and pronouncements and judicial decisions, all as of the date of this annual report. Unless otherwise noted, references to the "Company" include the Company's Subsidiaries. This discussion assumes that we do not have an office or other fixed place of business in the United States.

##### Taxation of the Company's Shipping Income: In General

The Company anticipates that it will derive a significant portion of its gross income from the use and operation of vessels in international commerce and that this income will principally consist of freights from the transportation of cargoes, hire or lease from time or voyage charters and the performance of services directly related thereto, which the Company refers to as "shipping income."

Shipping income that is attributable to transportation that begins or ends, but that does not both begin and end, in the United States will be considered to be 50% derived from sources within the United States. Shipping income attributable to transportation that both begins and ends in the United States will be considered to be 100% derived from sources within the United States. The Company is not permitted by law to engage in transportation that gives rise to 100% U.S. source income.

Shipping income attributable to transportation exclusively between non-U.S. ports will be considered to be 100% derived from sources outside the United States. Shipping income derived from sources outside the United States will not be subject to U.S. federal income tax.

Based upon the Company's anticipated shipping operations, the Company's vessels will operate in various parts of the world, including to or from U.S. ports. Unless exempt from U.S. federal income taxation under Section 883 of the Code, the Company will be subject to U.S. federal income taxation, in the manner discussed below, to the extent its shipping income is considered derived from sources within the United States.

### Application of Section 883 of the Code

Under the relevant provisions of Section 883 of the Code, or Section 883, the Company will be exempt from U.S. federal income taxation on its U.S. source shipping income if:

It is organized in a "qualified foreign country," which is one that grants an equivalent exemption from tax to (i) corporations organized in the United States in respect of the shipping income for which exemption is being claimed under Section 883, and which the Company refers to as the Country of Organization Requirement; and

(ii) It can satisfy any one of the following two stock ownership requirements for more than half the days during the taxable year:

the Company's stock is "primarily and regularly traded on an established securities market" located in the United States or a "qualified foreign country," which the Company refers to as the Publicly-Traded Test; or more than 50% of the Company's stock, in terms of value, is beneficially owned by any combination of one or more individuals who are residents of a "qualified foreign country" or foreign corporations that satisfy the Country of Organization Requirement and the Publicly-Traded Test, which the Company refers to as the 50% Ownership Test.

The U.S. Treasury Department has recognized Bermuda, the country of incorporation of the Company and certain of its subsidiaries, as a "qualified foreign country." In addition, the U.S. Treasury Department has recognized Liberia, the Marshall Islands, Malta and Cyprus, the countries of incorporation of certain of the Company's vessel-owning subsidiaries, as "qualified foreign countries." Accordingly, the Company and its vessel-owning subsidiaries satisfy the Country of Organization Requirement.

Therefore, the Company's eligibility to qualify for exemption under Section 883 is wholly dependent upon being able to satisfy one of the stock ownership requirements.

As discussed below, for the 2018 taxable year we believe the Company satisfied the Publicly-Traded Test, since on more than half the days in the taxable year we believe the Company's common shares were primarily and regularly traded on an established securities market in the United States, namely the NYSE.

As to the Publicly-Traded Test, the Treasury Regulations under Section 883 provide, in pertinent part, that stock of a foreign corporation will be considered to be "primarily traded" on an established securities market in a country if the number of shares of each class of stock that is traded during any taxable year on all established securities markets in that country exceeds the number of shares in each such class that is traded during that year on established securities markets in any other single country.

The Publicly-Traded Test also requires our common shares be "regularly traded" on an established securities market. Under the Treasury Regulations, our common shares are considered to be "regularly traded" on an established securities market if shares representing more than 50% of our outstanding common shares, by both total combined voting power of all classes of stock entitled to vote and total value, are listed on the market, referred to as the "listing threshold." The Treasury Regulations further require that with respect to each class of stock relied upon to meet the listing threshold (i) such class of stock is traded on the market, other than in minimal quantities, on at least 60 days during the taxable year or 1/6 of the days in a short taxable year, which is referred to as the "trading frequency test", and (ii) the aggregate number of shares of such class of stock traded on such market during the taxable year is at least 10% of the average number of shares of such class of stock outstanding during such year (as appropriately adjusted in the case of a short taxable year), which is referred to as the "trading volume test." Even if we do not satisfy both the trading frequency and trading volume tests, the Treasury Regulations provide that the trading frequency and trading volume tests will be deemed satisfied if our common shares are traded on an established securities market in the United States and such stock is regularly quoted by dealers making a market in our common shares, such as the NYSE on which our common shares are listed.

Notwithstanding the foregoing, our common shares will not be considered to be regularly traded on an established securities market for any taxable year in which 50% or more of the vote and value of the outstanding common shares are owned, actually or constructively under certain stock attribution rules, on more than half the days during the taxable year by persons who each own 5% or more of the value of our common shares, which we refer to as the 5 Percent Override Rule.

In order to determine the persons who actually or constructively own 5% or more of our common shares, or 5% Shareholders, we are permitted to rely on those persons that are identified on Schedule 13G and Schedule 13D filings with the U.S. Securities and Exchange Commission as having a 5% or more beneficial interest in our common shares. In addition, an investment company identified on a Schedule 13G or Schedule 13D filing which is registered under the Investment Company Act of 1940, as amended, will not be treated as a 5% Shareholder for such purposes.

For our 2018 taxable year, we do not believe that we were subject to the 5 Percent Override Rule and, therefore, we believe that we satisfied the Publicly-Traded Test. There are, however, factual circumstances beyond our control that could cause the Company to lose the benefit of the Section 883 exemption and thereby become subject to U.S. federal income tax on its U.S. source shipping income. For example, Hemen owned as much as approximately 22.5% of our outstanding common shares during the 2018 year. There is, therefore, a risk that the Company could no longer qualify for exemption under Section 883 for a particular taxable year if other 5% Shareholders were, in combination with Hemen, to own 50% or more of the outstanding common shares of the Company on more than half the days during the taxable year. Due to the factual nature of the issues involved, there can be no assurances as to the tax-exempt status of the Company or any of its subsidiaries.

In the event the 5 Percent Override Rule is triggered, the 5 Percent Override Rule will nevertheless not apply if we can establish that among the closely-held group of 5% Shareholders, there are sufficient 5% Shareholders that are considered to be "qualified shareholders" for purposes of Section 883 to preclude non-qualified 5% Shareholders in the closely-held group from owning 50% or more of our common shares for more than half the number of days during the taxable year.

In any year that the 5 Percent Override Rule is triggered with respect to us, we are eligible for the exemption from tax under Section 883 only if we can nevertheless satisfy the Publicly-Traded Test (which requires, among other things, showing that the exception to the 5 Percent Override Rule applies) or if we can satisfy the 50% Ownership Test. In either case, certain substantiation and reporting requirements regarding the identity of our shareholders must be satisfied in order to qualify for the Section 883 exemption. These requirements are onerous and there is no assurance that we would be able to satisfy them.

#### Taxation in Absence of the Section 883 Exemption

To the extent the benefits of Section 883 are unavailable with respect to any item of U.S. source income, the Company's U.S. source shipping income, to the extent not considered to be "effectively connected" with the conduct of a U.S. trade or business, as described below, would be subject to a 4% tax imposed by Section 887 of the Code on a gross basis, without the benefit of deductions, which we refer to as the "4% gross basis tax regime." Since, under the sourcing rules described above, no more than 50% of the Company's shipping income would be treated as being derived from U.S. sources, the maximum effective rate of U.S. federal income tax on the Company's shipping income, to the extent not considered to be "effectively connected" with the conduct of a U.S. trade or business, would never exceed 2% under the 4% gross basis tax regime.

To the extent the benefits of the Section 883 exemption are unavailable and our U.S. source shipping income is considered to be "effectively connected" with the conduct of a U.S. trade or business, as described below, any such "effectively connected" U.S. source shipping income, net of applicable deductions, would be subject to the U.S. federal corporate income tax imposed at rate of 21%. In addition, we may be subject to the 30% "branch profits" tax on earnings "effectively connected" with the conduct of such U.S. trade or business, as determined after allowance for certain adjustments, and on certain interest paid or deemed paid attributable to the conduct of such U.S. trade or business.

Our U.S. source shipping income would be considered "effectively connected" with the conduct of a U.S. trade or business only if:

- we had, or were considered to have, a fixed place of business in the United States involved in the earning of U.S. source shipping income; and

substantially all of our U.S. source shipping income were attributable to regularly scheduled transportation, such as the operation of a vessel that followed a published schedule with repeated sailings at regular intervals between the same points for voyages that begin or end in the United States, or, in the case of income from the chartering of a vessel, were attributable to a fixed place of business in the United States.

We do not have, nor will we permit circumstances that would result in having, any vessel sailing to or from the United States on a regularly scheduled basis. Based on the foregoing and on the expected mode of our shipping operations and other activities, we believe that none of our U.S. source shipping income is or will be "effectively connected" with the conduct of a U.S. trade or business.



### Gain on Sale of Vessels

Regardless of whether we qualify for exemption under Section 883, we will not be subject to U.S. federal income taxation with respect to gain realized on a sale of a vessel, provided the sale is considered to occur outside of the United States under U.S. federal income tax principles. In general, a sale of a vessel will be considered to occur outside of the United States for this purpose if title to the vessel, and risk of loss with respect to the vessel, pass to the buyer outside of the United States. It is expected that any sale of a vessel by us will be considered to occur outside of the United States.

### U.S. Taxation of Our Other Income

In addition to our shipping operations, we charter drilling rigs to third parties who conduct drilling operations in various parts of the world. Since we are not engaged in a trade or business in the United States, we do not expect to be subject to U.S. federal income tax on any of our income from such charters.

### Taxation of U.S. Holders

The following is a discussion of the material U.S. federal income tax considerations relevant to an investment decision by a U.S. Holder, as defined below, with respect to our common shares. This discussion does not purport to deal with the tax consequences of owning our common shares to all categories of investors, some of which may be subject to special rules. You are encouraged to consult your own tax advisors concerning the overall tax consequences arising in your own particular situation under U.S. federal, state, local or foreign law of the ownership of our common shares.

As used herein, the term U.S. Holder means a beneficial owner of our common shares that (i) is a U.S. citizen or resident, a U.S. corporation or other U.S. entity taxable as a corporation, an estate, the income of which is subject to U.S. federal income taxation regardless of its source, or a trust if a court within the United States is able to exercise primary jurisdiction over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, (ii) owns our common shares as a capital asset, generally, for investment purposes, and (iii) owns less than 10% of our common shares for U.S. federal income tax purposes.

If a partnership holds our common shares, the tax treatment of a partner will generally depend upon the status of the partner and upon the activities of the partnership. If you are a partner in a partnership holding our common shares, you are encouraged to consult your own tax advisor regarding this issue.

### Distributions

Subject to the discussion below of passive foreign investment companies, or PFICs, any distributions made by us with respect to our common shares to a U.S. Holder will generally constitute dividends, which may be taxable as ordinary income or "qualified dividend income" as described in more detail below, to the extent of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Distributions in excess of our earnings and profits will be treated first as a nontaxable return of capital to the extent of the U.S. Holder's tax basis in his common shares on a dollar-for-dollar basis and thereafter as capital gain. Because we are not a U.S. corporation, U.S. Holders that are corporations will generally not be entitled to claim a dividends-received deduction with respect to any distributions they receive from us.

Dividends paid on our common shares to a U.S. Holder who is an individual, trust or estate, which we refer to as a U.S. Individual Holder, will generally be treated as "qualified dividend income" that is taxable to such U.S. Individual Holders at preferential tax rates provided that (1) the common shares are readily tradable on an established securities market in the United States (such as the NYSE, on which our common shares are listed); (2) we are not a PFIC for the taxable year during which the dividend is paid or the immediately preceding taxable year (see discussion below); and (3) the U.S. Individual Holder has owned the common shares for more than 60 days in the 121-day period beginning 60 days before the date on which the common shares become ex-dividend.

There is no assurance that any dividends paid on our common shares will be eligible for these preferential rates in the hands of a U.S. Individual Holder. Any dividends paid by the Company which are not eligible for these preferential rates will be taxed as ordinary income to a U.S. Individual Holder.

### Sale, Exchange or other Disposition of Common Shares

Assuming we do not constitute a PFIC for any taxable year, a U.S. Holder generally will recognize taxable gain or loss upon a sale, exchange or other disposition of our common shares in an amount equal to the difference between the amount realized by the U.S. Holder from such sale, exchange or other disposition and the U.S. Holder's tax basis in such common shares. Such gain or loss will be treated as long-term capital gain or loss if the U.S. Holder's holding period in the common shares is greater than one year at the time of the sale, exchange or other disposition. Otherwise, it will be treated as short-term capital gain or loss. A U.S. Holder's ability to deduct capital losses is subject to certain limitations.

### Passive Foreign Investment Company Status and Significant Tax Consequences

Special U.S. federal income tax rules apply to a U.S. Holder that holds stock in a foreign corporation classified as a PFIC for U.S. federal income tax purposes. In general, we will be treated as a PFIC with respect to a U.S. Holder if, for any taxable year in which such holder held our common shares, either at least 75% of our gross income for such taxable year consists of "passive income" (e.g., dividends, interest, capital gains and rents derived other than in the active conduct of a rental business), or at least 50% of the average value of the assets held by the corporation during such taxable year produce, or are held for the production of, "passive income."

For purposes of determining whether we are a PFIC, we will be treated as earning and owning our proportionate share of the income and assets, respectively, of any of our subsidiary corporations in which we own at least 25% of the value of the subsidiary's stock. Income earned, or deemed earned, by us in connection with the performance of services would not constitute passive income. By contrast, rental income would generally constitute "passive income" unless we were treated under specific rules as deriving our rental income in the active conduct of a trade or business.

Although there is no legal authority directly on point, we believe that, for purposes of determining whether we are a PFIC, the gross income we derive or are deemed to derive from the time chartering activities of our wholly-owned subsidiaries more likely than not constitutes services income, rather than rental income. Correspondingly, we believe that such income does not constitute "passive income," and the assets that we or our wholly-owned subsidiaries own and operate in connection with the production of such income, in particular, the vessels, do not constitute passive assets for purposes of determining whether we are a PFIC. We believe there is substantial legal authority supporting our position consisting of case law and Internal Revenue Service, or IRS, pronouncements concerning the characterization of income derived from time charters and voyage charters as services income for other tax purposes. This position is principally based upon the positions that (1) our time charter income will constitute services income, rather than rental income, and (2) Frontline Management and Golden Ocean Management, which provide services to certain of our time-chartered vessels, will be respected as separate entities from Frontline Shipping and the Golden Ocean Charterer, with which they are respectively affiliated.

We intend to take the position that we were not treated as a PFIC for our 2018 taxable year. For the 2019 taxable year and future taxable years, depending upon the relative amount of income we derive from our various assets as well as their relative fair market values, it is possible that we may be treated as a PFIC.

We note that there is no direct legal authority under the PFIC rules addressing our current and proposed method of operation. In addition, although we intend to conduct our affairs in a manner to avoid being classified as a PFIC with respect to any taxable year, we cannot assure you that the nature of our operations will not change in the future. Accordingly, no assurance can be given that the IRS or a court of law will accept our position, and there is a significant risk that the IRS or a court of law could determine that we are a PFIC.

As discussed more fully below, if we were to be treated as a PFIC for any taxable year, a U.S. Holder would be subject to different taxation rules depending on whether the U.S. Holder makes an election to treat us as a "Qualified Electing Fund", which election we refer to as a QEF Election. As an alternative to making a QEF election, a U.S. Holder should be able to make a "mark-to-market" election with respect to our common shares, as discussed below, and which election we refer to as a Mark-to-Market Election. In any event, if we were to be treated as a PFIC for any taxable year ending on or after December 31, 2013, a U.S. Holder would be required to file an annual report with the Internal Revenue Service for that year with respect their holding in our common shares.

### Taxation of U.S. Holders Making a Timely QEF Election

If we were to be treated as a PFIC for any taxable year and a U.S. Holder makes a timely QEF Election, which U.S. Holder we refer to as an Electing Holder, the Electing Holder must report each year for U.S. federal income tax purposes its pro rata share of our ordinary earnings and our net capital gain, if any, for our taxable year that ends with or within the taxable year of the Electing Holder, regardless of whether or not distributions were received from us by the Electing Holder. The Electing Holder's adjusted tax basis in the common shares will be increased to reflect taxed but undistributed earnings and profits. Distributions of earnings and profits that had been previously taxed will result in a corresponding reduction in the adjusted tax basis in the common shares and will not be taxed again once distributed. A U.S. Holder would make a QEF Election with respect to any taxable year that we are a PFIC by filing one copy of IRS Form 8621 with its U.S. federal income tax return. To make a QEF Election, a U.S. Holder must receive annually certain tax information from us. There can be no assurances that we will be able to provide such information annually. An Electing Holder would generally recognize capital gain or loss on the sale, exchange or other disposition of our common shares.

### Taxation of U.S. Holders Making a Mark-to-Market Election

Alternatively, if we were to be treated as a PFIC for any taxable year and, as we anticipate, our common shares are treated as "marketable stock," a U.S. Holder would be permitted to make a Mark-to-Market Election with respect to our common shares, provided the U.S. Holder completes and files IRS Form 8621 in accordance with the relevant instructions and related Treasury Regulations. If that election is made, the U.S. Holder generally would include as ordinary income in each taxable year the excess, if any, of the fair market value of the common shares at the end of the taxable year over such holder's adjusted tax basis in the common shares. The U.S. Holder would also be permitted an ordinary loss in respect of the excess, if any, of the U.S. Holder's adjusted tax basis in the common shares over its fair market value at the end of the taxable year, but only to the extent of the net amount previously included in income as a result of the Mark-to-Market Election. A U.S. Holder's tax basis in its common shares would be adjusted to reflect any such income or loss amount. Gain realized on the sale, exchange or other disposition of our common shares would be treated as ordinary income, and any loss realized on the sale, exchange or other disposition of the common shares would be treated as ordinary loss to the extent that such loss does not exceed the net mark-to-market gains previously included in income by the U.S. Holder.

### Taxation of U.S. Holders Not Making a Timely QEF or Mark-to-Market Election

Finally, if we were to be treated as a PFIC for any taxable year, a U.S. Holder who does not make either a QEF Election or a Mark-to-Market Election for that year, whom we refer to as a Non-Electing Holder, would be subject to special rules with respect to (1) any excess distribution (i.e., the portion of any distributions received by the Non-Electing Holder on our common shares in a taxable year in excess of 125% of the average annual distributions received by the Non-Electing Holder in the three preceding taxable years, or, if shorter, the Non-Electing Holder's holding period for the common shares), and (2) any gain realized on the sale, exchange or other disposition of our common shares. Under these special rules:

- the excess distribution or gain would be allocated ratably over the Non-Electing Holders' aggregate holding period for the common shares;
- the amount allocated to the current taxable year and any taxable years before the Company became a PFIC would be taxed as ordinary income; and
- the amount allocated to each of the other taxable years would be subject to tax at the highest rate of tax in effect for the applicable class of taxpayer for that year, and an interest charge for the deemed deferral benefit would be imposed

with respect to the resulting tax attributable to each such other taxable year.

These penalties would not apply to a pension or profit sharing trust or other tax-exempt organization that did not borrow funds or otherwise utilize leverage in connection with its acquisition of our common shares. If we were a PFIC, and a Non-Electing Holder who is an individual died while owning our common shares, such holder's successor generally would not receive a step-up in tax basis with respect to such common shares.

#### Taxation of Non-U.S. Holders

A beneficial owner of common shares (other than a partnership) that is not a U.S. Holder is referred to herein as a Non-U.S. Holder.

### Dividends on Common Shares

Non-U.S. Holders generally will not be subject to U.S. federal income or withholding tax on dividends received from us with respect to our common shares, unless that dividend is effectively connected with the Non-U.S. Holder's conduct of a trade or business in the United States. If the Non-U.S. Holder is entitled to the benefits of a U.S. income tax treaty with respect to those dividends, that income is taxable, or taxable at the full rate, only if it is attributable to a permanent establishment maintained by the Non-U.S. Holder in the United States.

### Sale, Exchange or Other Disposition of Common Shares

Non-U.S. Holders generally will not be subject to U.S. federal income or withholding tax on any gain realized upon the sale, exchange or other disposition of our common shares, unless:

the gain is effectively connected with the Non-U.S. Holder's conduct of a trade or business in the United States (and, if the Non-U.S. Holder is entitled to the benefits of an income tax treaty with respect to that gain, that gain is attributable to a permanent establishment maintained by the Non-U.S. Holder in the United States); or the Non-U.S. Holder is an individual who is present in the United States for 183 days or more during the taxable year of disposition and other conditions are met.

If the Non-U.S. Holder is engaged in a U.S. trade or business for U.S. federal income tax purposes, the income from the common shares, including dividends and the gain from the sale, exchange or other disposition of the common shares, that is effectively connected with the conduct of that trade or business will generally be subject to regular U.S. federal income tax in the same manner as discussed in the previous section relating to the taxation of U.S. Holders. In addition, if you are a corporate Non-U.S. Holder, your earnings and profits that are attributable to the effectively connected income, subject to certain adjustments, may be subject to an additional branch profits tax at a rate of 30%, or at a lower rate as may be specified by an applicable income tax treaty.

### Backup Withholding and Information Reporting

In general, dividend payments, or other taxable distributions, made within the United States to you will be subject to information reporting requirements. Such payments will also be subject to "backup withholding" if you are a non-corporate U.S. Holder and you:

- fail to provide an accurate taxpayer identification number;
- are notified by the IRS that you have failed to report all interest or dividends required to be shown on your U.S. federal income tax returns; or
- in certain circumstances, fail to comply with applicable certification requirements.

Non-U.S. Holders may be required to establish their exemption from information reporting and backup withholding by certifying their status on an applicable IRS Form W-8.

If you are a Non-U.S. Holder and you sell your common shares to or through a U.S. office of a broker, the payment of the proceeds is subject to both U.S. backup withholding and information reporting unless you certify that you are a non-U.S. person, under penalties of perjury, or otherwise establish an exemption. If you sell your common shares through a non-U.S. office of a non-U.S. broker and the sales proceeds are paid to you outside the United States, then information reporting and backup withholding generally will not apply to that payment. However, U.S. information reporting, but not backup withholding, will apply to a payment of sales proceeds, including a payment made to you outside the United States, if you sell your common shares through a non-U.S. office of a broker that is a U.S. person

or has some other contacts with the United States. Such information reporting requirements will not apply, however, if the broker has documentary evidence that you are a non-U.S. person and certain other conditions are met, or you otherwise establish an exemption.

Backup withholding is not an additional tax. Rather, you generally may obtain a refund of any amounts withheld under backup withholding rules that exceed your income tax liability by filing a refund claim with the IRS.



Individuals who are U.S. Holders (and to the extent specified in applicable Treasury regulations, certain individuals who are Non-U.S. Holders and certain U.S. entities) who hold "specified foreign financial assets" (as defined in Section 6038D of the Code) are required to file IRS Form 8938 with information relating to the asset for each taxable year in which the aggregate value of all such assets exceeds \$75,000 at any time during the taxable year or \$50,000 on the last day of the taxable year (or such higher dollar amount as prescribed by applicable Treasury regulations). Specified foreign financial assets would include, among other assets, our common shares, unless the shares are held through an account maintained with a U.S. financial institution. Substantial penalties apply to any failure to timely file IRS Form 8938, unless the failure is shown to be due to reasonable cause and not due to willful neglect. Additionally, in the event an individual U.S. Holder (and to the extent specified in applicable Treasury regulations, an individual Non-U.S. Holder or a U.S. entity) that is required to file IRS Form 8938 does not file such form, the statute of limitations on the assessment and collection of U.S. federal income taxes of such holder for the related tax year may not close until three years after the date that the required information is filed. U.S. Holders (including U.S. entities) and Non-U.S. Holders are encouraged to consult their own tax advisors regarding their reporting obligations under this legislation.

#### Bermuda Taxation

Under current Bermuda law, we are not subject to tax on income or capital gains. We have received from the Minister of Finance under The Exempted Undertaking Tax Protection Act 1966, as amended, an assurance that, in the event that Bermuda enacts legislation imposing tax computed on profits, income, any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance, then the imposition of any such tax shall not be applicable to us or to any of our operations or shares, debentures or other obligations, until March 31, 2035. We could be subject to taxes in Bermuda after that date. This assurance is subject to the proviso that it is not to be construed to prevent the application of any tax or duty to such persons as are ordinarily resident in Bermuda or to prevent the application of any tax payable in accordance with the provisions of the Land Tax Act 1967 or otherwise payable in relation to any property leased to us. We and our subsidiaries incorporated in Bermuda pay annual government fees to the Bermuda government.

#### F. DIVIDENDS AND PAYING AGENTS

Not Applicable.

#### G. STATEMENT BY EXPERTS

Not Applicable.

#### H. DOCUMENTS ON DISPLAY

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act. In accordance with these requirements, we file reports and other information with the SEC. These materials, including this annual report and the accompanying exhibits, may be inspected and copied at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. You may obtain information on the operation of the public reference room by calling 1 (800) SEC-0330, and you may obtain copies at prescribed rates from the public reference facilities maintained by the SEC at its principal office in Washington, D.C. 20549. The SEC maintains a website (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. In addition, documents referred to in this annual report may be inspected at our principal executive offices at Par-la-Ville Place, 14 Par-la-Ville Road, Hamilton, Bermuda HM 08. Our filings are also available on our website at [www.shipfinance.bm](http://www.shipfinance.bm). This web address is

provided as an inactive textual reference only. Information on our website does not constitute part of this annual report.

#### I. SUBSIDIARY INFORMATION

Not Applicable.

#### ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to various market risks, including interest rates and foreign currency fluctuations. We use interest rate swaps to manage interest rate risk and currency swaps to manage currency risks. We may enter into derivative instruments from time to time for speculative purposes.

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At December 31, 2018, the Company had entered into combined currency and interest rate swap contracts with a total notional principal of NOK900 million (\$151.0 million), to hedge against fluctuations in interest and exchange rates on our NOK900 million senior unsecured bonds due 2019. Under these contracts, variable NIBOR interest rates including additional margin is swapped for fixed interest at an average of 6.03%, and both the payment of interest and eventual settlement of the bonds will have an effective exchange rate of NOK5.96 = \$1. The Company has also entered into a combined currency and interest rate counter swap contract with a total notional principal of NOK100 million (approximately \$16.8 million), with equal but opposite terms to one of the NOK900 million swaps. This counter swap is not designated for hedge accounting purposes. Upon the swaps' expiry in March 2019, the Company will settle the final exchange by receiving net NOK800 million and paying net \$134.2 million at an effective exchange rate of NOK5.96 = \$1. At December 31, 2018 NOK672 million (\$77.7million) was outstanding on the NOK900 million senior unsecured bonds.

Similarly, at December 31, 2018, the Company had entered into combined currency and interest rate swap contracts with a total notional principal of NOK500 million (\$64.0 million), to hedge against fluctuations in interest and exchange rates on our NOK500 million senior unsecured bonds due 2020. Under these contracts, variable NIBOR interest rates including additional margin is swapped for fixed interest at an average of 6.91%, and both the payment of interest and eventual settlement of the bonds will have an effective exchange rate of NOK7.81 = \$1. These contracts expire between March and June 2020 and we estimate that we would pay \$4.7 million to terminate them as of December 31, 2018 (2017: \$1.8 million).

At December 31, 2018, the Company had entered into currency rate swap contracts with a total notional principal of NOK472 million (\$62.1 million), to hedge against fluctuations in exchange rates on our NOK600 million senior unsecured bonds due 2023. Under these contracts, variable NIBOR interest rates including additional margins is swapped for variable LIBOR rates including additional margins. The eventual settlement of the bonds will have an effective exchange rate of NOK7.60 = \$1. These contracts expire in September 2023 and we estimate that we would pay \$9.6 million to terminate them as of December 31, 2018.

At December 31, 2018, the Company and its consolidated subsidiaries had entered into interest rate swap contracts with a combined notional principal amount of \$721 million at fixed interest rates between 1.07% per annum and 2.93% per annum. These interest rate swap agreements mature between January 2019 and April 2023, and we estimate that we would receive \$8.7 million to terminate them as of December 31, 2018 (2017: receive 2.4 million).

The overall effect of our swaps is to fix the interest rate on approximately \$0.9 billion of our floating rate debt at December 31, 2018 (2017: \$1.2 billion), at a weighted average interest rate of 4.68% per annum including margin (2017: 4.31%).

Several of our charter contracts contain interest adjustment clauses, whereby the charter rate is adjusted to reflect the actual interest rate on the outstanding loan, effectively transferring interest rate exposure to the counterparty under the charter contract. At December 31, 2018, a total of \$0.8 billion of our floating rate debt was subject to such interest adjustment clauses, including our equity accounted subsidiaries. None of this was subject to interest rate swaps entered into for the benefit of the charterer. The balance of \$0.8 billion remained on a floating rate basis. Comparably as at December 31, 2017, a total of \$0.9 billion of our floating rate debt was subject to such interest adjustment clauses, including our equity accounted subsidiaries. Of this, approximately \$0.2 billion was also subject to interest rate swaps entered into for the benefit of the charterer, with the balance of \$0.7 billion remaining on a floating rate basis.

At December 31, 2018, our net exposure, including equity-accounted subsidiaries, to interest rate fluctuations on our outstanding debt was \$114.8 million, compared with \$132.4 million at December 31, 2017. Our net exposure to interest fluctuations is based on our total of \$1.8 billion floating rate debt outstanding at December 31, 2018, less the

\$0.9 billion notional principle of our interest rate swaps and the \$0.8 billion remaining floating rate debt subject to interest adjustment clauses under charter contracts. A one per-cent change in interest rates would thus increase or decrease net exposure by approximately \$1.1 million per year as of December 31, 2018 (2017: \$1.3 million per year).

As of March 26, 2019, we were not party to any other derivative contracts.

The Company may in the future enter into short-term Total Return Swap ("TRS") arrangements relating to our own shares and bonds or securities in other companies.

Apart from our NOK900 million, NOK500 million and NOK600 million floating rate bonds, which have been hedged, the majority of our transactions, assets and liabilities are denominated in U.S. dollars, our functional currency.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not Applicable.

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PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Neither we nor any of our subsidiaries have been subject to a material default in the payment of principal, interest, a sinking fund or purchase fund installment or any other material default that was not cured within 30 days. In addition, the payments of our dividends are not, and have not been in arrears or have not been subject to material delinquency that was not cured within 30 days.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

ITEM 15. CONTROLS AND PROCEDURES

a) Disclosure Controls and Procedures

Pursuant to Rules 13a-15(e) and 15d-15(e) of the Exchange Act, management assessed the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2018. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the evaluation date.

b) Management's annual report on internal controls over financial reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) promulgated under the Exchange Act.

Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, our principal executive and principal financial officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;  
provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of Company's management and directors; and  
provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management conducted the evaluation of the effectiveness of the internal controls over financial reporting using the control criteria framework issued by the Committee of Sponsoring Organizations of the Treadway Commission

published in its report entitled Internal Control-Integrated Framework (2013).

Our management with the participation of our Principal Executive Officer and Principal Financial Officer assessed the effectiveness of the design and operation of the Company's internal controls over financial reporting pursuant to Rule 13a-15 of the Exchange Act, as of December 31, 2018. Based upon that evaluation, the Principal Executive Officer and Principal Financial Officer concluded that the Company's internal controls over financial reporting were effective as of December 31, 2018.

c) Attestation report of the registered public accounting firm

MSPC, Certified Public Accountants and Advisors, a Professional Corporation, our independent registered public accounting firm, has issued their attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2018. Such report appears on page F-2.

d) Changes in internal control over financial reporting

There were no changes in our internal controls over financial reporting that occurred during the period covered by this annual report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that our Audit Committee has one Audit Committee Financial Expert. James O'Shaughnessy is an independent Director and is the Audit Committee Financial Expert, as such terms are defined under SEC rules.

ITEM 16B. CODE OF ETHICS

We have adopted a Code of Ethics that applies to all entities controlled by us and our employees, directors, officers and agents of the Company. We have posted our code of ethics on our website at [www.shipfinance.bm](http://www.shipfinance.bm). We will provide any person, free of charge, with a copy of our code of ethics upon written request to our registered office.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Our principal accountant for 2018 and 2017 was MSPC, Certified Public Accountants and Advisors, A Professional Corporation ("MSPC"). The following table sets forth the fees related to audit and other services provided by MSPC.

|                        | 2018      | 2017      |
|------------------------|-----------|-----------|
| Audit Fees (a)         | \$560,000 | \$540,000 |
| Audit-Related Fees (b) | \$129,000 | \$117,000 |
| Tax Fees (c)           | —         | —         |
| All Other Fees (d)     | \$39,000  | \$30,075  |
| Total                  | \$728,000 | \$687,075 |

(a) Audit Fees

Audit fees represent professional services rendered for the audit of our annual financial statements and services provided by the principal accountant in connection with statutory and regulatory filings or engagements.

(b) Audit -Related Fees

Audit-related fees consisted of assurance and related services rendered by the principal accountant related to the performance of the audit or review of our financial statements which have not been reported under Audit Fees above.

(c) Tax Fees

Tax fees represent fees for professional services rendered by the principal accountant for tax compliance, tax advice and tax planning.



(d) All Other Fees

All other fees include services other than audit fees, audit-related fees and tax fees set forth above.

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(e) Audit Committee's Pre-Approval Policies and Procedures

Our Board of Directors has adopted pre-approval policies and procedures in compliance with paragraph (c)(7)(i) of Rule 2-01 of Regulation S-X, that require the Board of Directors to approve the appointment of our independent auditor before such auditor is engaged and approve each of the audit and non-audit related services to be provided by such auditor under such engagement by the Company. All services provided by the principal auditor in 2018 and 2017 were approved by the Board of Directors pursuant to the pre-approval policy.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASE OF EQUITY SECURITIES BY ISSUER AND AFFILIATED PURCHASERS

No shares have been repurchased by the Company or any "affiliated purchaser," as such term is defined in Rule 10b-18(a)(3) of the Exchange Act, since January 2006.

ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

Pursuant to an exception under the NYSE listing standards available to foreign private issuers, we are not required to comply with all of the corporate governance practices followed by U.S. companies under the NYSE listing standards. The significant differences between our corporate governance practices and the NYSE standards applicable to listed U.S. companies are set forth below.

**Executive Sessions.** The NYSE requires that non-management directors meet regularly in executive sessions without management. The NYSE also requires that all independent directors meet in an executive session at least once a year. As permitted under Bermuda law and our Bye-laws, our non-management directors have not regularly held executive sessions without management, and we do not expect them to do so in the future.

**Nominating/Corporate Governance Committee.** The NYSE requires that a listed U.S. company have a nominating/corporate governance committee of independent directors and a committee charter specifying the purpose, duties and evaluation procedures of the committee. As permitted under Bermuda law and our Bye-laws, we do not currently have a nominating or corporate governance committee.

**Audit Committee.** The NYSE requires, among other things, that a listed U.S. company have an audit committee with a minimum of three members. As permitted by Rule 10A-3 under the Exchange Act, our audit committee consists of one independent member of our Board of Directors.

**Corporate Governance Guidelines.** The NYSE requires U.S. companies to adopt and disclose corporate governance guidelines. The guidelines must address, among other things: director qualification standards, director responsibilities, director access to management and independent advisers, director compensation, director orientation and continuing education, management succession and an annual performance evaluation. We are not required to adopt such guidelines under Bermuda law and we have not adopted such guidelines.

**Independence of Directors.** The NYSE requires that a U.S. listed company maintain a majority of independent directors. As a Foreign Private Issuer, we are exempt from this rule and may comply with it voluntarily. Our Board of Directors currently consists of five directors, four of which are considered "independent" according to NYSE's standards for independence. However, as permitted under Bermuda law, our Board of Directors may in the future not consist of a majority of independent directors.

**Compensation Committee.** The NYSE requires that a listed U.S. company have a compensation committee of independent directors. As a Foreign Private Issuer we are exempt from this rule and may comply with it voluntarily. As permitted under Bermuda law, our Compensation Committee does not currently, and may not in the future, consist entirely of independent directors.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

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PART III

ITEM 17. FINANCIAL STATEMENTS

See Item 18.

ITEM 18. FINANCIAL STATEMENTS

The following financial statements listed below and set forth on pages F-1 through F-58 are filed as part of this annual report:

Financial Statements: Ship Finance International Limited

|  |             |
|--|-------------|
| <u>Report of Independent Registered Public Accounting Firm</u>   | <u>F-2</u>  |
| <u>Consolidated Statements of Operations for the years ended December 31, 2018, 2017 and 2016</u>                      | <u>F-4</u>  |
| <u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2018, 2017 and 2016</u>            | <u>F-5</u>  |
| <u>Consolidated Balance Sheets as of December 31, 2018 and 2017</u>  | <u>F-6</u>  |
| <u>Consolidated Statements of Cash Flows for the years ended December 31, 2018, 2017 and 2016</u>                      | <u>F-7</u>  |
| <u>Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2018, 2017 and 2016</u> | <u>F-8</u>  |
| <u>Notes to Consolidated Financial Statements</u>  | <u>F-10</u> |

ITEM 19. EXHIBITS

Number Description of Exhibit

- 1.1\* Memorandum of Association of Ship Finance International Limited (the "Company"), incorporated by reference to Exhibit 3.1 of the Company's Registration Statement, SEC File No. 333-115705, filed on May 21, 2004 (the "Original Registration Statement").
- 1.2\* Amended and Restated Bye-laws of the Company, as adopted on September 28, 2007, incorporated by reference to Exhibit 1 of the Company's 6-K filed on October 22, 2007.
- 1.3\* Amended and Restated Bye-laws of the Company, as adopted on September 20, 2013, incorporated by reference to Exhibit 1.3 of the Company's 2014 Annual Report filed on Form 20-F on April 9, 2015.
- 1.4\* Amended and Restated Bye-laws of the Company, as adopted on September 23, 2016, incorporated by reference to Exhibit 1 of the Company's Form 6-K filed on September 29, 2016.
- 2.1\* Form of Common Stock Certificate of the Company, incorporated by reference to Exhibit 4.1 of the Company's Original Registration Statement.
- 4.1\* Form of Performance Guarantee dated January 1, 2004, issued by Frontline Ltd, incorporated by reference to Exhibit 10.3 of the Company's Original Registration Statement.
- 4.2\* Amendment No. 4 to Performance Guarantee dated January 1, 2004, incorporated by reference to Exhibit 4.3 of the Company's 2009 Annual Report as filed on Form 20-F on April 1, 2010.
- 4.3\* Form of Time Charter, incorporated by reference to Exhibit 10.4 of the Company's Original Registration Statement.
- 4.4\* Form of Vessel Management Agreements, incorporated by reference to Exhibit 10.5 of the Company's Original Registration Statement.
- 4.5\* Form of Charter Ancillary Agreement dated January 1, 2004, incorporated by reference to Exhibit 10.6 of the Company's Original Registration Statement.
- 4.6\* Addendum No. 6 to Charter Ancillary Agreement dated January 1, 2004, incorporated by reference to Exhibit 4.8 of the Company's 2009 Annual Report as filed on Form 20-F on April 1, 2010.
- 4.7\* Amendments dated August 21, 2007, to the Charter Ancillary Agreements, incorporated by reference to Exhibit 4.8 of the Company's 2007 Annual Report as filed on Form 20-F on March 17, 2008.
- 4.8\* New Administrative Services Agreement dated November 29, 2007, incorporated by reference to Exhibit 4.10 of the Company's 2007 Annual Report as filed on Form 20-F on March 17, 2008.
- 4.9\* Share Option Scheme, incorporated by reference to Exhibit 2.2 of the Company's 2006 Annual Report as filed on Form 20-F on July 2, 2007.
- 4.11\* Bond Agreement relating to Ship Finance International Limited Callable Senior Unsecured Bond Issue 2010/2014, dated October 6, 2010 incorporated by reference to Exhibit 4.11 of the Company's 2010 Annual Report filed on Form 20-F on March 25, 2011.

- 4.12\* Bond Agreement relating to Ship Finance International Limited Senior Unsecured Callable Convertible Bond Issue 2011/2016, dated February 11, 2011 incorporated by reference to Exhibit 4.12 of the Company's 2010 Annual Report filed on Form 20-F on March 25, 2011.
- 4.13\* Addendum No. 7 to Charter Ancillary Agreement dated January 1, 2004, incorporated by reference to Exhibit 4.13 of the Company's 2011 Annual Report filed on Form 20-F on April 27, 2012.
- 4.14\* Addendum No. 3 to Charter Ancillary Agreement dated June 20, 2005, incorporated by reference to Exhibit 4.14 of the Company's 2011 Annual Report filed on Form 20-F on April 27, 2012.
- 4.15a\* Indenture by and among the Company, U.S. Bank National Association and Deutsche Bank Trust Company Americas, dated January 30, 2013, incorporated by reference to the Company's report on Form 6-K filed on February 4, 2013.
- 4.15b\* First Supplemental Indenture by and among the Company, U.S. Bank National Association and Deutsche Bank Trust Company Americas, dated January 30, 2013, incorporated by reference to the Company's report on Form 6-K filed on February 7, 2013.

- Bond Agreement relating to Ship Finance International Limited Callable Senior Unsecured Bond Issue  
4.16\* 2012/2017, dated October 16, 2012, incorporated by reference to the Company's 2013 Annual Report filed on Form 20-F on March 28, 2014.
- Bond Agreement relating to Ship Finance International Limited Callable Senior Unsecured Bond Issue  
4.17\* 2014/2019, dated March 17, 2014, incorporated by reference to the Company's 2013 Annual Report filed on Form 20-F on March 28, 2014.
- Amended and Restated Charter Ancillary Agreement among the Company, the vessel owning subsidiaries of the Company, Frontline Ltd. and Frontline Shipping Limited, dated June 5, 2015 incorporated by reference to the Company's 2015 Annual Report filed on Form 20-F on April 1, 2016.  
4.18\*
- Base Indenture relating to Ship Finance International Senior Unsecured Callable Convertible Bond Issue  
4.19\* 2016/2021 dated October 5, 2016, incorporated by reference to Exhibit 99.2 of the Company's report on Form 6-K filed on October 7, 2016.
- First Supplemental Indenture to Ship Finance International Senior Unsecured Callable Convertible Bond Issue  
4.20\* 2016/2021 dated October 5, 2016, incorporated by reference to Exhibit 99.3 of the Company's report on Form 6-K filed on October 7, 2016.
- Restructuring Support and Lock-Up Agreement dated September 12, 2017, incorporated by reference to Exhibit 10.2 of Seadrill Limited's report on Form 6-K filed on September 13, 2017  
4.21\*
- Bond Agreement relating to Ship Finance International Limited Callable Senior Unsecured Bond Issue 2017/2020, dated June 16, 2017.  
4.22
- Second Supplemental Indenture by and among Ship Finance International Ltd. And U.S. Bank National Association, as Trustee, dated April 23, 2018 to Indenture dated October 5, 2016 for 4.875% Convertible Senior Notes due 2023, incorporated by reference to Exhibit 99.2 of the Company's report on Form 6-K filed on April 24, 2018  
4.23
- 8.1 Subsidiaries of the Company.
- 12.1 Certification of the Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
- 12.2 Certification of the Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended.
- 13.1 Certification of the Principal Executive Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 13.2 Certification of the Principal Financial Officer pursuant to 18 USC Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 15.1 Consent of Independent Registered Public Accounting Firm.

\* Incorporated herein by reference.



101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Schema Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Schema Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Schema Label Linkbase Document

101.PRE XBRL Taxonomy Extension Schema Presentation Linkbase Document

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

SHIP FINANCE  
INTERNATIONAL LIMITED  
(Registrant)

Date: March 26, 2019 By: /s/ Aksel C. Olesen  
Aksel C. Olesen  
Principal Executive Officer

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Ship Finance International Limited  
Index to Consolidated Financial Statements

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| <u>Consolidated Statements of Operations for the years ended December 31, 2018, 2017 and 2016</u>                      | <u>F-4</u>  |
| <u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2018, 2017 and 2016</u>            | <u>F-5</u>  |
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
Ship Finance International Limited

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Ship Finance International Limited and subsidiaries (the "Company") as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively referred to as the financial statements). We also have audited the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ship Finance International Limited and subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control—Integrated Framework (2013) issued by the COSO.

Basis for Opinion

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's annual report on internal controls over financial reporting. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included, evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition of Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ MSPC  
Certified Public Accountants and Advisors,  
A Professional Corporation

We have served as the Company's auditor since 2004.

New York, New York  
March 26, 2019

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## Ship Finance International Limited

## CONSOLIDATED STATEMENTS OF OPERATIONS

for the years ended December 31, 2018, 2017 and 2016

(in thousands of \$, except per share amounts)

|  | 2018      | 2017     | 2016     |
|--|-----------|----------|----------|
| Operating revenues   |           |          |          |
| Direct financing lease interest income - related parties       | 9,623     | 16,362   | 22,850   |
| Direct financing and sales-type lease interest income - other  | 30,055    | 21,903   | 331      |
| Finance lease service revenues - related parties               | 22,095    | 35,010   | 44,523   |
| Profit sharing revenues - related parties                      | 1,779     | 5,753    | 51,470   |
| Profit sharing revenues - other                                | —         | 61       | 74       |
| Time charter revenues - related parties                        | 53,258    | 51,832   | 55,265   |
| Time charter revenues - other                                  | 239,468   | 186,577  | 171,483  |
| Bareboat charter revenues - related parties                    | —         | 5,736    | 10,075   |
| Bareboat charter revenues - other                              | 36,222    | 34,860   | 34,964   |
| Voyage charter revenues - other                                | 24,339    | 21,037   | 19,329   |
| Other operating income   | 1,873     | 1,747    | 2,587    |
| Total operating revenues                                       | 418,712   | 380,878  | 412,951  |
| Gain/(Loss) on sale of assets and termination of charters, net | (2,578 )  | 1,124    | (167 )   |
| Gain/(Loss) on sale of subsidiaries and disposal groups        | 7,613     | —        | —        |
| Operating expenses   |           |          |          |
| Vessel operating expenses - related parties                    | 45,266    | 57,714   | 67,221   |
| Vessel operating expenses - other                              | 83,282    | 74,080   | 68,795   |
| Depreciation   | 104,079   | 88,150   | 94,293   |
| Vessel impairment charge                                       | 64,338    | —        | 5,314    |
| Administrative expenses - related parties                      | 1,072     | 831      | 1,443    |
| Administrative expenses - other                                | 8,095     | 6,601    | 7,629    |
| Total operating expenses                                       | 306,132   | 227,376  | 244,695  |
| Net operating income   | 117,615   | 154,626  | 168,089  |
| Non-operating income / (expense)                               |           |          |          |
| Interest income – related parties, associated companies        | 14,128    | 15,265   | 18,675   |
| Interest income – related parties, other                       | 880       | 422      | 897      |
| Interest income - other  | 2,943     | 3,643    | 2,164    |
| Interest expense - related parties                             | (6,378 )  | —        | —        |
| Interest expense - other                                       | (107,508) | (90,414) | (71,843) |
| (Loss)/gain on purchase of bonds                               | 1,146     | (2,305 ) | (8,802 ) |
| Available-for-sale securities impairment charge                | —         | (4,410 ) | —        |
| Dividend income - related parties                              | —         | 3,300    | 11,550   |
| Net unrealized gain on equity securities                       | 12,277    | —        | —        |
| Realized gain on sale of debt and equity securities            | 13,477    | —        | —        |
| Other financial items, net                                     | 10,407    | (2,684 ) | (2,089 ) |
| Net income before equity in earnings of associated companies   | 58,987    | 77,443   | 118,641  |
| Equity in earnings of associated companies                     | 14,635    | 23,766   | 27,765   |
| Net income   | 73,622    | 101,209  | 146,406  |
| Per share information:   |           |          |          |
| Basic earnings per share                                       | \$ 0.70   | \$ 1.06  | \$ 1.57  |
| Weighted average number of shares outstanding, basic           | 105,898   | 95,597   | 93,497   |
| Diluted earnings per share                                     | \$ 0.69   | \$ 1.03  | \$ 1.50  |

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|  |         |         |         |
|--|---------|---------|---------|
| Weighted average number of shares outstanding, diluted | 107,606 | 102,900 | 108,040 |
| Cash dividend per share declared and paid              | \$ 1.40 | \$ 1.60 | \$ 1.80 |

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

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## Ship Finance International Limited

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

for the years ended December 31, 2018, 2017 and 2016

(in thousands of \$)

|   | 2018     | 2017      | 2016      |
|---|----------|-----------|-----------|
| Comprehensive income, net of tax  |          |           |           |
| Net income  | 73,622   | 101,209   | 146,406   |
| Fair value adjustments to hedging financial instruments   | (3,433 ) | 9,974     | 9,702     |
| Earnings reclassification of previously deferred fair value adjustments to hedging financial instruments                                    | (3,127 ) | 1,555     | —         |
| Fair value adjustments to investment securities classified as available-for-sale  | 2,244    | (23,528 ) | (93,406 ) |
| Unrealized loss from investment securities classified as available-for-sale securities reclassified to Consolidated Statement of Operations | —        | 2,106     | —         |
| Fair value adjustments to hedging financial instruments in associated companies   | (206 )   | 1,182     | 1,150     |
| Other items of comprehensive (loss)/income  | (74 )    | 60        | (38 )     |
| Other comprehensive (loss)/income, net of tax   | (4,596 ) | (8,651 )  | (82,592 ) |
| Comprehensive income  | 69,026   | 92,558    | 63,814    |

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

Ship Finance International Limited  
CONSOLIDATED BALANCE SHEETS  
as of December 31, 2018 and 2017  
(in thousands of \$)

|  | 2018      | 2017      |
|--|-----------|-----------|
| <b>ASSETS</b>  |           |           |
| Current assets   |           |           |
| Cash and cash equivalents  | 211,394   | 153,052   |
| Restricted cash  | 1,000     | —         |
| Investment in debt and equity securities   | 87,174    | 93,802    |
| Trade accounts receivable  | 2,976     | 12,583    |
| Due from related parties   | 41,771    | 9,625     |
| Other receivables  | 13,041    | 9,012     |
| Inventories  | 8,547     | 5,126     |
| Prepaid expenses and accrued income  | 2,593     | 2,291     |
| Investment in direct financing and sales-type leases, current portion  | 39,804    | 32,096    |
| Financial instruments (short-term): at fair value  | 5,279     | 108       |
| Total current assets   | 413,579   | 317,695   |
| Vessels and equipment, net   | 1,559,712 | 1,762,596 |
| Vessels and equipment under capital lease, net   | 749,889   | —         |
| Investment in direct financing and sales-type leases, long-term portion  | 762,355   | 585,975   |
| Investment in associated companies   | 25,107    | 10,678    |
| Loans to related parties - associated companies, long-term   | 310,144   | 314,000   |
| Long-term receivables from related parties   | 15,616    | —         |
| Other long-term assets   | 30,810    | 12,791    |
| Financial instruments (long-term): at fair value   | 10,633    | 8,347     |
| Total assets   | 3,877,845 | 3,012,082 |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |           |           |
| Current liabilities  |           |           |
| Short-term debt and current portion of long-term debt  | 267,149   | 313,823   |
| Current portion of obligations under capital leases  | 67,793    | 9,031     |
| Trade accounts payable   | 1,945     | 487       |
| Due to related parties   | 1,349     | 857       |
| Accrued expenses   | 12,510    | 13,351    |
| Financial instruments (short-term): at fair value  | 45,047    | 503       |
| Other current liabilities  | 8,332     | 5,693     |
| Total current liabilities  | 404,125   | 343,745   |
| Long-term liabilities  |           |           |
| Long-term debt   | 1,169,931 | 1,190,184 |
| Obligations under capital leases   | 1,104,258 | 230,576   |
| Financial instruments (long-term): at fair value   | 16,213    | 48,618    |
| Other long-term liabilities  | 3,286     | 3,962     |
| Total liabilities  | 2,697,813 | 1,817,085 |
| Commitments and contingent liabilities   |           |           |
| Stockholders' equity   |           |           |
| Share capital (\$0.01 par value; 200,000,000 shares authorized; 119,373,064 shares issued and outstanding at December 31, 2018). \$0.01 par value; 150,000,000 shares authorized; 110,930,873 shares issued and outstanding at December 31, 2017). | 1,194     | 1,109     |

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|   |           |           |
|---|-----------|-----------|
| Additional paid-in capital                                  | 468,844   | 403,659   |
| Contributed surplus   | 680,703   | 680,703   |
| Accumulated other comprehensive loss                        | (220 )    | (94,612 ) |
| Accumulated other comprehensive loss – associated companies | —         | 206       |
| Retained earnings   | 29,511    | 203,932   |
| Total stockholders' equity                                  | 1,180,032 | 1,194,997 |
| Total liabilities and stockholders' equity                  | 3,877,845 | 3,012,082 |

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

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Ship Finance International Limited  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
for the years ended December 31, 2018, 2017 and 2016  
(in thousands of \$)

|   | 2018        | 2017     | 2016      |
|---|-------------|----------|-----------|
| Operating activities  |             |          |           |
| Net income  | 73,622      | 101,209  | 146,406   |
| Adjustments to reconcile net income to net cash provided by operating activities: |             |          |           |
| Depreciation  | 104,079     | 88,150   | 94,293    |
| Amortization of deferred charges  | 10,187      | 9,013    | 10,972    |
| Amortization of seller's credit   | (447)       | (1,249)  | (1,324)   |
| Amortization of long-term charter contract values acquired with vessels           | 1,699       | —        | —         |
| Vessel impairment charge  | 64,338      | —        | 5,314     |
| Available-for-sale securities impairment charge                                   | —           | 4,410    | —         |
| Long-term assets impairment charge  | 1,730       | —        | —         |
| Equity in earnings of associated companies  | (14,635)    | (23,766) | (27,765)  |
| Loss/(gain) on sale of assets and termination of charters                         | 2,578       | (1,124)  | 167       |
| Gain on sale of subsidiary and disposal groups                                    | (7,613)     | —        | —         |
| Adjustment of derivatives to fair value recognized in net income                  | (13,898)    | (8,208)  | (4,399)   |
| Unrealized gain on marketable securities  | (12,277)    | —        | —         |
| Loss/(gain) on repurchase of bonds  | (1,146)     | 2,305    | 8,802     |
| Realized gain on sale of debt and equity securities                               | (13,476)    | —        | —         |
| Interest receivable in form of notes  | —           | (635)    | (633)     |
| Other, net  | 1,108       | 3,959    | 365       |
| Changes in operating assets and liabilities                                       |             |          |           |
| Trade accounts receivable   | 9,607       | (9,034)  | (1,492)   |
| Due from related parties  | (1,308)     | 10,543   | 8,433     |
| Other receivables   | (3,870)     | 2,418    | (856)     |
| Other current assets  | (157)       | —        | —         |
| Inventories   | (3,423)     | (42)     | (27)      |
| Prepaid expenses and accrued income   | (301)       | 1,317    | 2,181     |
| Trade accounts payable  | 2,370       | (742)    | 394       |
| Accrued expenses  | (433)       | (1,188)  | 1,046     |
| Other current liabilities   | 2,641       | 460      | (11,804)  |
| Net cash provided by operating activities   | 200,975     | 177,796  | 230,073   |
| Investing activities  |             |          |           |
| Repayments from investments in direct financing and sales-type leases             | 33,486      | 31,929   | 30,410    |
| Additions to newbuildings   | —           | (81,664) | (188,142) |
| Purchase of vessels   | (1,137,703) | —        | —         |
| Proceeds from sale of vessels and termination of charters                         | 145,654     | 74,791   | 29,102    |
| Proceeds from sale of subsidiaries, net of cash disposed of                       | 83,485      | —        | —         |
| Net amounts received from/(paid to) associated companies                          | (24,161)    | 27,322   | 193,517   |
| Other investments and long-term assets, net                                       | 32,675      | (4,016)  | (25,488)  |
| Net cash provided by/(used in) investing activities                               | (866,564)   | 48,362   | 39,399    |
| Financing activities  |             |          |           |
| Proceeds from shares issued, net of issuance costs                                | —           | 88       | 323       |
| Principal settlements of cross currency swaps, net                                | —           | (29,186) | —         |
| Proceeds from capital leases  | 944,097     | —        | —         |
| Repurchase of bonds   | (97,248)    | (68,383) | (296,800) |

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|   |           |           |           |
|---|-----------|-----------|-----------|
| Proceeds from issuance of short-term and long-term debt         | 825,984   | 302,104   | 522,000   |
| Repayments of short-term and long-term debt                     | (778,731) | (179,354) | (329,303) |
| Debt fees paid  | (8,257)   | (2,554)   | (5,099)   |
| Repayments of lease obligation liability                        | (11,653)  | (5,296)   | (97)      |
| Cash dividends paid   | (149,261) | (152,907) | (168,289) |
| Net cash provided by/(used in) financing activities             | 724,931   | (135,488) | (277,265) |
| Net increase/(decrease) in cash and cash equivalents            | 59,342    | 90,670    | (7,793)   |
| Cash, restricted cash and cash equivalents at start of the year | 153,052   | 62,382    | 70,175    |
| Cash, restricted cash and cash equivalents at end of the year   | 212,394   | 153,052   | 62,382    |
| Supplemental disclosure of cash flow information:               |           |           |           |
| Interest paid, net of capitalized interest                      | 104,620   | 88,201    | 65,184    |

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

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## Ship Finance International Limited

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

for the years ended December 31, 2018, 2017 and 2016

(in thousands of \$, except number of shares)

|  | 2018        | 2017        | 2016        |
|--|-------------|-------------|-------------|
| Number of shares outstanding   |             |             |             |
| At beginning of year   | 110,930,873 | 101,504,575 | 93,468,000  |
| Shares issued  | 8,442,191   | 9,426,298   | 8,036,575   |
| At end of year   | 119,373,064 | 110,930,873 | 101,504,575 |
| Share capital  |             |             |             |
| At beginning of year   | 1,109       | 1,015       | 93,468      |
| Shares issued  | 85          | 94          | 117         |
| Transfer arising from reduction in par value of issued shares  | —           | —           | (92,570)    |
| At end of year   | 1,194       | 1,109       | 1,015       |
| Additional paid-in capital   |             |             |             |
| At beginning of year   | 403,659     | 282,502     | 285,859     |
| Amortization of stock-based compensation   | 454         | 374         | 403         |
| Stock-based compensation forfeitures   | (33)        | —           | —           |
| Shares issued  | —           | 88          | 206         |
| Shares issued arising from conversion of 3.25% convertible bonds due 2018                                      | 9,927       | 137,063     | —           |
| Adjustment to equity component of convertible bonds due 2021 and 2023 arising from reacquisition of bonds      | (1,096)     | —           | —           |
| Equity component of convertible bond issuance due 2021   | —           | —           | 4,551       |
| Adjustment to equity component of 3.25% convertible bond issuance due 2018 arising from reacquisition of bonds | (9,933)     | (16,368)    | (8,517)     |
| Shares issued arising from consideration paid on vessel acquisition  | 57,960      | —           | —           |
| Recognition of equity component arising from issuance of 4.875% convertible bonds due 2023                     | 7,906       | —           | —           |
| At end of year   | 468,844     | 403,659     | 282,502     |
| Contributed surplus  |             |             |             |
| At beginning of year   | 680,703     | 680,703     | 588,133     |
| Transfer arising from reduction in par value of issued shares  | —           | —           | 92,570      |
| At end of year   | 680,703     | 680,703     | 680,703     |
| Accumulated other comprehensive loss   |             |             |             |
| At beginning of year   | (94,612)    | (84,779)    | (1,037)     |
| Fair value adjustments to hedging financial instruments  | (3,433)     | 9,974       | 9,702       |
| Earnings reclassification of previously deferred fair value adjustments to hedging financial instruments       | (3,127)     | 1,555       | —           |
| Reclassification of unrealised losses upon adopting of ASU 2016-01   | 98,782      | —           | —           |
| Fair value adjustments to available-for-sale securities  | 2,244       | (23,528)    | (93,406)    |
| Unrealized loss from available-for-sale securities reclassified to Consolidated Statement of Operations        | —           | 2,106       | —           |
| Other comprehensive loss   | (74)        | 60          | (38)        |
| At end of year (for breakdown see below)   | (220)       | (94,612)    | (84,779)    |
| Accumulated other comprehensive loss – associated companies  |             |             |             |
| At beginning of year   | 206         | (976)       | (2,126)     |
| Fair value adjustment to hedging financial instruments   | (206)       | 1,182       | 1,150       |
|  | —           | 206         | (976)       |

At end of year (consists entirely of fair value adjustments to hedging financial instruments)

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|  | 2018       | 2017       | 2016       |
|--|------------|------------|------------|
| Retained earnings  |            |            |            |
| At beginning of year   | 203,932    | 255,630    | 277,513    |
| Reclassification of unrealized losses upon adoption of ASU 2016-01 | (98,782 )  | —          | —          |
| Net income   | 73,622     | 101,209    | 146,406    |
| Dividends declared   | (149,261 ) | (152,907 ) | (168,289 ) |
| At end of year   | 29,511     | 203,932    | 255,630    |
| Total stockholders' equity   | 1,180,032  | 1,194,997  | 1,134,095  |
| Accumulated other comprehensive loss                               | 2018       | 2017       | 2016       |
| Fair value adjustments to hedging financial instruments            | (488 )     | 6,072      | (5,457 )   |
| Fair value adjustments to available-for-sale securities            | 644        | (100,382)  | (78,960)   |
| Other items  | (376 )     | (302 )     | (362 )     |
| Accumulated other comprehensive loss                               | (220 )     | (94,612 )  | (84,779)   |

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



## SHIP FINANCE INTERNATIONAL LIMITED

### Notes to the Consolidated Financial Statements

#### 1. GENERAL

Ship Finance International Limited ("Ship Finance" or the "Company") is an international ship and offshore asset owning and chartering company, incorporated in October 2003 in Bermuda as a Bermuda exempted company. The Company's common shares are listed on the New York Stock Exchange under the symbol "SFL". The Company is primarily engaged in the ownership, operation and chartering out of vessels and offshore related assets on medium and long-term charters.

As of December 31, 2018, the Company owned three very large crude oil carriers ("VLCCs"), two Suezmax crude oil carriers, five Supramax dry bulk carriers, seven Handysize dry bulk carriers, two Kamsarmax dry bulk carriers, eight Capesize dry bulk carriers, 45 container vessels (including four chartered-in 19,200 and 19,400 twenty-foot equivalent units ("TEU") container vessels and seven 10,600 TEU and 13,800 TEU container vessels financed through sale and leaseback), two car carriers, one jack-up drilling rig, two ultra-deepwater drilling units, five offshore support vessels, two chemical tankers and two oil product tankers.

The two ultra-deepwater drilling units and the one jack-up drilling rig referred to above are owned by wholly-owned subsidiaries of the Company that are accounted for using the equity method (see Note 17: Investment in associated companies).

Since the Company's incorporation in 2003 and public listing in 2004, Ship Finance has established itself as a leading international ship and offshore asset owning and chartering company, expanding both its asset and customer base.

#### 2. ACCOUNTING POLICIES

##### Basis of Accounting

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States ("US GAAP"). The consolidated financial statements include the assets and liabilities and results of operations of the Company and its subsidiaries. All inter-company balances and transactions have been eliminated on consolidation. Where necessary, comparative figures for previous years have been reclassified to conform to changes in presentation in the current year.

##### Consolidation of variable interest entities

A variable interest entity is defined in Accounting Standards Codification ("ASC") Topic 810 "Consolidation" ("ASC 810") as a legal entity where either (a) the total equity at risk is not sufficient to permit the entity to finance its activities without additional subordinated support; (b) equity interest holders as a group lack either i) the power to direct the activities of the entity that most significantly impact on its economic success, ii) the obligation to absorb the expected losses of the entity, or iii) the right to receive the expected residual returns of the entity; or (c) the voting rights of some investors in the entity are not proportional to their economic interests and the activities of the entity involve or are conducted on behalf of an investor with a disproportionately small voting interest.

ASC 810 requires a variable interest entity to be consolidated by its primary beneficiary, being the interest holder, if any, which has both (1) the power to direct the activities of the entity which most significantly impact on the entity's economic performance, and (2) the right to receive benefits or the obligation to absorb losses from the entity which could potentially be significant to the entity.

We evaluate our subsidiaries, and any other entities in which we hold a variable interest, in order to determine whether we are the primary beneficiary of the entity, and where it is determined that we are the primary beneficiary we fully consolidate the entity.

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#### Investments in associated companies

Investments in companies over which the Company exercises significant influence but which it does not consolidate are accounted for using the equity method. The Company records its investments in equity-method investees on the consolidated balance sheets as "Investment in associated companies" and its share of the investees' earnings or losses in the consolidated statements of operations as "Equity in earnings of associated companies." At December 31, 2018, two ultra-deepwater drilling units and one jack-up drilling rig are owned by three wholly-owned subsidiaries of the Company that are accounted for using the equity method.

#### Use of accounting estimates

The preparation of financial statements in accordance with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Foreign currencies

The Company's functional currency is the U.S. dollar as the majority of revenues are received in U.S. dollars and the majority of the Company's expenditures are made in U.S. dollars. The Company's reporting currency is also the U.S. dollar. Most of the Company's subsidiaries report in U.S. dollars. Transactions in foreign currencies during the year are translated into U.S. dollars at the rates of exchange in effect at the date of the transaction. Foreign currency monetary assets and liabilities are translated using rates of exchange at the balance sheet date. Foreign currency non-monetary assets and liabilities are translated using historical rates of exchange. Foreign currency transaction gains or losses are included under "Other financial items" in the consolidated statements of operations.

#### Revenue and expense recognition

Effective from January 1, 2018, we adopted the new accounting standard ASC Topic 606 "Revenue from Contracts with Customers" using the modified retrospective method, which resulted in no adjustment to our retained earnings on adoption and comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The Company generates its revenues from the charter hire of its vessels and offshore related assets, and freight billings. Revenues are generated from time charter hire, bareboat charter hire, direct financing lease interest income, sales-type lease interest income, finance lease service revenues, profit sharing arrangements, voyage charters and other freight billings.

In a time charter voyage, the vessel is hired by the charterer for a specified period of time in exchange for consideration which is based on a daily hire rate. Generally, the charterer has the discretion over the ports visited, shipping routes and vessel speed. The contract/charter party generally provides typical warranties regarding the speed and performance of the vessel. The charter party generally has some owner protective restrictions such that the vessel is sent only to safe ports by the charterer and carries only lawful or non hazardous cargo. In a time charter contract, we are responsible for all the costs incurred for running the vessel such as crew costs, vessel insurance, repairs and maintenance and lubes. The charterer bears the voyage related costs such as bunker expenses, port charges, and canal tolls during the hire period. The performance obligations in a time charter contract are satisfied over the term of the

contract beginning when the vessel is delivered to the charterer until it is redelivered back to us. The charterer generally pays the charter hire in advance of the upcoming contract period. The time charter contracts are either operating or direct financing or sales type leases. Where time charters and bareboat charters are considered operating leases, revenues are recorded over the term of the charter as a service is provided. When a time charter contract is linked to an index, we recognize revenue for the applicable period based on the actual index for that period.

Rental payments from either direct financing leases or sales-type leases, are allocated between lease service revenue, if applicable, lease interest income and repayment of net investment in leases. The amount allocated to lease service revenue is based on the estimated fair value, at the time of entering the lease agreement, of the services provided which consist of ship management and operating services.

In a voyage charter contract, the charterer hires the vessel to transport a specific agreed-upon cargo for a single voyage. The consideration in such a contract is determined on the basis of a freight rate per metric ton of cargo carried or occasionally on a lump sum basis. The charterer is responsible for any short loading of cargo or "dead" freight. The voyage charter party generally

has standard payment terms with freight paid on completion of discharge. The voyage charter party generally has a "demurrage" clause. As per this clause, the charterer reimburses us for any potential delays exceeding the allowed laytime as per the charter party clause at the ports visited, which is recorded as voyage revenue. Estimates and judgments are required in ascertaining the most likely outcome of a particular voyage and actual outcomes may differ from estimates. Such estimate is reviewed and updated over the term of the voyage charter contract. In a voyage charter contract, the performance obligations begin to be satisfied once the vessel begins loading the cargo.

We have determined that our voyage charter contracts consist of a single performance obligation of transporting the cargo within a specified time period. Therefore, the performance obligation is met evenly as the voyage progresses, and the revenue is recognized on a straight line basis over the voyage days from the commencement of loading to completion of discharge. Contract assets with regards to voyage revenues are reported as "Voyages in progress" as the performance obligation is satisfied over time. Voyage revenues typically become billable and due for payment on completion of the voyage and discharge of the cargo, at which point the receivable is recognized as "Trade accounts receivable, net".

In a voyage contract, the Company bears all voyage related costs such as fuel costs, port charges and canal tolls. To recognize costs incurred to fulfill a contract as an asset, the following criteria shall be met: (i) the costs relate directly to the contract, (ii) the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future and (iii) the costs are expected to be recovered. The costs incurred during the period prior to commencement of loading the cargo, primarily bunkers, are deferred as they represent setup costs and recorded as a current asset and are subsequently amortized on a straight-line basis as we satisfy the performance obligations under the contract. Costs incurred to obtain a contract, such as commissions, are also deferred and expensed over the same period.

For our vessels operating under revenue sharing agreements, or in pools, revenues and voyage expenses are pooled and allocated to each pool's participants in accordance with an agreed-upon formula. Revenues generated through revenue sharing agreements are presented gross when we are considered the principal under the charter parties with the net income allocated under the revenue sharing agreement presented as within voyage charter income. For revenue sharing agreements that meet the definition of a lease, we account for such contracts as variable rate operating leases and recognize revenue for the applicable period based on the actual net revenue distributed by the pool.

As detailed in Note 24: Related party transactions, the Company has, or has had, profit sharing arrangements with Frontline Shipping Limited ("Frontline Shipping"), Golden Ocean Group Limited ("Golden Ocean"). The Company also has profit sharing agreements with Deep Sea Supply Shipowning II AS (the "Solstad Charterer"), a wholly owned subsidiary of Solship Invest 3 AS ("Solship", formerly Deep Sea Supply Plc, or Deep Sea). Amounts receivable under these arrangements are accrued on the basis of amounts earned at the reporting date.

Any contingent elements of rental income, such as profit share and interest rate adjustments, are recognized when the contingent conditions have materialized.

#### Cash and cash equivalents

For the purposes of the consolidated statements of cash flows, all demand and time deposits and highly liquid, low risk investments with original maturities of three months or less are considered equivalent to cash.



#### Investment in debt and equity securities

Investments in debt and equity securities include share investments and interest-earning listed and unlisted corporate bonds. Any premium paid on their acquisition is amortized over the life of the bond. Investments in debt securities are recorded at fair value, with unrealized gains and losses recorded as a separate component of other comprehensive income. Investments in equity securities are recorded at fair value, with unrealized gains and losses recorded in the consolidated statement of operations. If circumstances arise which lead the Company to believe that the issuer of a corporate bond may be unable meet its payment obligations in full, or that the fair value at acquisition of the share investment or corporate bond may otherwise not be fully recoverable, then to the extent that a loss is expected to arise that unrealized loss is recorded as an impairment in the statement of operations, with an adjustment if necessary to any unrealized gains or losses previously recorded in other comprehensive income. In determining whether the Company has an other-than-temporary impairment in its investment in bonds, in addition to the Company's intention and ability to hold the investments until the market recovers, the Company considers the period of decline, the amount and the severity of the decline and the ability of the investment to recover in the near to medium term. The Company also evaluates if the underlying security provided by the bonds is sufficient to ensure that the decline in fair value of these bonds did not result in an other-than-temporary impairment.

The cost of disposals or reclassifications from other comprehensive income is calculated on an average cost basis, where applicable.

The fair value of unlisted corporate bonds is determined from an analysis of projected cash flows, based on factors including the terms, provisions and other characteristics of the bonds, credit ratings and default risk of the issuing entity, the fundamental financial and other characteristics of that entity, and the current economic environment and trading activity in the debt market.

#### Trade accounts receivable

The amount shown as trade accounts receivable at each balance sheet date includes receivables due from customers for hire of vessels and offshore related assets, net of allowance for doubtful balances. At each balance sheet date, all potentially uncollectable accounts are assessed individually to determine any allowance for doubtful receivables. At December 31, 2018 and 2017, no provision was made for doubtful receivables.

#### Inventories

Inventories are comprised principally of fuel and lubricating oils and are stated at the lower of cost and net realizable value. Cost is determined on a first-in first-out basis.

#### Vessels and equipment (including operating lease assets)

Vessels and equipment are recorded at historical cost less accumulated depreciation and, if appropriate, impairment charges. The cost of these assets less estimated residual value is depreciated on a straight-line basis over the estimated remaining economic useful life of the asset. The estimated economic useful life of our offshore assets, including drilling rigs and drillships, is 30 years and for all other vessels it is 25 years.

Where an asset is subject to an operating lease that includes fixed price purchase options, the projected net book value of the asset is compared to the option price at the various option dates. If any option price is less than the projected net

book value at an option date, the initial depreciation schedule is amended so that the carrying value of the asset is written down on a straight line basis to the option price at the option date. If the option is not exercised, this process is repeated so as to amortize the remaining carrying value, on a straight line basis, to the estimated scrap value or the option price at the next option date, as appropriate.

This accounting policy for fixed assets has the effect that if an option is exercised there will be either a) no gain or loss on the sale of the asset or b) in the event that the option is exercised at a price in excess of the net book value at the option date, a gain will be reported in the statement of operations at the date of delivery to the new owners, under the heading "gain on sale of assets and termination of charters".

Office equipment is depreciated at 20% per annum on a reducing balance basis.



#### Vessels and equipment under capital lease

The Company charters-in certain vessels and equipment under leasing agreements. Leases of vessels and equipment, where the Company has substantially all the risks and rewards of ownership, are classified as capital lease assets, with corresponding capital lease obligations recorded. Capital lease assets are capitalized at the commencement of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments.

For sale and lease back transactions, when the asset sold is for more or less than its carrying amount, any indicated loss or gain on the sale is in substance a prepayment of rent or unearned rent, respectively, and thus, in accordance with ASC 840-40-35-4, the Company defers this prepaid or unearned rental and amortizes it over the lease term. In case the fair value of the asset sold is less than its carrying amount, any indicated loss on the sale is recognized in the consolidated statement of operations as incurred.

Depreciation of vessels and equipment under capital lease is included within "Depreciation" in the consolidated statement of operations. Vessels and equipment under capital lease are depreciated on a straight-line basis over the vessels' remaining economic useful lives or on a straight-line basis over the term of the lease. The method applied is determined by the criteria by which the lease has been assessed to be a capital lease.

#### Newbuildings

The carrying value of vessels under construction ("newbuildings") represents the accumulated costs to the balance sheet date which the Company has paid by way of purchase installments and other capital expenditures together with capitalized loan interest and associated finance costs. No charge for depreciation is made until a newbuilding is put into operation.

#### Capitalized interest

Interest expense is capitalized during the period of construction of newbuilding vessels based on accumulated expenditures for the applicable vessel at the Company's capitalization rate of interest. The amount of interest capitalized in an accounting period is determined by applying an interest rate ("the capitalization rate") to the average amount of accumulated expenditures for the vessel during the period. The capitalization rate used in an accounting period is based on the rates applicable to borrowings outstanding during the period. The Company does not capitalize amounts in excess of actual interest expense incurred in the period.

#### Investment in direct financing and sales-type leases

Leases (charters) of our vessels where we are the lessor are classified as either direct financing or sales-type leases or operating leases, based on an assessment of the terms of the lease. For charters classified as direct financing leases, the minimum lease payments (reduced in the case of time-chartered vessels by projected vessel operating costs) plus the estimated residual value of the vessel are recorded as the gross investment in the capital lease.

For direct financing leases, the difference between the gross investment in the lease and the carrying value of the vessel is recorded as unearned lease interest income. The net investment in the lease consists of the gross investment less the unearned income. Over the period of the lease each charter payment received, net of vessel operating costs if applicable, is allocated between "lease interest income" and "repayment of investment in lease" in such a way as to produce a constant percentage rate of return on the balance of the net investment in the direct financing lease. Thus, as

the balance of the net investment in each direct financing lease decreases, a lower proportion of each lease payment received is allocated to lease interest income and a greater proportion is allocated to lease repayment. For direct financing leases relating to time chartered vessels, the portion of each time charter payment received that relates to vessel operating costs is classified as "lease service revenue".

For sales-type leases, the difference between the gross investment in the lease and the present value of its components, i.e. the minimum lease payments and the estimated residual value, is recorded as unearned lease interest income. The discount rate used in determining the present values is the interest rate implicit in the lease. The present value of the minimum lease payments, computed using the interest rate implicit in the lease, is recorded as the sales price, from which the carrying value of the vessel at the commencement of the lease is deducted in order to determine the profit or loss on sale. As is the case for direct financing leases, the unearned lease interest income is amortized to income over the period of the lease so as to produce a constant periodic rate of return on the net investment in the lease.

Where a direct financing or sales-type lease relates to a charter arrangement containing fixed price purchase options, the projected carrying value of the net investment in the lease is compared to the option price at the various option dates. If any option price is less than the projected net investment in the lease at an option date, the rate of amortization of unearned lease interest income is adjusted to reduce the net investment to the option price at the option date. If the option is not exercised, this process is repeated so as to reduce the net investment in the lease to the un-guaranteed residual value or the option price at the next option date, as appropriate.

This accounting policy for investments in direct financing or sales-type leases has the effect that if an option is exercised there will either be a) no gain or loss on the exercise of the option or b) in the event that an option is exercised at a price in excess of the net investment in the lease at the option date, a gain will be reported in the statement of operations at the date of delivery to the new owners.

If the terms of an existing lease are agreed to be amended, other than by renewing the lease or extending its term, in a manner that would have resulted in a different classification of the lease had such amended terms been in effect at the lease inception, the amended lease agreement shall be considered to be a new lease agreement over the remainder of its term. If the terms of a direct financing or sales-type lease are amended in a way that does not result in it being treated as a new operating lease agreement, the remaining minimum lease payments and, if appropriate, the estimated residual value will be amended to reflect the revised terms, with a corresponding increase or decrease in unearned income.

#### Obligations under capital lease

The Company charters-in and out four container vessels on a bareboat basis under long term leasing agreements with corresponding assets classified as investments in direct financing leases. The Company also charters-in seven container vessels through sale and leaseback financing arrangements with corresponding lease assets classified under vessels under capital lease. Leases of vessels and equipment, where the Company has substantially all the risks and rewards of ownership, are classified as capital leases. Each lease payment is allocated between liability and finance charges to achieve a constant rate on the capital balance outstanding. The interest element of the capital cost is charged to the Consolidated Statement of Operations over the lease period.

#### Impairment of long-lived assets, including other long-term investments

The carrying value of long-lived assets, including other long-term investments, that are held by the Company are reviewed whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For vessels, such indicators may include historically low spot charter rates and second hand vessel values. The Company assesses recoverability of the carrying value of the asset by estimating the future net cash flows expected to result from the asset, including eventual disposition, taking into account the possibility of any existing medium and long-term charter arrangements being terminated early. If the future expected net cash flows are less than the carrying value of the asset, an impairment loss is recorded equal to the difference between the carrying value of the asset and its fair value. In addition, long-lived assets to be disposed of are reported at the lower of carrying amount and fair value less estimated costs to sell.

#### Deferred charges

Loan costs, including debt arrangement fees, are capitalized and amortized on a straight line basis over the term of the relevant loan. The straight line basis of amortization approximates the effective interest method in the Company's statement of operations. Amortization of loan costs is included in interest expense. If a loan is repaid early, any

unamortized portion of the related deferred charges is charged against income in the period in which the loan is repaid. Similarly, if a portion of a loan is repaid early, the corresponding portion of the unamortized related deferred charges is charged against income in the period in which the early repayment is made.

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### Convertible bonds

The Company accounts for debt instruments with convertible features in accordance with the details and substance of the instruments at the time of their issuance. For convertible debt instruments issued at a substantial premium to equivalent instruments without conversion features, or those that may be settled in cash upon conversion, it is presumed that the premium or cash conversion option represents an equity component. Accordingly, the Company determines the carrying amounts of the liability and equity components of such convertible debt instruments by first determining the carrying amount of the liability component by measuring the fair value of a similar liability that does not have an equity component. The carrying amount of the equity component representing the embedded conversion option is then determined by deducting the fair value of the liability component from the total proceeds from the issue. The resulting equity component is recorded, with a corresponding offset to debt discount which is subsequently amortized to interest cost using the effective interest method over the period the debt is expected to be outstanding as an additional non-cash interest expense. Transaction costs associated with the instrument are allocated pro-rata between the debt and equity components.

For conventional convertible bonds which do not have a cash conversion option or where no substantial premium is received on issuance, it may not be appropriate to split the bond into the liability and equity components.

A conversion of the bonds at more favorable terms than the original bond is treated as an inducement and the Company recognizes a debt conversion expense equal to the fair value of all securities and other consideration transferred in the transaction in excess of the fair value of securities or consideration issuable pursuant to the original conversion terms.

### Financial instruments

In determining the fair value of its financial instruments, the Company uses a variety of methods and assumptions that are based on market conditions and risks existing at each balance sheet date. For the majority of financial instruments, including most derivatives and long-term debt, standard market conventions and techniques such as options pricing models are used to determine fair value. All methods of assessing fair value result in a general approximation of value, and such value may never actually be realized.

### Interest rate and currency swaps

The Company enters into interest rate swap transactions from time to time to hedge a portion of its exposure to floating interest rates. These transactions involve the conversion of floating interest rates into fixed rates over the life of the transactions without an exchange of underlying principal. The Company also enters into currency swap transactions from time to time to hedge against the effects of exchange rate fluctuations on loan liabilities. Currency swap transactions involve the exchange of fixed amounts of other currencies for fixed US dollar amounts over the life of the transactions, including an exchange of underlying principal. The Company may also enter into a combination of interest and currency swaps "cross currency interest rate swaps". The fair values of the interest rate and currency swap contracts, including cross currency interest rate swaps, are recognized as assets or liabilities, and for certain of the Company's swaps the changes in fair values are recognized in the consolidated statements of operations. When the interest rate and/or currency swap or combination, qualifies for hedge accounting under ASC Topic 815 "Derivatives and Hedging" ("ASC 815"), and the Company has formally designated the swap as a hedge to the underlying loan, and when the hedge is effective, the changes in the fair value of the swap are recognized in other comprehensive income. If it becomes probable that the hedged forecasted transaction to which these swaps relate will not occur, the amounts in other comprehensive income will be reclassified into earnings immediately.

### Drydocking provisions

Normal vessel repair and maintenance costs are charged to expense when incurred. The Company recognizes the cost of a drydocking at the time the drydocking takes place, that is, it applies the "expense as incurred" method.

#### Earnings per share

Basic earnings per share ("EPS") is computed based on the income available to common stockholders and the weighted average number of shares outstanding for basic EPS. Diluted EPS includes the effect of the assumed conversion of potentially dilutive instruments.

### Share-based compensation

The Company accounts for share-based payments in accordance with ASC Topic 718 "Compensation – Stock Compensation" ("ASC 718"), under which the fair value of stock options issued to employees is expensed over the period in which the options vest. The Company uses the simplified method for making estimates of the expected term of stock options.

### Recently Adopted Accounting Standards

In May 2014, issued ASU 2014-09 "Revenue from Contracts with Customers", subsequently amended and collectively Topic 606. The standard replaced almost all existing revenue recognition guidance in U.S. GAAP, with the intention to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. The core principle of ASC 606 is that an entity should recognize revenue for the transfer of goods or services equal to the amount that it expects to be entitled to receive for those goods or services. ASC 606 allows for adoption either on a full retrospective basis to each prior reporting period presented or on a modified retrospective basis with the cumulative effect of initially applying the new guidance recognized at the date of initial application, which became effective for the Company beginning January 1, 2018. The majority of vessels are on bareboat or time charters and these continue to be accounted as operating or finance leases in accordance with ASC 840 Leases and related interpretations and the implementation of the new revenue standard therefore did not have an effect on income recognition from such contracts.

The Company adopted ASC 606 in the first quarter of fiscal 2018 on a modified retrospective basis with no changes recognized in the prior year comparative financial statements. The adoption of this standard only impacted our vessels operating on voyage charters. For vessels operating on voyage charters, voyage revenues are, under the new revenue standard, recognized over the estimated length of each voyage, calculated on a load-to-discharge basis. Certain voyage expenses, primarily bunker fuel expenses, are capitalized between the previous discharge port, or contract date if later, and the next load port if they qualify as fulfillment costs under ASC 340 Deferred Costs and Other Assets. ASC 606 has been applied to those voyage contracts that were not completed at the date of initial application. Upon adoption, the cumulative effect of adopting this guidance resulted in a net minor adjustment of \$0.1 million to the opening balance of retained earnings as of January 1, 2018 and the Company did not consider this material enough to record. In addition, the adoption of this standard did not have a material impact on the consolidated financial statements of the Company for the year ended December 31, 2018.

In January 2016, the FASB issued ASU 2016-01 "Recognition and Measurement of Financial Assets and Financial Liabilities" to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. ASU 2016-01 particularly relates to the fair value and impairment of equity investments, financial instruments measured at amortized cost, and the use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes. ASU 2016-01 became effective for fiscal years and interim periods beginning after December 15, 2017. The Company adopted ASU 2016-01 in the first quarter of fiscal 2018 on a modified retrospective basis, with no changes recognized in the prior year comparatives and a cumulative catch up adjustment recognized in the opening retained earnings. Upon adoption of ASU 2016-01, the Company reclassified approximately \$98.8 million of unrealized losses related to its equity investments from accumulated other comprehensive income to retained earnings. As a result of the adoption of this guidance the Company is required to recognize the movement in the fair value of our equity securities in the consolidated statement of operations. For the year ended December 31, 2018, the adoption of the standard resulted in a net unrealized gain of \$12.3 million being included in the consolidated statement of operations. The Company anticipates additional volatility to the Company's statements of operations in future periods, due to changes in market prices of the Company's investments in equity securities.

In August 2016, the FASB issued ASU 2016-15 "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments", to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. It addresses the following eight specific cash flow issues: debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years with early adoption permitted. The amendments should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The adoption of these amendments did not have a material impact on the consolidated financial statements of the Company for the year ended December 31, 2018.

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In November 2016, the FASB issued ASU 2016-18 "Statement of Cash Flows (Topic 230): Restricted Cash", to address diversity in practice that exists in the classification and presentation of changes in restricted cash and require that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The standard was effective for fiscal years beginning after December 15, 2017, and interim periods within those years. For the year ended December 31, 2018, restricted cash has been disclosed as part of cash and cash equivalents in the Consolidated Statement of Cash Flows.

In January 2017, the FASB issued ASU 2017-01 "Business Combinations (Topic 805) - Clarifying the Definition of a Business" which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 is required to be applied prospectively and was effective for the Company beginning January 1, 2018. The adoption of ASU 2017-01 did not have a material impact on the consolidated financial statements of the Company for the year ended December 31, 2018.

In May 2017, the FASB issued ASU 2017-09 "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting" to clarify and reduce both diversity in practice and cost and complexity when applying the guidance in Topic 718, Compensation - Stock Compensation, to a change to the terms or conditions of a share-based payment award. The amendments provide guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting. ASU 2017-09 was effective for fiscal years and interim periods beginning after December 15, 2017. Early adoption was permitted. The adoption of ASU 2017-09 did not have a material impact on the consolidated financial statements of the Company for the year ended December 31, 2018.

### 3. RECENTLY ISSUED ACCOUNTING STANDARDS

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-02 "Leases" to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. ASU 2016-02 creates a new Accounting Standards Codification Topic 842 "Leases" to replace the previous Topic 840 "Leases." ASU 2016-02 affects both lessees and lessors, although for the latter the provisions are similar to the previous model, but updated to align with certain changes to the lessee model and also the new revenue recognition provisions contained in Topic 606. ASU 2016-02 is effective for fiscal years and interim periods beginning after December 15, 2018. Early adoption is permitted. Accounting Standards Codification ("ASC") 842 provides a group of practical expedients that allows entities to not (i) reassess whether any expired or existing contracts are considered or contain leases; (ii) reassess the lease classification for any expired or existing leases and (iii) reassess initial direct costs for any existing leases. The Company plans to adopt ASC 842 on January 1, 2019 and has elected the use of the practical expedients. Due to this election, the Company has determined the adoption of ASC 842 will not have a material impact on the consolidated financial statements.

In December 2018, the FASB issued ASU No. 2018-20 "Leases (Topic 842): Narrow-Scope Improvements for Lessors" to address issues facing lessors when applying the leases standard. The amendments addresses the following issues (i) Sales taxes and other similar taxes collected from lessees, which permits lessors, as an accounting policy election, to not evaluate whether certain sales taxes and other similar taxes are lessor costs or lessee costs. Instead, those lessors will account for those costs as if they are lessee costs and exclude the costs from being reported as lease revenue with an associated expense. (ii) Certain lessor costs paid directly by lessees, whereby certain lessor costs require lessors to exclude from variable payments, and therefore revenue, lessor costs paid by lessees directly to third parties. The amendments also require lessors to account for costs excluded from the consideration of a contract that are paid by the lessor and reimbursed by the lessee as variable payments. A lessor will record those reimbursed costs

as revenue. (iii) Recognition of variable payments for contracts with lease and non-lease components. The amendments relate to recognizing variable payments for contracts with lease and non-lease components require lessors to allocate (rather than recognize as currently required in the new leases standard) certain variable payments to the lease and non-lease components when the changes in facts and circumstances on which the variable payment is based occur. After the allocation, the amount of variable payments allocated to the lease components will be recognized as income in profit or loss in accordance with the new leasing guidance, while the amount of variable payments allocated to non-lease components will be recognized in accordance with other accounting guidance, such as revenue from contracts with customers. ASU 2018-20 is effective for fiscal years and interim periods beginning after December 15, 2018. The Company has determined the adoption of ASU 2018-20 will not have a material impact on the consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13 "Financial Instruments - Credit Losses" to introduce new guidance for the accounting for credit losses on instruments within its scope. ASU 2016-13 requires among other things, the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable supportable forecasts. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. ASU 2016-13 is effective for fiscal years and interim periods beginning after December 15, 2019. Early adoption is permitted. The Company is currently assessing the impact of ASU 2016-13 on its consolidated financial position, results of operations and cash flows.

In March 2017, the FASB issued ASU 2017-08 "Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities" to amend the amortization period for certain purchased callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. ASU 2017-08 is effective for fiscal years and interim periods beginning after December 15, 2018. Early adoption is permitted. The impact on the consolidated financial statements of the Company will depend on the facts and circumstances of any specific future transactions.

In August 2017, the FASB issued ASU 2017-12 "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities", to enable entities to better portray the economics of their risk management activities in the financial statements and enhance the transparency and understandability of hedge results. The amendments also simplify the application of hedge accounting in certain situations. ASU 2017-12 is effective for fiscal years and interim periods beginning after December 15, 2018. The Company has not elected to early adopt. The effect of the adoption of ASU 2017-12 will be that \$34.4 thousand of hedge ineffectiveness losses will be reclassified from retained earnings to other comprehensive income.

In July 2018, the FASB issued ASU 2018-10 "Codification Improvements to Topic 842, Leases" to provide amendments that affect narrow aspects of the guidance issued in the amendments in ASU 2016-02 including those regarding residual value guarantees, rate implicit in the lease, lessee reassessment of lease classification, lessor reassessment of lease term and purchase option, variable lease payments that depend on an index or a rate, investment tax credits, lease term and purchase option, transition guidance for amounts previously recognized in business combinations, certain transition adjustments, transition guidance for leases previously classified as capital leases under Topic 840, transition guidance for modifications to leases previously classified as direct financing or sales-type leases under Topic 840, transition guidance for sale and leaseback transactions, impairment of net investment in the lease, unguaranteed residual asset, effect of initial direct costs on rate implicit in the lease, and failed sale and leaseback transactions. ASU 2018-10 is effective for fiscal years and interim periods beginning after December 15, 2018. The Company does not expect that the adoption of ASU 2018-10 will have a material effect on the consolidated financial statements.

In October 2018, the FASB issued ASU No. 2018-16 "Derivatives and Hedging (Topic 815): Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes." In the United States, eligible benchmark interest rates under Topic 815 are interest rates on direct Treasury obligations of the U.S. government (UST), the London Interbank Offered Rate (LIBOR) swap rate, and the Overnight Index Swap (OIS) Rate based on the Federal Funds Effective Rate. When the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities, in August 2017, it introduced the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate as the fourth permissible U.S. benchmark rate. The new ASU adds the OIS rate based on SOFR as a U.S. benchmark interest rate to facilitate the LIBOR to SOFR transition and provide sufficient lead time for entities to prepare for changes to interest rate risk hedging strategies for both risk management and hedge accounting purposes. ASU

2018-16 is effective for fiscal years and interim periods beginning after December 15, 2019. The Company is currently assessing the impact of ASU 2018-16 on the consolidated financial statements.

In November 2018, the FASB issued ASU No. 2018-18 "Collaborative Arrangements (Topic 808): Clarifying the Interaction between Topic 808 and Topic 606", which defines a collaborative arrangement as a contractual arrangement under which two or more parties actively participate in a joint operating activity and are exposed to significant risks and rewards that depend on the activity's commercial success. The ASU provides guidance on how to assess whether certain transactions between collaborative arrangement participants should be accounted for within the revenue recognition standard.

The ASU also provides more comparability in the presentation of revenue for certain transactions between collaborative arrangement participants. It accomplishes this by allowing organizations to only present units of account in collaborative arrangements that are within the scope of the revenue recognition standard together with revenue accounted for under the revenue recognition standard. The parts of the collaborative arrangement that are not in the scope of the revenue recognition standard should be presented separately from revenue accounted for under the revenue recognition standard. ASU 2018-18 is effective for fiscal years and interim periods beginning after December 15, 2019. The Company does not expect that the adoption of ASU 2018-18 will have a material effect on the consolidated financial statements.

Also in November 2018, the FASB issued ASU No. 2018-19 "Codification Improvements to Topic 326, Financial Instruments-Credit Losses" to provide new guidance to mitigate the transition complexity by requiring entities other than public business entities, including not-for-profit organizations and certain employee benefit plans, to implement the credit losses standard issued in 2016, for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. This aligns the implementation date for their annual financial statements with the implementation date for their interim financial statements. The guidance also clarifies that receivables arising from operating leases are not within the scope of the credit losses standard, but rather, should be accounted for in accordance with the leases standard. ASU 2018-19 is effective for fiscal years and interim periods beginning after December 15, 2019. The Company is currently assessing the impact of ASU 2018-19 on the consolidated financial statements.

#### 4. SEGMENT INFORMATION

The Company has only one reportable segment. The Company's assets operate on a world-wide basis and the Company's management does not evaluate performance by geographical region or by asset type, as they believe that any such information would not be meaningful.

#### 5. TAXATION

##### Bermuda

Under current Bermudan law, the Company is not required to pay taxes in Bermuda on either income or capital gains. The Company has received written assurance from the Minister of Finance in Bermuda that, in the event of any such taxes being imposed, the Company will be exempted from taxation until the year 2035.

##### United States

The Company does not accrue U.S. income taxes as, in the opinion of U.S. counsel, the Company is not engaged in a U.S. trade or business and is exempted from a gross basis tax under Section 883 of the U.S. Internal Revenue Code.

A reconciliation between the income tax expense resulting from applying statutory income tax rates and the reported income tax expense has not been presented herein, as it would not provide additional useful information to users of the financial statements as the Company's net income is subject to neither Bermuda nor U.S. tax.

##### Other Jurisdictions

Certain of the Company's subsidiaries and branches in Norway and the United Kingdom are subject to income tax in their respective jurisdictions. The tax paid by subsidiaries of the Company that are subject to income tax is not material.

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## 6. EARNINGS PER SHARE

The computation of basic earnings per share ("EPS") is based on the weighted average number of shares outstanding during the year and the consolidated net income of the Company. Diluted EPS includes the effect of the assumed conversion of potentially dilutive instruments.

The components of the numerator for the calculation of basic and diluted EPS are as follows:

| (in thousands of \$)  | Year ended December 31, |         |         |
|---|-------------------------|---------|---------|
|   | 2018                    | 2017    | 2016    |
| Basic earnings per share:                                     |                         |         |         |
| Net income available to stockholders                          | 73,622                  | 101,209 | 146,406 |
| Diluted earnings per share:                                   |                         |         |         |
| Net income available to stockholders                          | 73,622                  | 101,209 | 146,406 |
| Interest and other expenses attributable to convertible bonds | 123                     | 4,511   | 15,310  |
| Net income assuming dilution                                  | 73,745                  | 105,720 | 161,716 |

The components of the denominator for the calculation of basic and diluted EPS are as follows:

| (in thousands)   | Year ended December 31, |         |         |
|--|-------------------------|---------|---------|
|  | 2018                    | 2017    | 2016    |
| Basic earnings per share:  |                         |         |         |
| Weighted average number of common shares outstanding                   | 105,898                 | 95,597  | 93,497  |
| Diluted earnings per share:  |                         |         |         |
| Weighted average number of common shares outstanding*                  | 105,898                 | 95,597  | 93,497  |
| Effect of dilutive share options                                       | 59                      | 26      | —       |
| Effect of dilutive convertible bonds                                   | 1,649                   | 7,277   | 14,543  |
| Weighted average number of common shares outstanding assuming dilution | 107,606                 | 102,900 | 108,040 |

|                             | Year ended December 31, |        |        |
|-----------------------------|-------------------------|--------|--------|
|                             | 2018                    | 2017   | 2016   |
| Basic earnings per share:   | \$0.70                  | \$1.06 | \$1.57 |
| Diluted earnings per share: | \$0.69                  | \$1.03 | \$1.50 |

\*The weighted average number of common shares outstanding excludes 8,000,000 shares issued as part of a share lending arrangement relating to the Company's issuance of 5.75% senior unsecured convertible bonds in October 2016. It also excludes 3,765,842 shares issued as of December 31, 2018 from up to 7,000,000 shares issuable under a share lending arrangement relating to the Company's issuance of 4.875% senior unsecured convertible bonds in April and May 2018. These lent shares are owned by the Company and will be returned on or before maturity of the bonds in 2021 and 2023, respectively.

In February 2018, the Company redeemed the full outstanding amount under the 3.25% senior unsecured convertible bonds due 2018. The remaining outstanding principal amount of \$63.2 million was paid in cash, and the premium settled in common shares with the issue of 651,365 new shares.

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As of December 31, 2018, the 4.875% senior unsecured convertible bonds issued in April and May 2018 and the 5.75% senior unsecured convertible bonds issued in October 2016 were both anti-dilutive.

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## 7. OPERATING LEASES

## Rental income

The minimum future revenues to be received under the Company's non-cancelable operating leases on its vessels as of December 31, 2018, are as follows:

| Year ending December 31,     | (in thousands of \$) |
|------------------------------|----------------------|
| 2019                         | 313,018              |
| 2020                         | 298,033              |
| 2021                         | 250,742              |
| 2022                         | 179,092              |
| 2023                         | 161,125              |
| Thereafter                   | 209,844              |
| Total minimum lease revenues | 1,411,854            |

There is no contingent rental income included above.

The cost and accumulated depreciation of vessels (owned and under capital lease) leased to third parties on non-cancelable operating leases at December 31, 2018 and 2017 were as follows:

| (in thousands of \$)     | 2018      | 2017      |
|--------------------------|-----------|-----------|
| Cost                     | 2,336,269 | 2,256,747 |
| Accumulated depreciation | 309,135   | 494,151   |
| Total                    | 2,027,134 | 1,762,596 |

## 8. GAIN/(LOSS) ON SALE OF ASSETS AND TERMINATION OF CHARTERS

The Company has recorded gains/losses on sale of assets and termination of charters as follows:

| (in thousands of \$)  | Year ended December 31, |         |       |
|---|-------------------------|---------|-------|
|   | 2018                    | 2017    | 2016  |
| (Loss)/gain on sale of vessels                                  | (2,578)                 | (1,699) | (167) |
| Gain on termination of charters                                 | —                       | 2,823   | —     |
| Total loss/(gain) on sale of assets and termination of charters | (2,578)                 | 1,124   | (167) |

The Company distinguishes between gains or losses on termination of charters, where ownership of the underlying vessel is retained, and gains or losses on sale of assets, where the vessel is disposed of and there may be an associated charter termination fee paid or received for early termination of the underlying charter.

## (Loss)/Gain on sale of vessels:

During the year ended December 31, 2018, the VLCC Front Circassia, which was accounted for as a direct financing lease asset, was sold to an unrelated third party. A loss of \$1.4 million was recorded on the disposal, the proceeds of which included \$17.9 million gross sales proceeds and compensation in the form of a loan note of \$4.4 million at fair

value was received for the early termination of the charter (see Note 24: Related party transactions).

The container vessel SFL Avon, which was accounted for as an operating lease asset, was sold to an unrelated third party during the year ended December 31, 2018 for a loss of \$0.2 million on disposal.

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The VLCCs Front Page, Front Stratus and Front Serenade which were accounted for as direct financing lease assets during the year ended December 31, 2018, were sold to a related party, ADS Crude Carriers Plc. ("ADS"). Gains of \$0.3 million, \$0.2 million and \$0.3 million were recorded on the disposal of the vessels, respectively. The gross proceeds from the sale was \$22.5 million per vessel in addition to compensation, in the form of loan notes of \$3.4 million each, received for the early termination of the charters (see Note 24: Related party transactions).

During the year ended December 31, 2018, the VLCCs Front Ariake and Front Falcon, which were accounted for as a direct financing lease assets, were sold to an unrelated third party. A gain of \$1,000 and a loss of \$1.8 million was recorded on the disposals respectively, and compensation in the form of a loan note of \$3.4 million at fair value was received for the early termination of the Front Ariake charter (see Note 24: Related party transactions).

During the year ended December 31, 2017, the Company recorded a net loss of \$1.7 million arising from the disposals of four crude oil tankers and the commencement of a sales-type lease for the 1,700 TEU container vessel MSC Alice as described below.

The VLCC Front Century, the Suezmax Front Brabant, the VLCC Front Scilla and the Suezmax Front Ardenne, which were accounted for as direct financing lease assets, were sold to unrelated third parties in March 2017, May 2017, June 2017 and August 2017, respectively. Losses of \$26,000, \$1.7 million, \$1.1 million and a gain of \$0.3 million, respectively, were recorded on the disposals. Sales proceeds included compensation received for early termination of the charters (see Note 24: Related party transactions). The 1,700 TEU container vessel MSC Alice which was previously an operating lease asset, was accounted for as a sales-type lease during the year ended December 31, 2017, following the commencement of a long-term bareboat charter in April 2017 to MSC Mediterranean Shipping Company S.A. ("MSC"), an unrelated party. The terms of the charter provides a minimum fixed price purchase obligation at the expiry of the five year charter period. A gain of \$0.7 million was recorded on the transaction.

During the year ended December 31, 2016, the Company sold one VLCC and one offshore support vessel to unrelated parties and realized aggregate net loss of \$0.2 million on their disposals.

#### Gain on termination of charters:

In April 2017, the 2007-built jack-up drilling rig Soehanah was redelivered to us by the previous charterer, PT Apexindo Pratama Duta ("Apexindo"). Ship Finance received a non-amortizing loan note with a term of six years from Apexindo as part of the settlement agreement for the early termination of the charter. The note which has an initial face value of \$6.0 million has been recorded at an initial fair value of \$2.8 million, resulting as a gain on the termination of the charter.

## 9. GAIN ON SALE OF SUBSIDIARIES AND DISPOSAL GROUPS

During the year ended December 31, 2018, the Company entered into an agreement to sell 100% of the share capital of Rig Finance Limited ("Rig Finance"), a wholly owned subsidiary, to an unrelated third party. Rig Finance owned the jack-up drilling rig Soehanah. Net proceeds of \$84.4 million were received for the shares, resulting in a net gain of

\$7.6 million on the sale. At the time of disposal on December 31, 2018, net assets held by Rig Finance were as follows:

| (in thousands of \$)      | December 31,<br>2018 |
|---------------------------|----------------------|
| Cash and cash equivalents | 915                  |
| Vessel and equipment, net | 76,875               |
| Charter deposit           | (913 )               |
| Other current liabilities | (90 )                |
| Net assets                | 76,787               |

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## 10. OTHER FINANCIAL ITEMS

Other financial items comprise the following items:

| (in thousands of \$)   | Year ended December 31, |         |         |
|--|-------------------------|---------|---------|
|  | 2018                    | 2017    | 2016    |
| Net cash payments on non-designated derivatives                            | (721 )                  | (5,124) | (4,913) |
| Net increase in fair value of non-designated derivatives                   | 13,908                  | 8,068   | 3,917   |
| Net increase in fair value of designated derivatives (ineffective portion) | (11 )                   | 140     | 482     |
| Other items  | (2,769 )                | (5,768) | (1,575) |
| Total other financial items  | 10,407                  | (2,684) | (2,089) |

The net movement in the fair values of non-designated derivatives and net cash payments thereon relate to non-designated, terminated or de-designated interest rate swaps and cross currency interest rate swaps. The net movement in the fair values of designated derivatives relates to the ineffective portion of interest rate swaps and cross currency interest rate swaps that have been designated as cash flow hedges. Changes in the fair values of the effective portion of interest rate swaps that are designated as cash flow hedges are reported under "Other comprehensive income". The above net movement in the valuation of non-designated derivatives in the year ended December 31, 2018, includes \$3.1 million (2017: \$1.6 million; 2016: \$nil) reclassified from "Other comprehensive income", as a result of certain interest rate swaps relating to loan facilities no longer being designated as cash flow hedges.

Other items in the year ended December 31, 2018, include a net loss of \$2.0 million arising from foreign currency translation (2017: loss \$4.5 million; 2016: gain \$0.1 million). Other items also include bank charges and fees relating to loan facilities.

## 11. INVESTMENTS IN DEBT AND EQUITY SECURITIES

Marketable securities held by the Company consist of corporate bonds and equity securities.

|  |        |           |
|--|--------|-----------|
| (in thousands of \$)                   | 2018   | 2017      |
| Amortized cost                         | 76,234 | 194,184   |
| Accumulated net unrealized (loss)/gain | 10,940 | (100,382) |
| Carrying value                         | 87,174 | 93,802    |

| (in thousands of \$)      | Year ended December 31, 2018 |                             |            | Year ended December 31, 2017 |                             |            |
|---------------------------|------------------------------|-----------------------------|------------|------------------------------|-----------------------------|------------|
|                           | Amortised Cost               | Unrealised gains/ (losses)* | Fair value | Amortised Cost               | Unrealised gains/ (losses)* | Fair value |
| <b>Corporate Bonds:</b>   |                              |                             |            |                              |                             |            |
| Golden Close Senior       | —                            | —                           | —          | 17,754                       | (2,240)                     | 15,514     |
| Golden Close Convertible  | —                            | —                           | —          | 9,960                        | —                           | 9,960      |
| Golden Close Super Senior | —                            | —                           | —          | 2,561                        | 347                         | 2,908      |
| NorAm Drilling            | 4,715                        | 477                         | 5,192      | 5,181                        | 293                         | 5,474      |
| Oro Negro                 | 7,886                        | 167                         | 8,053      | 7,886                        | —                           | 7,886      |
| Total corporate bonds     | 12,601                       | 644                         | 13,245     | 43,342                       | (1,600)                     | 41,742     |
| <b>Shares:</b>            |                              |                             |            |                              |                             |            |
| Frontline                 | 50,490                       | 10,340                      | 60,830     | 150,004                      | (99,514)                    | 50,490     |
| NorAm Drilling            | 3,035                        | 893                         | 3,928      | 730                          | 732                         | 1,462      |
| Golden Close              | 108                          | (108)                       | —          | 108                          | —                           | 108        |
| ADS Crude Carriers        | 10,000                       | (829)                       | 9,171      | —                            | —                           | —          |
| Total shares              | 63,633                       | 10,296                      | 73,929     | 150,842                      | (98,782)                    | 52,060     |
| Total                     | 76,234                       | 10,940                      | 87,174     | 194,184                      | (100,382)                   | 93,802     |

\* This includes foreign currency gains or losses on non U.S. dollar denominated equity investments in addition to the changes in the fair value from market prices movements.

The investments in corporate bonds at December 31, 2018, consist of investments in Oro Negro and NorAm Drilling Company AS ("NorAm Drilling") bonds which have a total carrying value of \$13.2 million (2017: \$41.7 million, including investments in Golden Close Corp. Ltd. ("Golden Close") bonds) and have maturities in 2019 and 2021, respectively. The corporate bonds are classified as available-for-sale securities and are recorded at fair value, with unrealized gains and losses recorded as a separate component of "Other comprehensive income". The accumulated net unrealized gain on these available-for-sale corporate debt securities included in "Other comprehensive income" at December 31, 2018, was \$0.6 million (2017: loss of \$1.6 million).

Following the adoption of ASU 2016-01 from January 2018, the Company now recognizes any changes in the fair value of equity investments in net income. The adoption of the standard resulted in a net unrealized gain of \$12.3 million recorded in the consolidated statement of operations for the year ended December 31, 2018. See also Recently Adopted Accounting Standards within Note 2.

The investments in shares at December 31, 2018, consist of listed shares in Frontline with a carrying value of \$60.8 million (2017: \$50.5 million) (see Note 24: Related party transactions), shares in NorAm Drilling traded in the Norwegian Over the Counter market ("OTC") market with a carrying value of \$3.9 million (2017: \$1.5 million) and shares in Golden Close, previously traded in the Norwegian OTC market with a carrying value of \$nil (2017: \$0.1 million).

During the year ended December 31, 2018, the Company acquired 4,031,800 shares in ADS, a recently formed company in 2018 trading on the Oslo Merkur Market and a related party. The investment in ADS shares were purchased for \$10.0 million and have a carrying value of \$9.2 million at December 31, 2018 (2017: \$nil). See also Note 24: Related party transactions.

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In November 2018 NorAm Drilling undertook a share consolidation of 20:1, resulting in a revised investment of 601,023 shares. On the same day NorAm Drilling participated in a rights issue, increasing the Company's investment in shares by 623,447 shares. In December 2018, the Company acquired an additional 41,756 shares bringing the total investment in NorAm Drilling to 1,266,226 shares with a fair value of \$3.9 million at December 31, 2018 (2017: \$1.5 million).

During the year ended December 31, 2018, Golden Close initiated liquidation proceedings. As a result of this, the Company received total proceeds of \$45.6 million in settlement of its total investment, resulting in an overall net gain of \$13.5 million. As at December 31, 2018, the net investment in Golden Close debt and equity securities is \$nil (2017: \$28.5 million).

In December 2017, the Company determined that the shares in Golden Close were other-than-temporarily impaired and recorded \$3.9 million impairment charge in a separate line in the consolidated statement of operations for the year ended December 31, 2017.

## 12. TRADE ACCOUNTS RECEIVABLE AND OTHER RECEIVABLES

### Trade accounts receivable

Trade accounts receivable are presented net of allowances for doubtful debts. The allowance for doubtful trade accounts receivable was \$nil at both December 31, 2018 and December 31, 2017. As at December 31, 2018, the Company has no reason to believe that any amount included in trade accounts receivable will not be recovered through due process or negotiation.

### Other receivables

Other receivables, mainly include amounts due from vessel managers and claims receivable, which are presented with no allowance for doubtful accounts as of December 31, 2018 and December 31, 2017.

## 13. VESSELS AND EQUIPMENT, NET

| (in thousands of \$)       | 2018      | 2017      |
|----------------------------|-----------|-----------|
| Cost                       | 1,955,880 | 2,256,747 |
| Accumulated depreciation   | 396,168   | 494,151   |
| Vessels and equipment, net | 1,559,712 | 1,762,596 |

The Company disposed of one container vessel, SFL Avon, with a net carrying value of \$12.3 million during the year ended December 31, 2018 (Refer Note 8: Gain/(loss) on sale of assets and termination of charters).

In addition, the Company sold a wholly owned subsidiary which owned one jack-up drilling rig, Soehanah with a net carrying value of \$76.9 million during the year ended December 31, 2018 (Refer Note 9: Gain on sale of subsidiaries and disposal groups).

In 2018, the Company had no agreements for the construction of newbuilding vessels. In 2017, the Company took delivery of two newbuilding oil product carriers at an aggregate cost of \$115.1 million and transferred one container



vessel from operating lease asset to a sales-type lease asset. The carrying value of the container vessel reclassified from vessels and equipment to investment in lease asset was \$2.3 million.

Depreciation expense was \$104.1 million for the year ended December 31, 2018 (2017: \$88.2 million; 2016: \$94.3 million).

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The Company owns five offshore support vessels which are chartered on a long-term bareboat charter to Deep Sea Supply Shipowning II AS (the “Solstad Charterer”), an indirect wholly owned subsidiary of Solship Invest 3 AS (“Solship”) which is in turn a wholly owned subsidiary of Solstad Offshore ASA (“Solstad”). Four of these vessels are accounted for as operating leases within Vessels and Equipment, net, and the other one is accounted for as a finance lease (Refer Note 16: Investments in direct financing and sales-type leases). In July 2018, the Company entered into a restructuring agreement with subsidiaries of Solstad, which became effective at the end of August 2018, whereby the Company will receive 50% of the agreed charter hire for two of the offshore support vessels accounted for as operating leases. All other contracted charter hire income earned from fixed assets and finance lease assets will be deferred until the end of 2019. In 2018, following indications that the Solstad Charterer may not have sufficient funds to fulfill its obligations under the charters, the vessels were written down to estimated fair value and impairment charges of \$25.4 million were made against the four offshore supply vessels accounted for as operating leases. (See also Note 16: Investments in direct financing and sales-type leases).

No impairment charges were made in 2017 and \$4.8 million was recorded against the carrying value of one container vessel in the year ended December 31, 2016.

Acquisitions, disposals and impairments in respect of vessels accounted for as direct financing and sales-type leases and vessels those accounted for as capital leases are discussed in Note 16: Investments in direct financing and sales-type leases and Note 14: Vessels under capital lease, net, respectively.

#### 14. VESSELS UNDER CAPITAL LEASE, NET

| (in thousands of \$)             | 2018    | 2017 |
|----------------------------------|---------|------|
| Cost                             | 754,392 | —    |
| Accumulated depreciation         | 4,503   | —    |
| Vessels under capital lease, net | 749,889 | —    |

In May 2018, the Company took delivery of four 2014 built container vessels, each with approximately 13,800 TEU carrying capacity. The Company initially recorded additions to cost of vessels and equipment of \$445.0 million, which included the issuance of 4,024,984 common shares with a value of \$58.0 million as part of the consideration. An additional \$18.0 million of the consideration paid was assigned to the long term time charter contracts acquired with the vessels which was recorded separately within long term assets and is being amortized to revenue over the remaining period of each contract.

In September and October 2018, the Company took delivery of three 2015 built container vessels, each with approximately 10,600 TEU carrying capacity. The Company initially recorded additions to cost of vessels and equipment of \$315.0 million

In the third and fourth quarter of 2018, the Company refinanced the four 13,800 TEU container vessels and the three 10,600 TEU container vessels with an Asian based financial institution by entering into separate sale and leaseback financing arrangements. The vessels are leased back for an original term ranging from six to 11 years, with options to purchase each vessel after six years. The vessels were derecognized from the Vessels and Equipment category and reclassified to the Vessels under Capital Lease category at a total net carrying value of \$748.9 million. The Company recorded additions of \$5.5 million. Depreciation charged on vessels under capital lease during the year ended December 31, 2018 was \$4.5 million and is included in depreciation in the accompanying consolidated statements of operations.

#### 15. NEWBUILDINGS

The carrying value of newbuildings represents the accumulated costs which the Company has paid in purchase installments and other capital expenditures relating to the acquisition of newbuilding vessels, together with capitalized loan interest. No interest was capitalized in the cost of newbuildings in the year ended December 31, 2018 (2017: \$1.2 million; 2016: \$1.2 million).

As at December 31, 2018, and December 31, 2017 the Company had no agreements for the construction of newbuilding vessels.

During 2017, the Company took delivery of two newbuilding oil product carriers, which were under construction as at December 31, 2016. Upon delivery, the vessels were transferred from newbuildings to vessels and equipment (see Note 13: Vessels and equipment, net).

## 16. INVESTMENTS IN DIRECT FINANCING AND SALES TYPE LEASES

As of December 31, 2018, three of the Company's VLCCs (2017: nine VLCCs and Suezmax tankers) were accounted for as direct financing leases. These vessels are chartered to Frontline Shipping on long-term, fixed rate time charters which extend for various periods depending on the age of the vessels, ranging from approximately six to eight years. Frontline Shipping is a subsidiary of Frontline, a related party, and the terms of the charters do not provide them with an option to terminate the charter before the end of its term. The VLCCs Front Page, Front Stratus and Front Serenade which were accounted for as direct financing leases, were sold in July 2018, August 2018 and September 2018, respectively. These vessels were sold to ADS, a related party (see Note 8: Gain/(loss) on sale of assets and termination of charters and Note 24: Related party transactions). Prior to the sale of these vessels, an impairment charge of \$21.8 million was recorded against the carrying value of these three vessels.

The VLCC Front Circassia, which was accounted for as a direct financing lease, was sold in February 2018 (see Note 8: Gain/(loss) on sale of assets and termination of charters and Note 24: Related party transactions).

The VLCCs Front Ariake and Front Falcon, which were accounted for as direct financing leases, were sold in October 2018 and November 2018, respectively. An impairment charge of \$6.8 million was recorded against the carrying value of VLCC Front Ariake leased to Frontline Shipping.

The Company owns one offshore supply vessel accounted for as a direct finance lease which is chartered on a long-term bareboat charter, together with four other vessels accounted for as operating leases, to the Solstad Charterer (see Note 13: Vessels and equipment, net). In 2018, the Company recorded an impairment charge of \$10.3 million, against the carrying value of this vessel.

In addition to the remaining four vessels above leased to related and unrelated third parties, the Company also had four (2017: two) container vessels accounted for as direct financing leases and one (2017: one) container vessel accounted for as a sales-type lease as at December 31, 2018, which are all on long-term bareboat charters to MSC Mediterranean Shipping Company S.A. ("MSC"), an unrelated party. The two additional container vessels, MSC Erica and MSC Reef, were also chartered in from unrelated third parties in December 2018, and immediately commenced a finance lease out to MSC. The terms of the charters provide a fixed price put option, purchase option or purchase obligation at the expiry of the 15 year charter period for four of the container vessels and a minimum fixed price purchase obligation at the expiry of the five year charter period for the fifth container vessel.

In April 2018, the Company acquired 15 second hand feeder size container vessels for an aggregate purchase price of \$105.5 million from a subsidiary of MSC. The vessels were immediately leased back to the seller under seven year bareboat charters. The charterer has purchase options throughout the term of the charters and the Company has a put option at the end of the seven year period.

As at December 31, 2018, the Company had a total of 24 vessels accounted for as direct financing and sales-type leases (2017: 13 vessels).

The following lists the components of the investments in direct financing leases as at December 31, 2018, and December 31, 2017:

| (in thousands of \$)                        | 2018      | 2017    |
|---|-----------|---------|
| Total minimum lease payments to be received | 1,173,152 | 916,765 |

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|   |            |           |
|---|------------|-----------|
| Less: amounts representing estimated executory costs including profit thereon, included in total minimum lease payments | (74,077 )  | (211,508) |
| Net minimum lease payments receivable   | 1,099,075  | 705,257   |
| Estimated residual values of leased property (un-guaranteed)  | 180,080    | 232,424   |
| Less: unearned income   | (476,996 ) | (319,610) |
| Total investment in direct financing leases   | 802,159    | 618,071   |
| Current portion   | 39,804     | 32,096    |
| Long-term portion   | 762,355    | 585,975   |
|   | 802,159    | 618,071   |

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The chartered-in vessels MSC Anna, MSC Viviana, MSC Erica and MSC Reef are included in the above and had a total carrying value of \$581.2 million (2017: \$283.9 million for MSC Anna, MSC Viviana). The minimum lease payments included above for these vessels at December 31, 2018 is \$870.0 million (2017: \$432.2 million).

The minimum future gross revenues to be received under the Company's non-cancellable direct financing leases as of December 31, 2018, are as follows:

| Year ending December 31,     | (in thousands of \$) |
|------------------------------|----------------------|
| 2019                         | 106,503              |
| 2020                         | 105,877              |
| 2021                         | 105,257              |
| 2022                         | 104,849              |
| 2023                         | 104,690              |
| Thereafter                   | 645,976              |
| Total minimum lease revenues | 1,173,152            |

The above minimum lease revenues includes \$162.4 million related to the three VLCCs leased to Frontline Shipping as of December 31, 2018. Frontline Shipping is a 100% owned subsidiary of Frontline, however the performance under the leases is not guaranteed by Frontline following the amendments agreed in 2015. There is no requirement for a minimum cash balance in Frontline Shipping, but in exchange for releasing the guarantee a dividend restriction was introduced on Frontline Shipping whereby it can only make distributions to its parent company if it can demonstrate it will have minimum free cash of \$2.0 million per vessel both prior to and following (i) such distribution and (ii) the payment of the next hire due and any profit share accrued under the charters. Due to the current depressed tanker market, there is a risk that Frontline Shipping may not have sufficient funds to pay the agreed charterhires. However, the performance under the fixed price agreements with Frontline Management whereby we pay management fees of \$9,000 per day for each vessel to cover all operating costs including drydocking costs, is guaranteed by Frontline.

## 17. INVESTMENT IN ASSOCIATED COMPANIES

The Company has, and has had, certain wholly-owned subsidiaries which are accounted for using the equity method, as it has been determined under ASC 810 that they are variable interest entities in which Ship Finance is not the primary beneficiary.

At December 31, 2018, 2017 and 2016, the Company had the following participation in investments that are recorded using the equity method:

|                   | 2018    | 2017    | 2016    |
|-------------------|---------|---------|---------|
| SFL Deepwater Ltd | 100.00% | 100.00% | 100.00% |
| SFL Hercules Ltd  | 100.00% | 100.00% | 100.00% |
| SFL Linus Ltd     | 100.00% | 100.00% | 100.00% |

SFL Deepwater Ltd. ("SFL Deepwater"), SFL Hercules Ltd. ("SFL Hercules"), and SFL Linus Ltd. ("SFL Linus") each own drilling units which have been leased to subsidiaries of Seadrill Limited ("Seadrill"), a related party, as further described below. In September 2017, Seadrill announced that it has entered into a restructuring agreement (the "Restructuring Plan") with more than 97% of its secured bank lenders, approximately 40% of its bondholders and a consortium of investors led by its largest shareholder, Hemen Holding Limited ("Hemen"), who is also the largest shareholder in the Company. The Company, SFL Deepwater, SFL Hercules and SFL Linus have also entered into the Restructuring Plan, which has been implemented by way of prearranged Chapter 11 cases. As part of the Restructuring Plan, the financial covenants on Seadrill have been replaced by financial covenants on a newly established subsidiary of Seadrill, Seadrill Rig Holding Company Limited ("RigCo"), who also acts as guarantor for the obligations under the leases for the three drilling units, on a subordinated basis to the senior secured lenders in Seadrill and new secured notes.

SFL Deepwater is a 100% owned subsidiary of Ship Finance, incorporated in 2008 for the purpose of holding two ultra deepwater drilling rigs and leasing those rigs to Seadrill Deepwater Charterer Ltd. and Seadrill Offshore AS, fully guaranteed by their parent company Seadrill. In June 2013, SFL Deepwater transferred one of the rigs and the corresponding lease to SFL Hercules (see below). Accordingly, SFL Deepwater now holds one ultra deepwater drilling rig which is leased to Seadrill Deepwater Charterer Ltd. In October 2013, SFL Deepwater entered into a \$390 million five year term loan and revolving credit facility with a syndicate of banks, which was used in November 2013 to refinance the previous loan facility. In connection with the Restructuring Plan, certain amendments were agreed with the banks under the loan facility, including an extension of the final maturity date by four years. At December 31, 2018, the balance outstanding under the new facility was \$203.7 million (2017: \$225.8 million), and the available amount under the revolving part of the facility was \$nil (2017: \$nil). The Company guaranteed \$84.7 million of this debt at December 31, 2018 (2017: \$75.0 million). In addition, the Company has given the banks a first priority pledge over all shares of SFL Deepwater and assigned all claims under a secured loan made by the Company to SFL Deepwater in favor of the banks. This loan is secured by a second priority mortgage over the rig which has been assigned to the banks. The rig is chartered on a bareboat basis and the terms of the charter provide the charterer with various call options to acquire the rig at certain dates throughout the charter. In addition, there is an obligation for the charterer to purchase the rig at a fixed price at the end of the charter, which originally expired in November 2023. In connection with the Restructuring Plan, the lease has been extended by 13 months until December 2024. Because the main asset of SFL Deepwater is the subject of a lease which includes both fixed price call options and a fixed price purchase obligation, it has been determined that this subsidiary of Ship Finance is a variable interest entity in which Ship Finance is not the primary beneficiary.





SFL Hercules is a 100% owned subsidiary of Ship Finance, incorporated in 2012 for the purpose of holding an ultra deepwater drilling rig and leasing that rig to Seadrill Offshore AS, fully guaranteed by its parent company Seadrill. The rig was transferred, together with the corresponding lease, to SFL Hercules from SFL Deepwater in June 2013. In May 2013, SFL Hercules entered into a \$375 million six year term loan and revolving credit facility with a syndicate of banks to partly finance its acquisition of the rig from SFL Deepwater. The facility was drawn in June 2013. In connection with the Restructuring Plan, certain amendments were agreed with the banks under the loan facility, including an extension of the final maturity date by four years. At December 31, 2018, the balance outstanding under this facility was \$210.0 million (2017: \$251.3 million), and the available amount under the revolving part of the facility was \$nil (2017: \$nil). The Company guaranteed \$78.9 million of this debt at December 31, 2018 (2017: \$70.0 million). In addition, the Company has given the banks a first priority pledge over all shares of SFL Hercules and assigned all claims under a secured loan made by the Company to SFL Hercules in favour of the banks. This loan is secured by a second priority mortgage over the rig which has been assigned to the banks. The rig is chartered on a bareboat basis and the terms of the charter provide the charterer with various call options to acquire the rig at certain dates throughout the charter. In addition, there is an obligation for the charterer to purchase the rig at a fixed price at the end of the charter, which originally expired in November 2023. In connection with the Restructuring Plan, the lease has been extended by 13 months until December 2024. Because the main asset of SFL Hercules is the subject of a lease which includes both fixed price call options and a fixed price purchase obligation at the end of the charter, it has been determined that this subsidiary of Ship Finance is a variable interest entity in which Ship Finance is not the primary beneficiary.

SFL Linus is a 100% owned subsidiary of Ship Finance, acquired in 2013 from North Atlantic Drilling Ltd ("NADL"), a related party. SFL Linus holds a harsh environment jack-up drilling rig which was delivered from the shipyard in February 2014 and immediately leased to North Atlantic Linus Charterer Ltd., fully guaranteed by its parent company NADL. In October 2013, SFL Linus entered into a \$475 million five year term loan and revolving credit facility with a syndicate of banks to partly finance the acquisition of the rig. The facility was drawn in February 2014. In connection with the Restructuring Plan, certain amendments were agreed with the banks under the loan facility, including an extension of the final maturity date by four years. At December 31, 2018, the balance outstanding under this facility was \$241.5 million (2017: \$308.8 million) and, the available amount under the revolving part of the facility was \$nil (2017: \$nil). The Company guaranteed \$102.5 million of this debt at December 31, 2018 (2017: \$90.0 million). In addition, the Company has given the banks a first priority pledge over all shares of SFL Linus and assigned all claims under a secured loan made by the Company to SFL Linus in favour of the banks. This loan is secured by a second priority mortgage over the rig which has been assigned to the banks. In February 2015, amendments were made to the lease, whereby Seadrill replaced NADL as lease guarantor. The rig is chartered on a bareboat basis and the terms of the charter provide the charterer with various call options to acquire the rig at certain dates throughout the charter. In addition, the charter includes a fixed price put option at the expiry of the charter in 2029. Because the main asset of SFL Linus is the subject of a lease which includes both fixed price call options and a fixed price put option, it has been determined that this subsidiary of Ship Finance is a variable interest entity in which Ship Finance is not the primary beneficiary.

Summarized balance sheet information of the Company's equity method investees is as follows:

|                             | As of December 31, 2018 |               |              |           |
|-----------------------------|-------------------------|---------------|--------------|-----------|
| (in thousands of \$)        | TOTAL                   | SFL Deepwater | SFL Hercules | SFL Linus |
| Current assets              | 58,089                  | 19,558        | 16,858       | 21,673    |
| Non-current assets          | 967,954                 | 302,362       | 290,370      | 375,222   |
| Total assets                | 1,026,043               | 321,920       | 307,228      | 396,895   |
| Current liabilities         | 69,181                  | 18,252        | 19,487       | 31,442    |
| Non-current liabilities (1) | 931,755                 | 297,060       | 281,627      | 353,068   |

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|                                |           |         |         |         |
|--------------------------------|-----------|---------|---------|---------|
| Total liabilities              | 1,000,936 | 315,312 | 301,114 | 384,510 |
| Total shareholders' equity (2) | 25,107    | 6,608   | 6,114   | 12,385  |

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|                                | As of December 31, 2017 |               |              |           |
|--------------------------------|-------------------------|---------------|--------------|-----------|
| (in thousands of \$)           | TOTAL                   | SFL Deepwater | SFL Hercules | SFL Linus |
| Current assets                 | 97,723                  | 26,242        | 29,152       | 42,329    |
| Non-current assets             | 1,020,067               | 317,450       | 305,852      | 396,765   |
| Total assets                   | 1,117,790               | 343,692       | 335,004      | 439,094   |
| Current liabilities            | 106,628                 | 25,642        | 29,443       | 51,543    |
| Non-current liabilities (1)    | 1,000,484               | 315,415       | 302,819      | 382,250   |
| Total liabilities              | 1,107,112               | 341,057       | 332,262      | 433,793   |
| Total shareholders' equity (2) | 10,678                  | 2,635         | 2,742        | 5,301     |

SFL Deepwater, SFL Hercules and SFL Linus non-current liabilities at December 31, 2018, include \$109.0 million (2017: \$113.0 million), \$80.0 million (2017: \$80.0 million) and \$121.0 million (2017: \$121.0 million) due to Ship Finance, respectively (see Note 24: Related party transactions). In addition, SFL Hercules and SFL Linus current liabilities at December 31, 2018, include a further \$10.1 million and \$21.7 million due to Ship Finance. SFL Deepwater balance was \$nil (2017: \$0.1 million, \$3.6 million and \$0.2 million) due to Ship Finance (see Note 24: Related party transactions).

In the year ended December 31, 2018, SFL Deepwater, SFL Hercules and SFL Linus did not pay any dividends (2017: \$3.4 million; 2016: \$46.3 million), (2017: \$3.8 million; 2016: \$25.1 million), (2017: \$7.3 million; 2016: \$42.1 million), respectively.

Summarized statement of operations information of the Company's wholly-owned equity method investees is shown below.

|                        | Year ended December 31, 2018 |               |              |           |
|------------------------|------------------------------|---------------|--------------|-----------|
| (in thousands of \$)   | TOTAL                        | SFL Deepwater | SFL Hercules | SFL Linus |
| Operating revenues     | 64,572                       | 19,594        | 19,126       | 25,852    |
| Net operating revenues | 64,410                       | 19,540        | 19,049       | 25,821    |
| Net income (3)         | 14,635                       | 3,973         | 3,372        | 7,290     |

|                        | Year ended December 31, 2017 |               |              |           |
|------------------------|------------------------------|---------------|--------------|-----------|
| (in thousands of \$)   | TOTAL                        | SFL Deepwater | SFL Hercules | SFL Linus |
| Operating revenues     | 73,487                       | 20,873        | 21,827       | 30,787    |
| Net operating revenues | 73,487                       | 20,873        | 21,827       | 30,787    |
| Net income (3)         | 23,766                       | 5,981         | 6,462        | 11,323    |

|                        | Year ended December 31, 2016 |               |              |           |
|------------------------|------------------------------|---------------|--------------|-----------|
| (in thousands of \$)   | TOTAL                        | SFL Deepwater | SFL Hercules | SFL Linus |
| Operating revenues     | 80,269                       | 22,088        | 23,292       | 34,889    |
| Net operating revenues | 80,269                       | 22,088        | 23,292       | 34,889    |
| Net income (3)         | 27,765                       | 6,778         | 6,424        | 14,563    |

The net income of SFL Deepwater, SFL Hercules and SFL Linus for the year ended December 31, 2018, includes interest payable to Ship Finance amounting to \$5.1 million (2017: \$5.4 million; 2016: \$6.5 million), \$3.6 million (2017: \$4.3 million; 2016: \$6.5 million), and \$5.4 million (2017: \$5.5 million; 2016: \$5.6 million), respectively (see Note 24: Related party transactions).

SFL Deepwater, SFL Hercules and SFL Linus have loan facilities for which Ship Finance provides limited guarantees, as indicated above. These loan facilities contain financial covenants, with which Ship Finance and Seadrill must comply. As part of the Restructuring Plan, the financial covenants on Seadrill were replaced by financial covenants on a newly established subsidiary of Seadrill, who also acts as guarantor for the obligations under the leases for the three drilling units, on a subordinated basis to the senior secured lenders in Seadrill and new secured notes. As at December 31, 2018, Ship Finance and Seadrill were in compliance with all of the applicable covenants under these long-term debt facilities.

#### 18. ACCRUED EXPENSES

| (in thousands of \$)      | 2018   | 2017   |
|---------------------------|--------|--------|
| Vessel operating expenses | 5,395  | 6,111  |
| Administrative expenses   | 628    | 552    |
| Interest expense          | 6,487  | 6,688  |
|                           | 12,510 | 13,351 |

#### 19. OTHER CURRENT LIABILITIES

| (in thousands of \$)                 | 2018  | 2017  |
|--------------------------------------|-------|-------|
| Deferred and prepaid charter revenue | 7,562 | 3,936 |
| Employee taxes                       | 195   | 18    |
| Other items                          | 575   | 1,739 |
|                                      | 8,332 | 5,693 |

#### 20. SHORT-TERM AND LONG-TERM DEBT

| (in thousands of \$)   | 2018       | 2017       |
|--|------------|------------|
| Long-term debt:  |            |            |
| 3.25% senior unsecured convertible bonds due 2018                          | —          | 63,218     |
| Norwegian kroner 900 million senior unsecured floating rate bonds due 2019 | 77,722     | 92,477     |
| Norwegian kroner 500 million senior unsecured floating rate bonds due 2020 | 57,829     | 61,001     |
| 5.75% senior unsecured convertible bonds due 2021                          | 212,230    | 225,000    |
| Norwegian kroner 600 million senior unsecured floating rate bonds due 2023 | 69,395     | —          |
| 4.875% senior unsecured convertible bonds due 2023                         | 151,700    | —          |
| U.S. dollar denominated floating rate debt due through 2025                | 891,471    | 1,081,204  |
| Total debt principal   | 1,460,347  | 1,522,900  |
| Less: unamortized debt issuance costs                                      | (23,267 )  | (18,893 )  |
| Less: current portion of long-term debt                                    | (267,149 ) | (313,823 ) |
| Total long-term debt   | 1,169,931  | 1,190,184  |

The outstanding debt as of December 31, 2018, is repayable as follows:

| Year ending December 31, | (in thousands of \$) |
|--------------------------|----------------------|
| 2019                     | 267,149              |
| 2020                     | 196,093              |
| 2021                     | 463,516              |
| 2022                     | 199,466              |
| 2023                     | 321,830              |
| Thereafter               | 12,293               |
| Total debt principal     | 1,460,347            |

The weighted average interest rate for consolidated floating rate debt denominated in U.S. dollars and Norwegian kroner ("NOK") as at December 31, 2018, was 4.22% per annum including margin (2017: 4.26%). This rate takes into consideration the effect of related interest rate swaps. At December 31, 2018, the three month US Dollar London Interbank Offered Rate ("LIBOR") was 2.808% (2017: 1.694%) and the three month Norwegian Interbank Offered Rate ("NIBOR") was 1.27% (2017: 0.81%).

### 3.25% senior unsecured convertible bonds due 2018

On January 30, 2013, the Company issued a senior unsecured convertible bond loan totaling \$350.0 million. Interest on the bonds is fixed at 3.25% per annum and is payable in cash quarterly in arrears on February 1, May 1, August 1 and November 1. The bonds are convertible into Ship Finance International Limited common shares at any time up to 10 banking days prior to February 1, 2018. Subject to adjustment for any dividend payments in the future, the conversion price at the time of issue was \$21.945 per share which represented a premium of approximately 33% to the share price at the time.

In October 2017, the Company entered into separate privately negotiated transactions with certain holders of the bonds and converted principal amounts totaling \$121.0 million of the outstanding bonds into 9,418,798 common shares. The Company had previously purchased and canceled bonds with principal amounts totaling \$165.8 million in October 2016. The net amount outstanding at December 31, 2018, was \$nil (2017: \$63.2 million). No gain or loss was recorded in the year ended December 31, 2018 in respect of the equity conversions (2017: a loss of \$1.5 million was recorded in the year ended December 31, 2017 on the purchase and cancellation of bonds; 2016: \$8.8 million).

In conjunction with the bond issue, the Company loaned up to 6,060,606 of its common shares to an affiliate of one of the underwriters of the issue, in order to assist investors in the bonds to hedge their position. The shares that were lent by the Company were borrowed from Hemen, the largest shareholder of the Company, for a one-time loan fee of \$1.0 million.

In February 2018, the Company redeemed the full outstanding amount of \$63.2 million. This was fully paid in cash, and the premium settled in common shares with the issuance of 651,365 new shares.

As required by ASC 470-20 "Debt with conversion and Other Options", the Company calculated the equity component of the convertible bond, taking into account both the fair value of the conversion option and the fair value of the share lending arrangement. The equity component was valued at \$20.7 million in 2013 and this amount was recorded as "Additional paid-in capital", with a corresponding adjustment to "Deferred charges", which are amortized to "Interest expense" over the appropriate period. The amortization of this item amounted to \$0.1 million in the year ended December 31, 2018 (2017: \$1.8 million). The equity component of the converted bonds in 2018 was valued at \$nil (2017: \$16.4 million for the purchased and canceled bonds) and this amount has been deducted from "Additional

paid-in capital".

**NOK900 million senior unsecured bonds due 2019**

On March 19, 2014, the Company issued a senior unsecured bond loan totaling NOK900.0 million in the Norwegian credit market. The bonds bear quarterly interest at NIBOR plus a margin and are redeemable in full on March 19, 2019. The bonds may, in their entirety, be redeemed at the Company's option from September 19, 2018, upon giving the bondholders at least 30 business days notice and paying 100.50% of par value plus accrued interest. Subsequent to their issue, at December 31, 2018, the Company has purchased bonds with principal amounts totaling NOK228.0 million (2017: NOK142.0 million), which are being held as treasury bonds. The net amount outstanding at December 31, 2018, was NOK672.0 million, equivalent to \$77.7 million (2017: NOK758.0 million, equivalent to \$92.5 million).

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#### NOK500 million senior unsecured bonds due 2020

On June 22, 2017, the Company issued a senior unsecured bond loan totaling NOK500.0 million in the Norwegian credit market. The bonds bear quarterly interest at NIBOR plus a margin and are redeemable in full on June 22, 2020. The net amount outstanding at December 31, 2018, was NOK500.0 million, equivalent to \$57.8 million (2017: NOK500.0 million, equivalent to \$61.0 million).

#### 5.75% senior unsecured convertible bonds due 2021

On October 5, 2016, the Company issued a senior unsecured convertible bond loan totaling \$225.0 million. Interest on the bonds is fixed at 5.75% per annum and is payable in cash quarterly in arrears on January 15, April 15, July 15 and October 15. The bonds are convertible into Ship Finance International Limited common shares and mature on October 15, 2021. The net amount outstanding at December 31, 2018 was \$212.2 million (2017: \$225.0 million). The initial conversion rate at the time of issuance was 56.2596 common shares per \$1,000 bond, equivalent to a conversion price of approximately \$17.7747 per share. The conversion rate will be adjusted for dividends in excess of \$0.225 per common share per quarter. Since the issuance, dividend distributions have increased the conversion rate to 62.9233 common shares per \$1,000 bond, equivalent to a conversion price of approximately \$15.8924 per share. Based on the closing price of our common stock of \$10.53 on December 31, 2018, the if-converted value was less than the principal amounts by \$77.5 million. In December 2018, the Company purchased bonds with principal amounts totaling \$12.8 million (2017: \$nil) resulting in a gain of \$0.9 million being recorded (2017: \$nil; 2016: \$nil).

In conjunction with the bond issue, the Company loaned up to 8,000,000 of its common shares to an affiliate of one of the underwriters of the issue, in order to assist investors in the bonds to hedge their position. The shares that were lent by the Company were initially borrowed from Hemen, the largest shareholder of the Company, for a one-time loan fee of \$120,000. In November 2016, the Company issued 8,000,000 new shares, to replace the shares borrowed from Hemen and received \$80,000 from Hemen upon the return of the borrowed shares.

As required by ASC 470-20 "Debt with conversion and Other Options", the Company calculated the equity component of the convertible bond, taking into account both the fair value of the conversion option and the fair value of the share lending arrangement. The equity component was valued at \$4.6 million in 2016 and this amount was recorded as "Additional paid-in capital", with a corresponding adjustment to "Deferred charges", which are amortized to "Interest expense" over the appropriate period. The equity component was valued at \$4.1 million in 2018. The amortization of this item amounted to \$0.9 million in the year ended December 31, 2018 (2017: \$0.9 million). As a result of the purchase of bonds with principal amounts totaling \$12.8 million (2017: \$nil), a total of \$0.5 million (2017: \$nil) was allocated as the reacquisition of the equity component.

#### NOK600 million senior unsecured bonds due 2023

On September 13, 2018 the Company issued a senior unsecured bond totaling NOK600 million in the Norwegian credit market. The bonds bear quarterly interest at NIBOR plus a margin and are redeemable in full on September 13, 2023. The net amount outstanding at December 31, 2018, was NOK600 million, equivalent to \$69.4 million (2017: NOKnil, equivalent to \$nil).

#### 4.875% senior unsecured convertible bonds due 2023

On April 23, 2018, the Company issued a senior unsecured convertible bond totaling \$150.0 million. Additional bonds were issued on May 4, 2018 at a principal amount of \$14.0 million. Interest on the bonds is fixed at 4.875% per annum and is payable in cash quarterly in arrears on February 1, May 1, August 1 and November 1. The bonds are convertible into Ship Finance International Limited common shares and mature on May 1, 2023. The net amount outstanding at December 31, 2018 was \$151.7 million (December 31, 2017: \$nil). The initial conversion rate at the time of issuance was 52.8157 common shares per \$1,000 bond, equivalent to a conversion price of approximately \$18.93 per share. Since the issuance, dividend distributions have increased the conversion rate to 58.7171 common

shares per \$1,000 bond, equivalent to a conversion price of approximately \$17.03 per share. Based on the closing price of our common stock of \$10.53 on December 31, 2018, the if-converted value was less than the principal amounts by \$65.5 million. In December 2018, the Company purchased bonds with principal amounts totaling \$12.3 million (2017: \$nil). A gain of \$0.4 million was recorded on the transaction (2017: \$nil; 2016: \$nil).

In conjunction with the bond issue, the Company agreed to loan up to 7,000,000 of its common shares to affiliates of the underwriters of the issue, in order to assist investors in the bonds to hedge their position. As at December 31, 2018, a total of 3,765,842 shares were issued from up to 7,000,000 shares issuable under a share lending arrangement.

As required by ASC 470-20 "Debt with conversion and Other Options", the Company calculated the equity component of the convertible bond, taking into account both the fair value of the conversion option and the fair value of the share lending arrangement. The equity component was valued at \$7.9 million at issue date and this amount was recorded as "Additional paid-in capital", with a corresponding adjustment to "Deferred charges", which are amortized to "Interest expense" over the appropriate period. The



amortization of this item amounted to \$1.0 million in the year ended December 31, 2018 (2017: \$nil). As a result of the purchase of bonds with principal amounts totaling \$12.3 million (2017: \$nil), a total of \$0.6 million (2017: \$nil) was allocated as the reacquisition of the equity component.

**\$50 million secured term credit facility**

In June 2018, 15 wholly-owned subsidiaries of the Company entered into a \$50.0 million secured term loan facility with a bank, secured against 15 feeder size container vessels. The 15 vessels were delivered in April 2018. The Company has provided a corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of seven years. The net amount outstanding at December 31, 2018, was \$46.9 million (2017: \$nil).

**\$17.5 million secured term loan facility due 2023**

In December 2018, two wholly-owned subsidiaries of the Company entered into a \$17.5 million secured term loan facility with a bank, secured against two Supramax dry bulk carriers. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of approximately five years. The net amount outstanding at December 31, 2018, was \$17.5 million (2017: \$nil).

**\$43 million secured term loan facility**

In February 2010, a wholly-owned subsidiary of the Company entered into a \$42.6 million secured term loan facility with a bank, bearing interest at LIBOR plus a margin and with a term of approximately five years. The facility is secured against a Suezmax tanker. In November 2014, the terms of the loan were amended and restated, and the facility now matures in November 2019. The net amount outstanding at December 31, 2018, was \$17.8 million (2017: \$20.6 million).

**\$43 million secured term loan facility**

In March 2010, a wholly-owned subsidiary of the Company entered into a \$42.6 million secured term loan facility with a bank, bearing interest at LIBOR plus a margin and with a term of approximately five years. The facility is secured against a Suezmax tanker. In March 2015, the terms of the loan were amended and restated, and the facility now matures in March 2020. The net amount outstanding at December 31, 2018, was \$17.8 million (2017: \$20.6 million).

**\$54 million secured term loan facility**

In November 2010, two wholly-owned subsidiaries of the Company entered into a \$53.7 million secured term loan facility with a bank, secured against two Supramax dry bulk carriers. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and had a term of approximately eight years. This was fully repaid in December 2018. The net amount outstanding at December 31, 2018, was \$nil (2017: \$26.3 million).

**\$75 million secured term loan facility**

In March 2011, three wholly-owned subsidiaries of the Company entered into a \$75.4 million secured term loan facility with a bank, secured against three Supramax dry bulk carriers. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of approximately eight years. The net amount outstanding at December 31, 2018, was \$32.7 million (2017: \$39.0 million).

**\$171 million secured term loan facility**

In May 2011, eight wholly-owned subsidiaries of the Company entered into a \$171.0 million secured loan facility with a syndicate of banks. The facility is supported by China Export & Credit Insurance Corporation, or SINOSURE, which provides an insurance policy in favor of the banks for part of the outstanding loan. The facility is secured

against a 1,700 TEU container vessel and seven Handysize dry bulk carriers. The facility bears interest at LIBOR plus a margin and has a term of approximately ten years from delivery of each vessel. The net amount outstanding at December 31, 2018, was \$73.7 million (2017: \$98.0 million).

**\$45 million secured term loan and revolving credit facility**

In June 2014, seven wholly-owned subsidiaries of the Company entered into a \$45.0 million secured term loan and revolving credit facility with a bank, secured against seven 4,100 TEU container vessels. The facility bears interest at LIBOR plus a margin and has a term of five years. At December 31, 2018, the available amount under the revolving part of the facility was \$nil (2017: \$9.0 million). The net amount outstanding at December 31, 2018, was \$45.0 million (2017: \$36.0 million).

**\$101 million secured term loan facility**

In August 2014, six wholly-owned subsidiaries of the Company entered into a \$101.4 million secured term loan facility with a syndicate of banks, secured against six offshore support vessels. One of the vessels was sold in February 2016 and the facility now relates to the remaining five vessels. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of five years. In October 2017, certain amendments were made to the agreement, including an extension of the final maturity date until January 2023. The net amount outstanding at December 31, 2018, was \$44.1 million (2017: \$44.1 million).

**\$20 million secured term loan facility**

In September 2014, two wholly-owned subsidiaries of the Company entered into a \$20.0 million secured term loan facility with a bank, secured against two 5,800 TEU container vessels. The facility bears interest at LIBOR plus a margin and has a term of five years. The net amount outstanding at December 31, 2018, was \$20.0 million (2017: \$20.0 million).

**\$128 million secured term loan facility**

In September 2014, two wholly-owned subsidiaries of the Company entered into a \$127.5 million secured term loan facility with a bank, secured against two 8,700 TEU container vessels, which were delivered in 2014. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of seven years. The net amount outstanding at December 31, 2018, was \$92.4 million (2017: \$100.9 million).

**\$128 million secured term loan facility**

In November 2014, two wholly-owned subsidiaries of the Company entered into a \$127.5 million secured term loan facility with a bank, secured against two 8,700 TEU container vessels, which were delivered in 2015. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of seven years. The net amount outstanding at December 31, 2018 was \$95.6 million (2017: \$104.1 million).

**\$39 million secured term loan facility**

In December 2014, two wholly-owned subsidiaries of the Company entered into a \$39.0 million secured term loan facility with a bank, secured against two Kamsarmax dry bulk carriers. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of approximately eight years. The net amount outstanding at December 31, 2018, was \$26.7 million (2017: \$29.1 million).

**\$250 million secured revolving credit facility**

In June 2015, 17 wholly-owned subsidiaries of the Company entered into a \$250.0 million secured revolving credit facility with a syndicate of banks, secured against 17 tankers chartered to Frontline Shipping. Eight of the tankers were sold and delivered to their new owners prior to December 31, 2017, and the facility was secured against the remaining nine tankers at December 31, 2017. The facility bore interest at LIBOR plus a margin and had a term of three years before repayment in December 2018. At December 31, 2018, the available amount under the facility was \$nil (2017: \$nil). The net amount outstanding at December 31, 2018, was \$nil (2017: \$149.0 million).

\$166 million secured term loan facility

In July 2015, eight wholly-owned subsidiaries of the Company entered into a \$166.4 million secured term loan facility with a syndicate of banks, secured against eight Capesize dry bulk carriers. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of seven years. The net amount outstanding at December 31, 2018 was \$117.9 million (2017: \$131.7 million).

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**\$210 million secured term loan facility**

In November 2015, three wholly-owned subsidiaries of the Company entered into a \$210.0 million secured term loan facility with a syndicate of banks, to partly finance the acquisition of three container vessels, against which the facility is secured. One of the vessels was delivered in 2015, and the remaining two vessels were delivered in 2016. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of five years from the delivery of each vessel. At December 31, 2018, the net amount outstanding was \$173.9 million (2017: \$187.0 million).

**\$76 million secured term loan facility**

In August 2017, two wholly-owned subsidiaries of the Company entered into a \$76.0 million secured term loan facility with a bank, secured against two product tanker vessels. The two vessels were delivered in August 2017. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of seven years. At December 31, 2018, the net amount outstanding was \$69.5 million (2017: \$74.7 million).

The aggregate book value of assets pledged as security against borrowings at December 31, 2018, was \$1,527 million (2017: \$1,908 million).

Agreements related to long-term debt provide limitations on the amount of total borrowings and secured debt, and acceleration of payment under certain circumstances, including failure to satisfy certain financial covenants. As of December 31, 2018, the Company is in compliance with all of the covenants under its long-term debt facilities. In addition, the \$101.4 million secured term loan facility entered into in August 2014 contains certain financial covenants on Solship. As at December 31, 2018, Solship was in compliance with all covenants under the loan agreement.

**21. CAPITAL LEASE OBLIGATIONS AND OTHER LONG-TERM LIABILITIES**

| (in thousands of \$)        | 2018  | 2017  |
|-----------------------------|-------|-------|
| Unamortized sellers' credit | 3,282 | 3,958 |
| Other items                 | 4     | 4     |
|                             | 3,286 | 3,962 |

The unamortized seller's credit is in respect of the five offshore support vessels on long-term bareboat charters to the Solstad Charterer, a wholly owned subsidiary of Deep Sea Supply AS, which in turn is a wholly owned subsidiary of Solship (formerly Deep Sea). Solship is a wholly owned subsidiary of Solstad Offshore ASA. Between 2007 and 2008, the Company acquired seven offshore support vessels from subsidiaries of then Deep Sea, which were chartered back to the subsidiaries under bareboat charter agreements. As part of the purchase consideration, the Company received seller's credits totaling \$39.5 million which are being recognized as additional bareboat revenues over the period of the charters. One of the vessels was sold in January 2008 and the other vessel was sold in February 2016.

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| (in thousands of \$)                                 | 2018      | 2017    |
|--|-----------|---------|
| Current portion of obligations under capital leases  | 67,793    | 9,031   |
| Obligations under capital leases - long-term portion | 1,104,258 | 230,576 |
|  | 1,172,051 | 239,607 |

In October 2015, the Company entered into agreements to charter in two 19,200 TEU newbuildings container vessels on a bareboat basis, each for a period of 15 years from delivery by the shipyard, and to charter out each vessel for the same 15-year period on a bareboat basis to MSC, an unrelated party. The first vessel was delivered in December 2016 and the second vessel was delivered in March 2017. Both vessels are accounted for as direct financing lease assets.

In December 2018, the Company entered into agreements to charter in a further two 19,400 TEU container vessels on a bareboat basis, each for a period of 15 years, and to charter out each vessel for the same 15-year period on a bareboat basis to MSC, an unrelated party. The vessels were delivered in December 2018 and both are accounted for as direct financing lease assets.

In the second, third and fourth quarter of 2018, the Company acquired four 13,800 TEU container vessels and three 10,600 TEU container vessels, which were subsequently refinanced with an Asian based financial institution by entering into separate sale and leaseback financing arrangements. The vessels are leased back for terms ranging from six to 11 years, with options to purchase the vessel after six years. Due to the terms of the sale and leaseback arrangements, each option is expected to be exercised on the sixth anniversary. These sale and leaseback transactions were accounted for as capital leases (Refer Note 14: Vessels under capital lease, net).

The Company's future minimum lease obligations under the non-cancellable capital leases are as follows:

| Year ending December 31,                             | (in thousands of \$) |
|--|----------------------|
| 2019   | 130,169              |
| 2020   | 126,868              |
| 2021   | 126,726              |
| 2022   | 126,726              |
| 2023   | 126,726              |
| Thereafter   | 976,801              |
| Total lease obligations                              | 1,614,016            |
| Less: imputed interest payable                       | (441,965 )           |
| Present value of obligations under capital leases    | 1,172,051            |
| Less: current portion                                | (67,793 )            |
| Obligations under capital leases - long-term portion | 1,104,258            |

Interest incurred on capital leases was \$21.8 million (2017: \$16.0 million; 2016: \$0.2 million).

## 22. SHARE CAPITAL, ADDITIONAL PAID-IN CAPITAL AND CONTRIBUTED SURPLUS

Authorized share capital is as follows:

| (in thousands of \$, except share data)   | 2018  | 2017  |
|---|-------|-------|
| 200,000,000 common shares of \$0.01 par value each (2017: 150,000,000 common shares of \$0.01 par value each) | 2,000 | 1,500 |

Issued and fully paid share capital is as follows:

| (in thousands of \$, except share data) | 2018  | 2017  |
|---|-------|-------|
|   | 1,194 | 1,109 |

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119,373,064 common shares of \$0.01 par value each (2017: 110,930,873 common shares of \$0.01 par value each)

The Company's common shares are listed on the New York Stock Exchange.

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During the year ended December 31, 2018, the Company issued a total of no new shares of \$0.01 each following the exercise of share options (2017: 7,500 new shares of \$0.01 issued to satisfy options exercised). The weighted average exercise price of the options exercised in 2017 was \$11.78 per share resulting in a premium on issue of \$0.1 million. In November 2016, the Board of Directors renewed the Ship Finance International Limited Share Option Scheme (the "Option Scheme"), originally approved in November 2006. The Option Scheme permits the Board of Directors, at its discretion, to grant options to employees, officers and directors of the Company or its subsidiaries. The fair value cost of options granted is recognized in the statement of operations, and the corresponding amount is credited to additional paid in capital (see also Note 23: Share option plan).

At the Annual General Meeting of the Company in September 2018, a resolution was passed to approve an increase of the Company's authorized share capital from \$1,500,000 divided into 150,000,000 common shares of \$0.01 par value each to \$2,000,000 divided into 200,000,000 common shares of \$0.01 par value each by the authorization of an additional 50,000,000 common shares of \$0.01 par value each.

In May 2018, the Company issued a total of 4,024,984 new shares as part of the consideration paid for the acquisition of four 2014 built container vessels, each with 13,800 TEU carrying capacity. The vessels are employed under long-term time-charters to an unrelated third party (see Note 13: Vessels and equipment, net).

In April 2018, the Company issued a total of 3,765,842 new shares of par value \$0.01 each from up to 7,000,000 issuable under a share lending arrangement in relation with the Company's issuance of 4.875% senior unsecured convertible bonds in April and May 2018. The shares issued have been loaned to affiliates of the underwriters of the bond issue in order to assist investors in the bonds to hedge their position. The bonds are convertible into common shares and mature on May 1, 2023. As required by ASC 470-20 "Debt with conversion and Other Options", the Company calculated the equity component of the convertible bond, which was valued at \$7.9 million at issue date and recorded as "Additional paid-in capital" (see Note 20: Short-term and long-term debt). In December 2018, the Company purchased bonds with principal amounts totaling \$12.3 million (2017: \$nil). The equity component of these extinguished bonds was valued at \$0.6 million (2017: \$nil) and has been deducted from "Additional paid-in capital".

In February 2018, the Company redeemed the full outstanding amount under the 3.25% senior unsecured convertible bonds due 2018. The remaining outstanding principal amount of \$63.2 million was paid in cash, and the premium settled in common shares with the issue of 651,365 new shares (see Note 20: Short-term and long-term debt).

In October 2017, the Company issued a total of 9,418,798 new shares following separate privately negotiated transactions with certain holders of the 3.25% senior unsecured convertible bonds due 2018 for the conversion of a principal amount of \$121.0 million from the outstanding balance of the convertible bonds. In January 2013, the Company issued a senior unsecured convertible bond loan totaling \$350 million. The bonds are convertible into common shares at any time up to ten banking days prior to February 1, 2018. The conversion price at the time of issue was \$21.945 per share, representing a premium of approximately 33% to the share price at the time.

As required by ASC 470-20 "Debt with Conversion and Other Options", the Company calculated the equity component of the convertible bond, which was valued at \$20.7 million and recorded as "Additional paid-in capital" (see Note 20: Short-term and long-term debt). Previously in October 2016, the Company purchased and canceled bonds with principal amounts totaling \$165.8 million. The equity component of the converted bonds in 2018 was valued at \$nil (2017: \$16.4 million for the purchased and canceled bonds) and this amount has been deducted from "Additional paid-in capital".

In November 2016, in relation with the Company's issue in October 2016 of senior unsecured convertible bonds totaling \$225 million, the Company issued 8,000,000 new shares of par value \$0.01 each. The shares were issued at par value and have been loaned to an affiliate of one of the underwriters of the bond issue, in order to assist investors



in the bonds to hedge their position. The bonds are convertible into common shares and mature on October 15, 2021. The initial conversion rate at the time of issuance was 56.2596 common shares per \$1,000 bond, equivalent to a conversion price of approximately \$17.7747 per share to the share price at the time. Since then, dividend distributions have increased the conversion rate to 62.9233, equivalent to a conversion price of approximately \$15.8924 per share. As required by ASC 470-20 "Debt with conversion and Other Options", the Company calculated the equity component of the convertible bond, which was valued at \$4.1 million and recorded as "Additional paid-in capital" (see Note 20: Short-term and long-term debt). In December 2018, the Company purchased bonds with principal amounts totaling \$12.8 million (2017: \$nil). The equity component of these extinguished bonds was valued at \$0.5 million (2017: \$nil) and has been deducted from "Additional paid-in capital".

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A reorganization of share capital was approved at the Annual General Meeting of the Company held in September 2016, in accordance with the Bermuda Companies Act. Following the reorganization, the Company's authorized share capital was adjusted to 150,000,000 shares of par value \$0.01 each, prior to which it had been 125,000,000 shares of par value \$1.00 each. As there were 93,504,575 shares issued and fully paid at the time of the reorganization, to reflect the decrease in the par value of each share from \$1.00 to \$0.01, \$92.6 million was transferred from share capital to contributed surplus. The shares of par value \$0.01 each rank pari passu in all respects with each other.

### 23. SHARE OPTION PLAN

In November 2006, the Board of Directors approved the Ship Finance International Limited Share Option Scheme (the "Option Scheme"). The Option Scheme will expire in November 2026, following the renewal in November 2016. The terms and conditions remain unchanged from those originally adopted in November 2006 and permits the Board of Directors, at its discretion, to grant options to employees, officers and directors of the Company or its subsidiaries. The fair value cost of options granted is recognized in the statement of operations, and the corresponding amount is credited to additional paid-in capital. As of December 31, 2018 additional paid-in capital was credited with \$0.5 million relating to the fair value of options granted in March 2016, September 2017 and April 2018.

As of December 31, 2018 no options were exercised under the Option Scheme.

During the year ended December 31, 2018, the Company awarded a total of 83,000 options to officers and employees, pursuant to the Company's Share Option Scheme. The options have a five year term and a three year vesting period and the first options will be exercisable from April 2019 onwards. The initial strike price was \$14.67 per share.

The following summarizes share option transactions related to the Option Scheme in 2018, 2017 and 2016:

|  | 2018      |                                    | 2017      |                                    | 2016      |                                    |
|--|-----------|------------------------------------|-----------|------------------------------------|-----------|------------------------------------|
|  | Options   | Weighted average exercise price \$ | Options   | Weighted average exercise price \$ | Options   | Weighted average exercise price \$ |
| Options outstanding at beginning of year | 369,500   | 12.20                              | 279,000   | 13.03                              | 125,000   | 12.56                              |
| Granted                                  | 83,000    | 14.67                              | 113,000   | 14.30                              | 279,000   | 14.38                              |
| Exercised                                | —         | —                                  | (7,500 )  | 11.78                              | (125,000) | 12.11                              |
| Forfeited                                | (35,000 ) | 10.03                              | (15,000 ) | 11.78                              | —         | —                                  |
| Options outstanding at end of year       | 417,500   | 11.43                              | 369,500   | 12.20                              | 279,000   | 13.03                              |
| Exercisable at end of year               | 111,500   | 10.03                              | 85,500    | 11.43                              | —         | —                                  |

The exercise price of each option is progressively reduced by the amount of any dividends declared. The above figures show the average of the reduced exercise prices at the beginning and end of the year for options then outstanding. For options granted, exercised or forfeited during the year, the above figures show the average of the exercise prices at the time the options were granted, exercised or forfeited, as appropriate.

The fair values of options granted are estimated on the date of the grant, using the Black-Scholes-Merton option valuation model. The fair values are then expensed over the periods in which the options vest. The weighted average fair value of options granted in 2018 was \$3.49 per share as at grant date (2017: \$3.77; 2016: \$3.06). The weighted average assumptions used to calculate the fair values of the new options granted in 2018 were (a) risk free interest rate of 2.63% (2017: 1.58%; 2016: 1.08%); (b) expected share price volatility of 29.5% (2017: 33.0%; 2016: 31.3%); (c) expected dividend yield of 0% (2017: 0%; 2016: 0%) and (d) expected life of options 3.5 years (2017: 3.5 years; 2016: 3.5 years).

The total intrinsic value of options exercised in 2018 was \$nil on the day of exercise (2017: \$0.02 million; 2016: \$0.3 million). The total amount of cash received from options exercised in 2018 was \$nil (2017: \$0.1 million; 2016: \$0.1 million).

As of December 31, 2018, there are 111,500 options fully vested but not exercised (2017: 85,500 options; 2016: nil options) and their intrinsic value amounted to \$nil (2017: \$0.3 million; 2016: \$nil). The weighted average remaining term of the vested exercisable options is 2.7 years as of December 31, 2018.

As of December 31, 2018, the unrecognized compensation costs relating to non-vested options granted under the Option Scheme was \$0.3 million (2017: \$0.5 million; 2016: \$0.5 million) and their intrinsic value amounted to \$nil (2017: \$0.9 million; 2016: \$0.5 million). This cost will be recognized over the remaining vesting periods, which average 1.4 years (2017: 2.0 years; 2016: 2.2 years).

During the year ended December 31, 2018, the Company recognized an expense of \$0.5 million in compensation cost relating to the stock options (2017: \$0.4 million; 2016: \$0.4 million).

#### 24. RELATED PARTY TRANSACTIONS

The Company has had transactions with the following related parties, being companies in which our principal shareholder Hemen and companies associated with Hemen have, or had, a significant direct or indirect interest:

- Frontline
- Frontline Shipping
- Seadrill
- Golden Ocean
- United Freight Carriers ("UFC" - which is a joint venture approximately 50% owned by Golden Ocean)
- Deep Sea Supply Plc. ("Deep Sea") (1)
- Seatankers Management Co. Ltd. ("Seatankers")
- NorAm Drilling
- Golden Close
- Sterna Finance
- ADS Crude Carriers Plc ("ADS")

(1) From October 2017, Deep Sea was determined to no longer be a related party (see below).

The Consolidated Balance Sheets include the following amounts due from and to related parties, excluding direct financing lease balances (see Note 16: Investments in direct financing and sales type leases):

| (in thousands of \$)   | 2018    | 2017    |
|--|---------|---------|
| Amounts due from:  |         |         |
| Frontline Shipping   | 1,225   | —       |
| Frontline  | 8,430   | 5,579   |
| Deep Sea   | —       | —       |
| Seadrill   | 223     | —       |
| SFL Linus  | 21,718  | 3,559   |
| SFL Deepwater  | —       | 171     |
| SFL Hercules   | 10,125  | 97      |
| Golden Ocean   | 50      | 153     |
| Other related parties  | —       | 66      |
| Total amount due from related parties                            | 41,771  | 9,625   |
| Loans to related parties - associated companies, long-term       |         |         |
| SFL Deepwater  | 109,144 | 113,000 |
| SFL Hercules   | 80,000  | 80,000  |
| SFL Linus  | 121,000 | 121,000 |
| Total loans to related parties - associated companies, long-term | 310,144 | 314,000 |
| Long-term receivables from related parties                       |         |         |
| Frontline  | 11,170  | —       |
| Frontline Shipping   | 4,446   | —       |
| Total long-term receivables from related parties                 | 15,616  | —       |
| Amounts due to:  |         |         |
| Frontline Shipping   | 1,125   | 539     |
| Frontline  | 125     | 147     |
| Seatankers   | —       | 60      |
| Golden Ocean   | 91      | —       |
| Other related parties  | 8       | 111     |
| Total amount due to related parties                              | 1,349   | 857     |

SFL Deepwater, SFL Hercules and SFL Linus are wholly-owned subsidiaries which are not fully consolidated but are accounted for under the equity method as at December 31, 2018. As described below in "Related party loans", at December 31, 2018 and 2017, the long-term loans from Ship Finance to SFL Deepwater, SFL Hercules, and SFL Linus are presented net of amounts due to them by Ship Finance on their respective current accounts.

#### Related party leasing and service contracts

One of the Company's offshore support vessels (2017: one) accounted for as a direct finance lease and four of the Company's offshore support vessels (2017: four) accounted for as operating leases were employed under long term charters to a subsidiary of Deep Sea. In June 2017, Deep Sea completed a merger with Solstad Offshore ASA and Farstad Shipping ASA, creating Solstad Farstad, with Hemen's shareholding in Solstad Farstad being below 20%. In October 2018, Solstad Farstad changed its name to Solstad Offshore ASA ("Solstad"). The Company determined that Solstad was not a related party as a result of the merger. Following the merger, Solship (formerly Deep Sea), a wholly owned subsidiary of Solstad Farstad, acts as charter guarantor under the long term charter agreements.

As at December 31, 2018, three of the Company's vessels leased to Frontline Shipping (2017: nine) are recorded as direct financing leases. In addition, at December 31, 2018, eight dry bulk carriers were leased to a subsidiary of Golden Ocean under operating leases.



At December 31, 2018, the balance of net investments in direct financing leases with Frontline Shipping was \$115.0 million (2017: \$314.0 million) of which \$8.0 million (2017: \$22.3 million) represents short-term maturities.

At December 31, 2018, the net book value of assets leased under operating leases to Golden Ocean was \$217.7 million (2017: \$233.7 million).

During the year ended December 31, 2016, the Company also earned income from another offshore support vessel leased to a subsidiary of Deep Sea, which was sold in February 2016, and from six dry bulk carriers leased to UFC on short-term charters, which all ended during 2016.

A summary of leasing revenues earned from the Frontline Shipping, Deep Sea, Golden Ocean and UFC is as follows:

| (in millions of \$)                    | 2018 | 2017 | 2016 |
|--|------|------|------|
| Operating lease income                 | 53.3 | 59.4 | 65.3 |
| Direct financing lease interest income | 9.6  | 16.4 | 22.9 |
| Finance lease service revenue          | 22.1 | 35.0 | 44.5 |
| Direct financing lease repayments      | 16.8 | 25.1 | 30.3 |
| Profit sharing revenues                | 1.8  | 5.8  | 51.5 |

In June 2015, amendments were made to the charter agreements relating to 17 vessels. The amendments, which are effective from July 1, 2015, and do not affect the duration of the leases, include reductions in the daily time-charter rates to \$20,000 per day for VLCCs and \$15,000 per day for Suezmax tankers. As consideration for the agreed amendments, the Company received 55 million ordinary shares in Frontline, and also an increase in the profit sharing percentage (see below). A dividend restriction was introduced on Frontline Shipping whereby it can only make distributions to its parent company if it can demonstrate it meets certain conditions.

In February 2016, Frontline enacted a 1-for-5 reverse stock split of its ordinary shares, and the Company's holding in Frontline consists of 11 million ordinary shares. In the year ended December 31, 2018, the Company received dividend income totaling \$nil (2017: \$3.3 million; 2016: \$11.6 million) on these shares.

Frontline Shipping pays the Company profit sharing of 50% of their earnings on a time-charter equivalent basis from their use of the Company's fleet above average threshold charter rates calculated on a quarterly basis. The Company earned and recognized profit sharing revenue under the 50% arrangement of \$1.5 million in the year ended December 31, 2018 (2017: \$5.6 million; 2016: \$50.9 million).

In the event that vessels on charter to the Frontline Shipping are agreed to be sold, the Company may either pay or receive compensation for the early termination of the lease. In the year ended December 31, 2018, the Company sold the VLCC Front Circassia to an unrelated third party. The vessel was delivered to the new owner in February 2018, and a termination fee of \$4.4 million at fair value was received from Frontline Shipping in the form of a loan note. The loan note bears interest at a rate of 7.5% and matures in December 2021. The Company also sold the VLCCs Front Page, Front Stratus and Front Serenade to a related third party. The vessels were delivered to the new owner, ADS, in July 2018, August 2018 and September 2018, respectively, and an aggregate termination fee of \$10.1 million at fair value was received from Frontline in the form of three loan notes. The loan notes bear interest at a rate of 7.5% and mature between November 2024 and May 2025. In October 2018, the Company sold the VLCC Front Ariake to an unrelated third party. The vessel was delivered to the new owner in October 2018 and a termination fee of \$3.4 million at fair value was received from Frontline in the form of a loan note. The loan note bears interest at a rate of 7.5% and matures in November 2023.

In March 2017, May 2017, June 2017 and August 2017, Front Century, Front Brabant, Front Scilla and Front Ardenne on charter to Frontline Shipping were sold and their leases canceled, with agreed termination fees received of \$4.1

million, \$3.6 million, \$6.5 million and \$4.8 million, respectively.

In July 2016, the VLCC Front Vanguard on charter to Frontline Shipping was sold and its lease canceled, with an agreed termination fee of \$0.3 million received.

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In February 2016, the offshore support vessel Sea Bear on charter to a subsidiary of Deep Sea was sold and its lease canceled. An agreed termination fee was received in the form of loan notes from Deep Sea, receivable over the approximately six remaining years of the canceled lease. The initial face value of the notes received, on which interest at 7.25% is receivable, was \$14.6 million and their initial fair value of \$11.6 million was determined from analysis of projected cash flows, based on factors including the terms, provisions and other characteristics of the notes, default risk of the issuing entity, the fundamental financial and other characteristics of that entity, and the current economic environment and trading activity in the debt market. From October 2017, due to the merger of Deep Sea, Solstad Offshore ASA and Farstad Shipping ASA, this loan note is no longer considered a related party receivable. The Company received \$0.4 million interest on the loan note in 2017 up until it was considered a related party receivable (2016: \$0.9 million).

In the year ended December 31, 2018, the Company had eight dry bulk carriers operating on time-charters to a subsidiary of Golden Ocean, which include profit sharing arrangements whereby the Company earns a 33% share of profits earned by the vessels above threshold levels. In the year ended December 31, 2018, the Company earned \$0.2 million income under this arrangement (2017: \$0.2 million; 2016: \$nil).

Until their short-term charters ended on the relevant dates during 2016, the Company had up to six dry bulk carriers operating on time-charters to UFC during 2016, which included profit-sharing arrangements whereby the Company earned a 50% share of profits earned by the vessels above threshold levels. In the year ended December 31, 2016, the Company earned and recognized \$0.6 million under this arrangement.

As at December 31, 2018, the Company was owed a total of \$1.2 million (2017: owes \$0.3 million) to Frontline Shipping in respect of leasing contracts and profit share.

At December 31, 2018, the Company was owed \$8.4 million (2017: \$5.6 million) by Frontline in respect of various short-term items, including vessel management fees and items relating to the operation of vessels trading in a pool with two vessels owned by Frontline.

At December 31, 2018, the Company was owed \$21.7 million (2017: \$3.6 million), \$nil (2017: \$0.2 million) and \$10.1 million (2017: \$0.1 million) by SFL Linus, SFL Deepwater and SFL Hercules respectively in addition to the loan due to the Company - see below.

The vessels leased to Frontline Shipping are on time charter terms and for each such vessel the Company pays a fixed management/operating fee of \$9,000 per day to Frontline Management (Bermuda) Ltd. ("Frontline Management"), a wholly owned subsidiary of Frontline. An exception to this arrangement is for any vessel leased to Frontline Shipping which is sub-chartered on a bareboat basis, for which there is no management fee payable for the duration of the bareboat sub-charter. In addition, during the year ended December 31, 2018, the Company also had 15 container vessels, 14 dry bulk carriers, two Suezmax tankers, two car carriers and two product tankers operating on time charter or in the spot market, for which the supervision of the technical management was sub-contracted to Frontline Management. Management fees incurred are included in the table below.

The vessels leased to a subsidiary of Golden Ocean are on time charter terms and for each vessel the Company pays a fixed management/operating fee of \$7,000 per day to Golden Ocean Group Management (Bermuda) Ltd. ("Golden Ocean Management"), a wholly-owned subsidiary of Golden Ocean. Additionally, in the year ended December 31, 2018, the Company had 15 container vessels and 14 dry bulk carriers operating on time-charters, for which part of the operational management was sub-contracted to Golden Ocean Management. Management fees incurred are included in the table below. Management fees are classified as vessel operating expenses in the consolidated statements of operations.

In addition to leasing revenues and repayments, the Company incurred fees with related parties. The Company operates the Suezmax tankers Glorycrown and Everbright in the spot market (until the latter commenced a two year time charter in January 2016) and pays Frontline and its subsidiaries, a management fee of 1.25% of chartering revenues. The Company paid fees to Frontline Management for administrative services, including corporate services, and fees to Seatankers for the provision of advisory and support services. The Company also pays fees to Frontline Management for the management supervision of some of its newbuildings. The Company paid fees to Seatankers Management Norway AS for the provision of office facilities in Oslo, and fees to Frontline Corporate Services Ltd for the provision of office facilities in London. Fees incurred for these services are as follows:

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| (in thousands of \$)             | Year ended        |                   |                   |
|----------------------------------|-------------------|-------------------|-------------------|
|                                  | December 31, 2018 | December 31, 2017 | December 31, 2016 |
| Frontline:                       |                   |                   |                   |
| Vessel Management Fees           | 24,033            | 36,536            | 45,931            |
| Newbuilding Supervision Fees     | —                 | 979               | —                 |
| Commissions and Brokerage        | 287               | 269               | 390               |
| Administration Services Fees     | 323               | 335               | 576               |
| Golden Ocean:                    |                   |                   |                   |
| Vessel Management Fees           | 20,440            | 20,440            | 20,496            |
| Operating Management Fees        | 793               | 738               | 795               |
| Seatankers:                      |                   |                   |                   |
| Administration Services Fees     | 290               | 82                | 315               |
| Office Facilities:               |                   |                   |                   |
| Seatankers Management Norway AS  | 108               | 105               | —                 |
| Frontline Management AS          | 185               | 136               | 317               |
| Frontline Corporate Services Ltd | 166               | 173               | 235               |

As at December 31, 2018, the Company owes Frontline Management and Frontline Management AS a combined total of \$0.1 million (2017: \$0.1 million) for various items, including technical supervision fees and office costs. At December 31, 2018, the Company also owes Seatankers \$nil (2017: \$0.1 million) for advisory and support services.

On October 5, 2016, the Company issued a senior unsecured convertible bond loan totaling \$225.0 million. In conjunction with the bond issue, the Company loaned up to 8,000,000 of its common shares to an affiliate of one of the underwriters of the issue, in order to assist investors in the bonds to hedge their position. The shares that were lent by the Company were initially borrowed from Hemen, the largest shareholder of the Company, for a one-time loan fee of \$120,000. In November 2016, the Company issued 8,000,000 new shares, to replace the shares borrowed from Hemen and received \$80,000 from Hemen.

In the year ended December 31, 2017, in addition to the above, the Company also paid \$0.4 million to a subsidiary of Seadrill for the provision of management services for the jack-up drilling rig Soehanah.

#### Related party loans – associated companies

Ship Finance has entered into agreements with SFL Deepwater, SFL Hercules and SFL Linus granting them loans of \$145.0 million, \$145.0 million and \$125.0 million, respectively. The loans to SFL Deepwater and SFL Hercules are fixed interest rate loans, and the loan to SFL Linus was interest free until the newbuilding jack-up drilling rig was delivered to that company, since when it has been a fixed interest rate loan. These loans are repayable in full on October 1, 2023, October 1, 2023 and June 30, 2029, respectively, or earlier if the companies sell their drilling units. The net outstanding loan balances as at December 31, 2018, were \$109.0 million, \$80.0 million, and \$121.0 million for SFL Deepwater, SFL Hercules and SFL Linus, respectively. Ship Finance is entitled to take excess cash from these companies, and such amounts are recorded within their current accounts with Ship Finance. The loan agreements specify that the balance on the current accounts will have no interest applied and will be settled by offset against the eventual repayments of the fixed interest loans. In addition to this, as at December 31, 2018 the Company has current receivables of \$nil, \$10.1 million, \$21.7 million from SFL Deepwater, SFL Hercules and SFL Linus, respectively (2017: \$0.2 million; \$0.1 million; \$3.6 million, respectively). In the year ended December 31, 2018, the Company received interest income on these loans of \$5.1 million from SFL Deepwater (2017: \$5.4 million; 2016: \$6.5 million), \$3.6 million from SFL Hercules (2017: \$4.3 million; 2016: \$6.5 million) and \$5.4 million from SFL Linus (2017: \$5.5 million; 2016: \$5.6 million) totaling \$14.1 million (2017: \$15.2 million; 2016: \$18.7 million).

Related party purchases and sales of vessels

In the year ended December 31, 2018, the VLCCs Front Page, Front Stratus and Front Serenade which were accounted for as direct financing lease assets, were sold to a related party, ADS Crude Carriers Plc. ("ADS"). Gains of \$0.3 million, \$0.2 million and \$0.3 million were recorded on the disposal of the vessels, respectively. The gross proceeds from the sale was \$22.5 million

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per vessel in addition to compensation, in the form of loan notes of \$3.4 million each, received for the early termination of the charters.

No vessels were acquired from or sold to related parties in the year ended December 31, 2017.

#### Long-term receivables from related parties

The Company received a loan note from Frontline Shipping as compensation for the early termination of the charter of Front Circassia in February 2018. The initial face value of the note was \$8.9 million, however, Ship Finance recorded the loan note at an initial fair market value of \$4.4 million. The loan note bears interest at a rate of 7.5% and matures in December 2021. In the year ended December 31, 2018, the Company received interest income on this loan note of \$0.5 million.

The Company received loan notes from Frontline as compensation for the early termination of the charter of Front Page, Front Stratus and Front Serenade in July, August and September 2018, respectively. The face value of the notes is \$3.4 million each, and bears interest at a rate of 7.5%. The loan notes mature in between November 2024 and May 2025. In the year ended December 31, 2018, the Company received interest income on these loan notes of \$0.3 million.

The Company received a loan note from Frontline as compensation for the early termination of the charter of Front Ariake in October 2018. The initial face value of the note was \$3.4 million and bears interest at a rate of 7.5%. The note matures in December 2023. In the year ended December 31, 2018, the Company received interest income on this loan note of \$0.1 million.

#### Other related party transactions

In May 2018, four wholly-owned subsidiaries of the Company entered into a \$320.0 million unsecured loan facility provided by an affiliate of Hemen, Sterna Finance. The unsecured intermediary loan facility was entered into to partly fund the acquisition of four 13,800 TEU container vessels acquired in May 2018. The Company had provided a corporate guarantee for this loan facility, which had a fixed interest rate, was non-amortizing and had a term of 13 months from the drawdown date of the loan. Interest expense incurred on the loan in the year ended December 31, 2018 was \$6.4 million. The loan balance was prepaid in full in November 2018.

In August 2018, the Company acquired 4,031,800 shares in ADS, a newly formed company trading on the Oslo Merkur Market. The shares were purchased for \$10.0 million, and have a fair value of \$9.2 million at December 31, 2018 (see Note 11: Investments in debt and equity securities). These shares, on which no dividend income was received in the year ended December 31, 2018, represent 17.24% of the outstanding shares in the company.

In November 2016, the Company acquired approximately 12 million shares in NorAm Drilling for a consideration of approximately \$0.7 million. In November 2018 NorAm undertook a share consolidation of 20:1, resulting in a revised investment of 601,023 shares. On the same day NorAm participated in a rights issue, increasing the Company's investment in shares by 623,447 shares. In December 2018, the Company acquired an additional 41,756 shares bringing the total investment in NorAm to 1,266,226 shares with a fair value of \$3.9 million. This investment, on which no dividend was received in the year ended December 31, 2018, is included in "Investments in debt and equity securities" (Note 11) (2017: \$nil; 2016: \$nil).

The Company also holds within "Investments in Debt and Equity Securities" senior secured corporate bonds in NorAm Drilling due 2021. During the year ended December 31, 2018, the Company redeemed a total of 466,667 units at par value and recorded no gain or loss on redemption. This investment is included in Note 11: Investments in debt and equity securities. Interest amounting to \$0.5 million was earned in the year ended December 31, 2018 (2017: \$0.5

million; 2016: \$0.5 million). In addition, the Company earned other income of \$nil in the year ended December 31, 2018, (2017: \$0.1 million; 2016: \$nil).

During the year ended December 31, 2018, Golden Close initiated liquidation proceedings. As a result of this, the Company received total proceeds of \$45.6 million in settlement of its total investment, resulting in an overall net gain of \$13.5 million. The Company earned interest income on the Golden Close notes up to the date of redemption of \$0.2 million in the year ended December 31, 2018 (2017: \$0.6 million; 2016: \$0.2 million). As at December 31, 2018, the net investment in Golden Close debt and equity securities is \$nil (2017: \$28.5 million).

In June 2017, the Company facilitated a performance guarantee in favour of an oil company relating to a contract for the drillship Deepsea Metro 1. The guarantee had a maximum liability limited to \$18.0 million, a maturity of up to six months, and was secured under a first lien mortgage over the drillship, ranking ahead of other secured claims. In the year ended December 31, 2017, the Company recorded net fee income of \$0.4 million for facilitating the guarantee. The performance guarantee agreement was terminated in September 2017.

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## 25. FINANCIAL INSTRUMENTS

In certain situations, the Company may enter into financial instruments to reduce the risk associated with fluctuations in interest rates and exchange rates. The Company has a portfolio of swaps which swap floating rate interest to fixed rate, and which also fix the Norwegian kroner to US dollar exchange rate applicable to the interest payable and principal repayment on the NOK bonds. From a financial perspective these swaps hedge interest rate and exchange rate exposure. The counterparties to such contracts are DNB Bank, Nordea Bank Finland Plc., ABN AMRO Bank N.V., NIBC Bank N.V., Skandinaviska Enskilda Banken AB (publ), ING Bank N.V., Danske Bank A/S, Swedbank AB (publ), Credit Agricole Corporate & Investment Bank and Commonwealth Bank of Australia. Credit risk exists to the extent that the counterparties are unable to perform under the contracts, but this risk is considered not to be substantial as the counterparties are all banks which have provided the Company with loans.

The following tables present the fair values of the Company's derivative instruments that were designated as cash flow hedges and qualified as part of a hedging relationship, and those that were not designated:

|  |        |        |
|--|--------|--------|
| (in thousands of \$)   | 2018   | 2017   |
| Designated derivative instruments -short-term assets:          |        |        |
| Interest rate swaps  | —      | 108    |
| Non-designated derivative instruments -short-term assets:      |        |        |
| Cross currency interest rate swaps                             | 5,279  | —      |
| Total derivative instruments - short-term assets               | 5,279  | 108    |
| Designated derivative instruments -long-term assets:           |        |        |
| Interest rate swaps  | 5,459  | 5,136  |
| Non-designated derivative instruments -long-term assets:       |        |        |
| Interest rate swaps  | 5,174  | 3,211  |
| Total derivative instruments - long-term assets                | 10,633 | 8,347  |
| (in thousands of \$)   | 2018   | 2017   |
| Designated derivative instruments -short-term liabilities:     |        |        |
| Interest rate swaps  | —      | 248    |
| Cross currency interest rate swaps                             | 33,004 | —      |
| Non-designated derivative instruments -short-term liabilities: |        |        |
| Interest rate swaps  | —      | 255    |
| Cross currency interest rate swaps                             | 12,043 | —      |
| Total derivative instruments - short-term liabilities          | 45,047 | 503    |
| Designated derivative instruments -long-term liabilities:      |        |        |
| Interest rate swaps  | 1,811  | 5,109  |
| Cross currency interest rate swaps                             | 4,709  | 36,120 |
| Cross currency swaps   | 9,607  | —      |
| Non-designated derivative instruments -long-term liabilities:  |        |        |
| Interest rate swaps  | 86     | 553    |
| Cross currency interest rate swaps                             | —      | 6,836  |
| Total derivative instruments - long-term liabilities           | 16,213 | 48,618 |

## Interest rate risk management

The Company manages its debt portfolio with interest rate swap agreements denominated in U.S. dollars and Norwegian kroner to achieve an overall desired position of fixed and floating interest rates. At December 31, 2018, the Company and its consolidated subsidiaries had entered into interest rate swap transactions, involving the payment of fixed rates in exchange for LIBOR or NIBOR, as summarized below. The summary includes all swap transactions, most of which are hedges against specific loans.

| Notional Principal (in thousands of \$)  | Inception date | Maturity date     | Fixed interest rate |    |
|--|----------------|-------------------|---------------------|----|
| \$11,130 (remaining at \$11,130)         | May 2011       | January 2019      | 2.08% - 2.58%       |    |
| \$100,000 (remaining at \$100,000)       | August 2011    | August 2021       | 2.50% - 2.93%       |    |
| \$121,133 (terminating at \$79,733)      | May 2012       | August 2022       | 1.76% - 1.85%       |    |
| \$100,000 (remaining at \$100,000)       | March 2013     | April 2023        | 1.85% - 1.97%       |    |
| \$151,008 (equivalent to NOK900 million) | March 2014     | March 2019        | 6.03                | %* |
| \$92,438 (reducing to \$70,125)          | December 2016  | December 2021     | 2.29% - 2.63%       |    |
| \$95,625 (reducing to \$70,125)          | January 2017   | January 2022      | 2.12% - 2.58%       |    |
| \$26,693 (reducing to \$19,413)          | September 2015 | March 2022        | 1.67                | %  |
| \$173,906 (reducing to \$149,844)        | February 2016  | February 2021     | 1.07% - 1.26%       |    |
| \$63,987 (equivalent to NOK500 million)  | October 2017   | March - June 2020 | 6.86% - 6.96%       | *  |
| \$16,833 (equivalent to NOK100 million)  | September 2018 | March 2019        | 6.03                | %† |

\* These swaps relate to the NOK900 million and NOK500 million unsecured bonds due 2019 and 2020, respectively, and the fixed interest rates paid are exchanged for NIBOR plus the margin on the bonds.

This swap relates to the NOK900 million unsecured bond due 2019, where NIBOR plus a margin is paid in exchange for a fixed interest rate. For the remaining swaps, the fixed interest rate paid is exchanged for LIBOR, excluding margin on the underlying loans.

The total net notional principal amount subject to interest swap agreements as at December 31, 2018, was \$0.9 billion (2017: \$1.1 billion).

## Foreign currency risk management

The Company has entered into currency swap transactions, involving the payment of U.S. dollars in exchange for Norwegian kroner and the payment of Norwegian kroner in exchange for U.S. dollars, which are designated as hedges against the NOK900 million, NOK500 million and NOK600 million senior unsecured bonds due 2019, 2020 and 2023 respectively. During the last quarter of 2018, the Company entered into a currency swap transaction involving the payment of Norwegian kroner in exchange for U.S. dollars. This swap relates to the NOK900 million bond, but is not designated as a hedging instrument.

| Principal Receivable | Principal Payable | Inception date | Maturity date     |
|----------------------|-------------------|----------------|-------------------|
| NOK900 million       | US\$151.0 million | March 2014     | March 2019        |
| NOK500 million       | US\$64.0 million  | October 2017   | March - June 2020 |
| NOK472 million       | US\$62.1 million  | September 2018 | September 2023    |
| US\$16.8 million     | NOK100 million    | September 2018 | March 2019        |

Apart from the NOK900 million, NOK500 million and NOK600 million senior unsecured bonds due 2019, 2020 and 2023, respectively, the majority of the Company's transactions, assets and liabilities are denominated in U.S. dollars, the functional currency of the Company. Other than the corresponding currency swap transactions summarized above, the Company has not entered into forward contracts for either transaction or translation risk. Accordingly, there is a risk that currency fluctuations could have an adverse effect on the Company's cash flows, financial condition and results of operations.





## Fair Values

The carrying value and estimated fair value of the Company's financial assets and liabilities at December 31, 2018, and 2017, are as follows:

| (in thousands of \$)  | 2018<br>Carrying value | 2018<br>Fair value | 2017<br>Carrying value | 2017<br>Fair value |
|---|------------------------|--------------------|------------------------|--------------------|
| Non-derivatives:  |                        |                    |                        |                    |
| Available-for-sale debt securities                              | 13,245                 | 13,245             | 41,742                 | 41,742             |
| Equity Securities   | 73,929                 | 73,929             | 52,060                 | 52,060             |
| Floating rate NOK bonds due 2019                                | 77,722                 | 77,916             | 92,477                 | 92,709             |
| Floating rate NOK bonds due 2020                                | 57,829                 | 58,841             | 61,001                 | 61,306             |
| Floating rate NOK bonds due 2023                                | 69,395                 | 69,568             | —                      | —                  |
| 3.25% unsecured convertible bonds due 2018                      | —                      | —                  | 63,218                 | 71,662             |
| 5.75% unsecured convertible bonds due 2021                      | 212,230                | 199,496            | 225,000                | 242,719            |
| 4.875% unsecured convertible bonds due 2023                     | 151,700                | 139,374            | —                      | —                  |
| Derivatives:  |                        |                    |                        |                    |
| Interest rate/ currency swap contracts – short-term receivables | 5,279                  | 5,279              | 108                    | 108                |
| Interest rate/ currency swap contracts – long-term receivables  | 10,633                 | 10,633             | 8,347                  | 8,347              |
| Interest rate/ currency swap contracts – short-term payables    | 45,047                 | 45,047             | 503                    | 503                |
| Interest rate/ currency swap contracts – long-term payables     | 16,213                 | 16,213             | 48,618                 | 48,618             |

The above short-term receivables relating to interest rate/ currency swap contracts at December 31, 2018, all relate to non-designated hedges. The above long-term receivables relating to interest rate/ currency swap contracts at December 31, 2018, include \$5.2 million which relates to non-designated swap contracts (2017: \$3.2 million), with the balance relating to designated hedges. The above short-term payables relating to interest rate/ currency swap contracts at December 31, 2018, include \$12.0 million which relates to non-designated swap contracts (2017: \$0.3 million), with the balance relating to designated hedges. The above long-term payables relating to interest rate/ currency swap contracts at December 31, 2018, include \$0.1 million which relates to non-designated swap contracts (2017: \$7.4 million), with the balance relating to designated hedges.

In accordance with the accounting policy relating to interest rate and currency swaps (see Note 2 "Accounting policies: Derivatives – Interest rate and currency swaps"), where the Company has designated the swap as a hedge, and to the extent that the hedge is effective, changes in the fair values of interest rate swaps are recognized in other comprehensive income. Changes in the fair value of other swaps and the ineffective portion of swaps designated as hedges are recognized in the consolidated statement of operations.

The above fair values of financial assets and liabilities as at December 31, 2018, are measured as follows:

|   | December<br>31, 2018 | Fair value measurements using   |   |  |
|---|----------------------|---|---|--|
|   |                      | Quoted<br>Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (in thousands of \$)  |                      |   |   |  |
| Assets:   |                      |   |   |  |
| Available-for-sale debt securities                              | 13,245               | 13,245  |   |  |
| Equity securities   | 73,929               | 73,929  |   |  |
| Interest rate/ currency swap contracts – short-term receivables | 5,279                |   | 5,279   |  |
| Interest rate/ currency swap contracts - long-term receivables  | 10,633               |   | 10,633  |  |
| Total assets  | 103,086              | 87,174  | 15,912  | —  |
| Liabilities:  |                      |   |   |  |
| Floating rate NOK bonds due 2019                                | 77,916               | 77,916  |   |  |
| Floating rate NOK bonds due 2020                                | 58,841               | 58,841  |   |  |
| Floating rate NOK bonds due 2023                                | 69,568               | 69,568  |   |  |
| 5.75% unsecured convertible bonds due 2021                      | 199,496              | 199,496   |   |  |
| 4.875% unsecured convertible bonds due 2023                     | 139,374              | 139,374   |   |  |
| Interest rate/ currency swap contracts – short-term payables    | 45,047               |   | 45,047  |  |
| Interest rate/ currency swap contracts – long-term payables     | 16,213               |   | 16,213  |  |
| Total liabilities   | 606,455              | 545,195   | 61,260  | —  |

The above fair values of financial assets and liabilities as at December 31, 2017, were measured as follows:

| (in thousands of \$)  | December 31, 2017 | Fair value measurements using                                  |   |   |
|---|-------------------|--|---|---|
|   |                   | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| <b>Assets:</b>  |                   |  |   |   |
| Available-for-sale debt securities                              | 41,742            | 41,742   |   | —   |
| Equity securities   | 52,060            | 52,060   |   |   |
| Interest rate/ currency swap contracts – short-term receivables | 108               |  | 108   |   |
| Interest rate/ currency swap contracts – long-term receivables  | 8,347             |  | 8,347   |   |
| <b>Total assets</b>   | <b>102,257</b>    | <b>93,802</b>  | <b>8,455</b>                                  | <b>—</b>                                  |
| <b>Liabilities:</b>   |                   |  |   |   |
| Floating rate NOK bonds due 2019                                | 92,709            | 92,709   |   |   |
| Floating rate NOK bonds due 2020                                | 61,306            | 61,306   |   |   |
| 3.25% unsecured convertible bonds due 2018                      | 71,662            | 71,662   |   |   |
| 5.75% unsecured convertible bonds due 2021                      | 242,719           | 242,719  |   |   |
| Interest rate/ currency swap contracts – short-term payables    | 503               |  | 503   |   |
| Interest rate/ currency swap contracts – long-term payables     | 48,618            |  | 48,618  |   |
| <b>Total liabilities</b>  | <b>517,517</b>    | <b>468,396</b>   | <b>49,121</b>                                 | <b>—</b>                                  |

ASC Topic 820 "Fair Value Measurement and Disclosures" ("ASC 820") emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, ASC 820 establishes a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within levels one and two of the hierarchy) and the reporting entity's own assumptions about market participant assumptions (unobservable inputs classified within level three of the hierarchy).

Level 1 inputs utilize unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Level 2 inputs are inputs other than quoted prices included in level one that are observable for the asset or liability, either directly or indirectly. Level 2 inputs may include quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability, other than quoted prices, such as interest rates, foreign exchange rates and yield curves that are observable at commonly quoted intervals. Level 3 inputs are unobservable inputs for the assets or liabilities, which typically are based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

Investment in equity securities consist of (i) listed Frontline shares (ii) NorAm Drilling shares traded in the OTC market (iii) Golden Close shares traded in the OTC market and (iv) ADS shares traded on the Merkur Market whilst

the investments in available-for-sale debt securities consist of listed and unlisted corporate bonds. The estimated fair value of the debt and equity securities consists of their aggregate market value as at the balance sheet date.

The estimated fair values for the floating rate NOK bonds due 2019, 2020 and 2023, and the 5.75% and 4.875% unsecured convertible bonds are based on the quoted market prices as at the balance sheet date.

The fair value of interest rate and currency swap contracts is calculated using established independent valuation techniques applied to contracted cash flows and LIBOR/NIBOR interest rates as at the balance sheet date.

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#### Concentrations of risk

There is a concentration of credit risk with respect to cash and cash equivalents to the extent that most of the amounts are carried with Skandinaviska Enskilda Banken, ABN AMRO, Nordea, Bank of Valletta and Credit Agricole Corporate and Investment Bank. However, the Company believes this risk is remote, as these financial institutions are established and reputable establishments with no prior history of default. The Company does not require collateral or other securities to support financial instruments that are subject to credit risk.

There is also a concentration of revenue risk with certain customers to whom the Company has chartered multiple vessels:

In the year ended December 31, 2018, Frontline Shipping accounted for approximately 8% of our consolidated operating revenues (2017: 15%, 2016: 28%). Frontline Shipping is a 100% owned subsidiary of Frontline, but the performance under the leases is not guaranteed by Frontline following amendments agreed in 2015. There is no requirement for a minimum cash balance in Frontline Shipping, but in exchange for releasing the guarantee a dividend restriction was introduced on Frontline Shipping whereby it can only make distributions to its parent company if it can demonstrate it will have minimum free cash of \$2 million per vessel both prior to and following (i) such distribution and (ii) the payment of the next hire due and any profit share accrued under the charters. Due to the current depressed tanker market, there is a risk that Frontline Shipping may not have sufficient funds to pay the agreed charter hires. However, the performance under the fixed price agreements with Frontline Management whereby we pay management fees of \$9,000 per day for each vessel to cover all operating costs including drydocking costs, is guaranteed by Frontline.

In the year ended December 31, 2018, the Company had eight Capesize dry bulk carriers leased to a subsidiary of Golden Ocean which accounted for approximately 13% of our consolidated operating revenues (2017: 14%, 2016: 12%). The Company also had 29 container vessels on long-term bareboat charters to MSC, which accounted for approximately 11% of our consolidated operating revenues in the year ended December 31, 2018 (2017: 10%, 2016: 4%).

Following the acquisition of Hamburg Süd by Maersk Line A/S (“Maersk”) in November 2017, the Company had 10 container vessels on long-term time charters to Maersk at December 31, 2018, which accounted for approximately 27% of our consolidated operating revenues (2017: 14%; 2016: 9%).

In addition, a significant portion of our net income is generated from our associated companies that lease rigs to subsidiaries of Seadrill including NADL, which is fully guaranteed by Seadrill. In the year ended December 31, 2018, income from our associated companies accounted for 39.1% of our net income (2017: 38.6%, 2016: 31.7%).

The Company and three of the Company's subsidiaries, who own and lease the drilling rigs West Linus, West Hercules and West Taurus to subsidiaries of Seadrill, agreed to the Restructuring Plan announced by Seadrill in September 2017. As part of the agreement, Ship Finance and its relevant subsidiaries have agreed to reduce the contractual charter hire payable by the relevant Seadrill subsidiaries by approximately 29% for a five year period with economic effect from January 1, 2018, with the reduced amounts added back in the period thereafter. The call options on behalf of the Seadrill subsidiaries under the relevant leases were also amended as part of the Restructuring Plan. The leases for West Hercules and West Taurus have been extended for a period of 13 months until December 2024, with amended purchase obligations at the new expiry of the charters. Concurrently, the banks who finance the three rigs also extended the loan period by approximately four years under each of the facilities, with reduced amortization in the extension period compared to the current amortization. The Restructuring Plan was implemented in July 2018, at which time Seadrill emerged from Chapter 11.

As discussed in Note 26: Commitments and contingent liabilities, the Company, at December 31, 2018, guaranteed a total of \$266.1 million (2017: \$235.0 million) of the bank debt in these companies and had net outstanding receivable balance on loans granted by the Company to these associated companies totaling \$342.0 million (2017: \$317.8 million). The loans granted by the Company are considered not impaired at December 31, 2018, due to the fair value of the jack-up rig owned by SFL Linus and the ultra deepwater drilling rigs owned by SFL Deepwater and SFL Hercules exceeding the book values at December 31, 2018.

## 26. COMMITMENTS AND CONTINGENT LIABILITIES

## Assets Pledged

|  | 2018            | 2017            |
|--|-----------------|-----------------|
| Carrying value of consolidated assets pledged under ship mortgages | \$1,527 million | \$1,908 million |

Of the above, \$1,424.4 million relates to assets recorded as vessels and equipment (2017: \$1,576.3 million) and \$103.1 million relates to assets accounted for as investments in direct financing leases (2017: \$331.3 million).

In addition, as at December 31, 2018 the Company had 11 vessels (2017: two vessels) with obligations under capital lease with a total net book value of \$1,331.1 million (2017: \$283.9 million). Of these, seven vessels with net book value of \$749.9 million (2017: nil) were recorded as vessels under capital lease and four vessels with net book value of \$581.2 million (2017: \$283.9 million) were accounted for as investments in direct financing leases.

The Company and its equity-accounted subsidiaries have funded their acquisition of vessels, jack-up rigs and ultra-deepwater drilling units through a combination of equity, short-term debt and long-term debt. Providers of long-term loan facilities usually require that the loans be secured by mortgages against the assets being acquired. As at December 31, 2018, the Company (\$1.5 billion) and its 100% equity-accounted subsidiaries (\$655.2 million) had a combined outstanding principal indebtedness of \$2.1 billion (2017: \$2.3 billion) under various credit facilities.

## Other Contractual Commitments and Contingencies

The Company has arranged insurance for the legal liability risks for its shipping activities with Gard P.& I. (Bermuda) Ltd, Assuranceforeningen Skuld (Gjensidig), The Steamship Mutual Underwriting Association Limited, The Korea Shipowner's Mutual Protection & Indemnity Association, The West of England Ship Owners Mutual Insurance Association (Luxembourg), North of England P&I Association Limited, The Standard Club Europe Ltd and The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited, all of which are mutual protection and indemnity associations. The Company is subject to calls payable to the associations based on the Company's claims record in addition to the claims records of all other members of the associations. A contingent liability exists to the extent that the claims records of the members of the associations in the aggregate show significant deterioration, which may result in additional calls on the members.

SFL Deepwater, SFL Hercules and SFL Linus are wholly-owned subsidiaries of the Company, which are accounted for using the equity method. Accordingly, their assets and liabilities are not consolidated in the Company's Consolidated Balance Sheets, but are presented on a net basis under "Investment in associated companies" - see Note 17. As at December 31, 2018, their combined bank borrowings amounted to \$655.2 million (2017: \$785.8 million) and the Company guaranteed \$266.1 million (2017: \$235.0 million) of this debt which is secured by first priority mortgages over the relevant rigs.

In addition, the Company has assigned all claims it may have under its secured loans to SFL Deepwater, SFL Hercules and SFL Linus, in favor of the lenders under the respective credit facilities. These loans had a net outstanding balance of \$342.0 million at December 31, 2018 (2017: \$317.8 million) and are secured by second priority mortgages over each of the rigs, which have been assigned to the lenders under the respective credit facilities. The lenders under the respective credit facilities have also been granted a first priority pledge over all shares of the relevant asset owning subsidiaries.

As at December 31, 2018, the Company had no commitments under contracts to acquire newbuilding vessels (2017: \$nil).

As at December 31, 2018, the Company had committed \$3.4 million towards the procurement of exhaust gas cleaning systems ("EGCS") on four of its oil tankers (2017: \$nil). There were no other material contractual commitments as at December 31, 2018.

The Company is routinely party both as plaintiff and defendant to laws suits in various jurisdictions under charter hire obligations arising from the operation of its vessels in the ordinary course of business. The Company believes that the



resolution of such claims will not have a material adverse effect on its results of operations or financial position. The Company has not recognized any contingent gains or losses arising from the pending results of any such law suits.

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## 27. CONSOLIDATED VARIABLE INTEREST ENTITIES

As at December 31, 2018, the Company's consolidated financial statements included 40 variable interest entities, all of which are wholly-owned subsidiaries. These subsidiaries own vessels with existing charters during which related and third parties have fixed price options to purchase the respective vessels, at dates varying from March 2019 to November 2033. It has been determined that the Company is the primary beneficiary of these entities, as none of the purchase options are deemed to be at bargain prices and none of the charters include sales options.

At December 31, 2018, 18 of the consolidated variable interest entities have a vessel which is accounted for as a direct financing

lease asset. At December 31, 2018, the vessels had a carrying value of \$403.9 million, unearned lease income of \$221.4 million and estimated residual value of \$126.2 million. The outstanding loan balances in 16 of these entities amounted to a total of \$47.0 million, of which the short-term portion was \$6.2 million as at December 31, 2018. Also, two of the vessels that are included in the direct financing lease assets had outstanding obligations under capital lease which amounted to a total of \$274.3 million, of which the short-term portion was \$11.3 million, as at December 31, 2018.

At December 31, 2018, 19 fully consolidated variable interest entities each own vessels which are accounted for as operating lease assets and had a total net book value of \$353.9 million at December 31, 2018. The outstanding loan balances in these entities amounted to a total of \$182.9 million, of which the short-term portion was \$78.9 million as at December 31, 2018.

The other three fully consolidated variable interest entities each own vessels which are accounted for as vessels and equipment under capital lease and had a total net book value of \$312.4 million at December 31, 2018. The outstanding obligations under capital lease for these entities amounted to a total of \$270.6 million, of which the short-term portion was \$20.3 million as at December 31, 2018.

## 28. SUBSEQUENT EVENTS

In January 2019, 100,000 options were awarded to one officer pursuant to the Company's Share Option Scheme. The options vest over a three year period and have a five year term. The initial exercise price was \$11.50 per share and the first options will be exercisable from January 2020.

On February 26, 2019, the Board of Ship Finance declared a dividend of \$0.35 per share which will be paid in cash on or around March 29, 2019.

In March 2019, 2,461 new common shares were issued to satisfy employee options being exercised.

In March 2019, 425,000 options were awarded to employees, officers and directors pursuant to the Company's Share Option Scheme. The options vest over a three year period and have a five year term. The initial exercise price was \$12.35 per share and the first options will be exercisable from March 2020.