Atlantica Tender Drilling Ltd. & Subsidiaries

Consolidated Financial Statements

For the Quarter Ended September 30, 2018

Atlantica Tender Drilling Ltd. & Subsidiaries

Contents

Consolidated Financial Statements

Atlantica Tender Drilling Ltd. & Subsidiaries

Consolidated Balance Sheets

		September 30, 2018		December 31, 2017
				(Audited)
Assets				
Current Assets				
Cash and cash equivalents	$	34,936,147	$	31,783,098
Restricted cash		6,756,440		8,373,443
Accounts receivable		20,026,403		15,457,583
Accounts receivable - related parties		112,649		167,142
Note receivable, net - related party		-		360,040
Derivative instruments		1,535,407		1,065,550
Inventory		20,757,806		-
Prepaid and other current assets		1,009,849		788,527
Total Current Assets		85,134,701		57,995,383
Property and Equipment, Net		490,579,876		520,239,709
Long Term Deposits		-		18,599,625
Derivative Instruments		4,125,482		2,678,706
Other Assets		764,887		112,320
Total Assets	$	580,604,946	$	599,625,743

See notes to consolidated financial statements.

Atlantica Tender Drilling Ltd. & Subsidiaries

Consolidated Balance Sheets

	September 30, 2018	December 31, 2017 (Audited)
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable	$ 3,396,002	$ 3,294,152
Accounts payable - related parties	163,862	143,567
Accrued liabilities	7,503,633	8,733,523
Current portion of long-term debt	164,346,087	30,555,552
Deferred revenue - current	8,708,856	12,251,154
Total Current Liabilities	184,118,440	54,977,948
Long-Term Liabilities		
Deferred revenue - non-current	2,943,489	9,391,878
Long-term debt, net	122,299,039	276,765,011
Deferred income taxes, net	3,745,774	3,745,774
Total Long-Term Liabilities	128,988,302	289,902,663
Total Liabilities	313,106,742	344,880,611
Commitments and Contingencies (Note 8)		
Stockholders' Equity		
Common stock, $0.10 par value, 310,000,000 shares authorized at September 30, 2018 and December 31, 2017; 261,323,309 shares issued at September 30, 2018 and December 31, 2017; and 252,199,264 shares outstanding at September 30, 2018 and December 31, 2017	26,132,331	26,132,331
Additional paid-in capital	213,293,228	213,254,754
Treasury stock (9,124,045 shares at cost)	(2,297,539)	(2,297,539)
Subscription receivable	(1,500)	(1,500)
Retained earnings	30,371,684	17,657,086
Total Stockholders' Equity	267,498,204	254,745,132
Total Liabilities and Stockholders' Equity	$ 580,604,946	$ 599,625,743

See notes to consolidated financial statements.

Atlantica Tender Drilling Ltd. & Subsidiaries

Consolidated Statements of Income

		Three Months Ended September 30,				Nine Months Ended September 30,		
		2018		2017		2018		2017
Revenues								
Contract drilling	$	40,225,090	$	38,509,111	$	109,724,520	$	108,310,038
Mobilization and demobilization revenue		2,369,452		5,008,395		10,256,703		15,012,847
Management and other fees		5,026		92		5,207		273
Total Revenues		42,599,568		43,517,598		119,986,430		123,323,158
Operating Expenses								
Operating		17,648,324		17,718,999		55,802,333		50,789,645
Depreciation and amortization		6,739,505		6,973,721		20,181,627		20,679,085
Loss on cancellation of construction contract		-		-		18,599,625		-
Impairment of long-lived assets		1,089,314		-		1,089,314		-
Total Operating Expenses		25,477,143		24,692,720		95,672,899		71,468,730
Income from Operations		17,122,425		18,824,878		24,313,531		51,854,428
Other Income (Expense)								
Interest income		309,862		291,269		880,895		721,631
Interest expense		(5,518,723)		(5,803,568)		(15,221,240)		(18,660,147)
Gain on reacquisition of debt		-		558,746		-		1,472,169
Foreign currency loss		(193,346)		(162,003)		(748,935)		(399,647)
Bad debt expense - note receivable		-		-		(31,144)		-
Other		11,311		84,824		45,241		50,894
Total Other Expense		(5,390,896)		(5,030,732)		(15,075,183)		(16,815,100)
Income Before Income Tax Expense		11,731,529		13,794,146		9,238,348		35,039,328
Income Tax Expense, Net		(2,973,442)		(2,570,518)		(8,607,851)		(7,404,837)
Net Income	$	8,758,087	$	11,223,628	$	630,497	$	27,634,491
Net Income Per Share								
Basic and diluted	$	0.03	$	0.04	$	0.00	$	0.11
Weighted Average Common Shares Outstanding								
Basic and diluted		252,199,264		252,199,264		252,199,264		252,199,264

See notes to consolidated financial statements.

Atlantica Tender Drilling Ltd. & Subsidiaries

Consolidated Statements of Stockholders' Equity

	Common Stock		Additional Paid-in Capital	Treasury Stock	Subscription Receivable	Retained Earnings (Accumulated Deficit)	Total Stockholders' Equity
	Shares Outstanding	Amount					
Balance at January 1, 2017	252,199,264	$ 26,132,331	$ 213,203,452	$ (2,297,539)	$ (1,500)	$ (6,391,486)	$ 230,645,258
Stock compensation expense	-	-	51,302	-	-	-	51,302
Net income	-	-	-	-	-	24,048,572	24,048,572
Balance at December 31, 2017, as originally reported	252,199,264	$ 26,132,331	$ 213,254,754	$ (2,297,539)	$ (1,500)	$ 17,657,086	$ 254,745,132
Change in accounting principle - inventory	-	-	-	-	-	11,604,934	11,604,934
Change in accounting principle - revenue recognition	-	-	-	-	-	479,167	479,167
Balance at January 1, 2018	252,199,264	$ 26,132,331	$ 213,254,754	$ (2,297,539)	$ (1,500)	$ 29,741,187	$ 266,829,233
Stock compensation expense	-	-	38,474	-	-	-	38,474
Net income	-	-	-	-	-	630,497	630,497
Balance at September 30, 2018	**252,199,264**	**$ 26,132,331**	**$ 213,293,228**	**$ (2,297,539)**	**$ (1,500)**	**$ 30,371,684**	**$ 267,498,204**

See notes to consolidated financial statements.

Atlantica Tender Drilling Ltd. & Subsidiaries

Consolidated Statements of Cash Flows

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Cash Flows From Operating Activities				
Net income	$ 8,758,087	$ 11,223,628	$ 630,497	$ 27,634,491
Adjustments to reconcile net income to net cash provided by operating activities:				
Impairment of long-lived assets	1,089,314	-	1,089,314	-
Loss on cancellation of construction contract	-	-	18,599,625	-
Depreciation and amortization	6,739,505	6,973,721	20,181,627	20,679,085
Stock compensation expense	12,824	14,250	38,474	42,752
Bad debt expense - note receivable	-	-	31,144	-
Gain on reacquisition of debt	-	(558,746)	-	(1,472,169)
Noncash interest expense, net	746,145	665,576	324,594	2,948,729
Noncash mobilization and demobilization revenue	(2,369,452)	(5,008,395)	(10,256,703)	(15,012,847)
Other non-cash expense	(33,929)	(84,824)	186,897	(50,894)
Changes in operating assets and liabilities:				
Accounts receivable	12,098,205	(1,938,644)	(4,490,304)	(4,631,580)
Accounts and note receivable - related parties	81,513	102,094	54,493	117,179
Prepaid expenses and other assets	564,106	102,543	(236,786)	166,036
Accounts payable	(1,597,297)	(854,998)	101,850	(2,626,683)
Accounts payable - related parties	(160,399)	150,184	20,295	149,141
Accrued liabilities	(916,828)	1,313,405	(1,229,890)	250,110
Deferred revenue	-	-	-	1,565,221
Net Cash Provided By Operating Activities	25,011,794	12,099,794	25,045,127	29,758,571
Cash Flows From Investing Activities				
Capital expenditures for construction in progress and capital spares	(396,327)	67,763	(396,327)	(1,906,426)
Capital expenditures for drilling rig and equipment and other	(161,337)	(53,601)	(196,090)	(509,813)
Purchase of Super Senior Bonds	-	-	-	(2,497,497)
Net Cash (Used In) Provided By Investing Activities	(557,664)	14,162	(592,417)	(4,913,736)
Cash Flows from Financing Activities				
Payments on long term debt	(7,638,888)	(6,388,889)	(22,916,664)	(19,166,667)
Repurchase of bonds	-	(1,584,000)	-	(4,051,500)
Debt issuance costs	-	(6,042)	-	(22,435)
Change in restricted cash	(1,203,974)	(449,510)	1,617,003	(1,425,287)
Net Cash Used In Financing Activities	(8,842,862)	(8,428,441)	(21,299,661)	(24,665,889)
Net Increase In Cash and Cash Equivalents	15,611,268	3,685,515	3,153,049	178,946
Cash and Cash Equivalents - Beginning of Period	19,324,879	29,767,575	31,783,098	33,274,144
Cash and Cash Equivalents - End of Period	$ 34,936,147	$ 33,453,090	$ 34,936,147	$ 33,453,090
Supplemental Cash Flow Information				
Cash paid for interest	$ 4,846,460	$ 5,187,652	$ 14,813,672	$ 15,783,772
Cash paid for income taxes	3,717,748	3,159,340	9,536,367	7,444,111

See notes to consolidated financial statements.

1. Organization and Nature of Operations

Atlantica Tender Drilling Ltd. ("Atlantica" or the "Company") was incorporated in Bermuda in September 2008 and in April 2011 became registered on the Norwegian OTC-list under the symbol "ATDL." Atlantica is in the business of providing management and contract drilling services for oil and gas wells for the offshore tender assist market and related offshore oilfield services.

The following entities are wholly-owned subsidiaries of the Company:

- Atlantica Management (USA) Inc. ("AM"), incorporated in the state of Texas
- Atlantica International Ltd. ("AI"), a Bermuda-based entity
- BassDrill Beta Ltd. ("BDB"), a Malta-based entity
- BassDrill Beta B.V. ("BDB-BV"), a Holland-based entity
- BassDrill Brasil Servicos de Petroleo Ltda. ("BBB"), a Brazil-based entity
- Atlantica International B.V. ("AI-BV"), a Holland-based entity
- Atlantica (Malta) Holding Ltd. ("AMH"), a Malta-based entity
- Atlantica Gamma Ltd. ("AG"), a Malta-based entity
- Atlantica Delta Ltd. ("AD"), a Malta-based entity
- Atlantica BDA Ltd. ("ABDA"), a Malta-based entity
- Atlantica (Holding) B.V. ("ABV"), a Holland-based entity

The Company's primary assets and liabilities currently pertain to *BassDrill Beta*, owned by BDB, which the Company took delivery of in November 2013 and placed into service under a drilling contract with Petróleo Brasileiro S.A. ("Petrobras") in March 2014; *Atlantica Delta*, owned by AD, which the Company took delivery of in December of 2015 and placed into service under a drilling contract with Total Congo E&P ("Total") in January 2016; and AM.

As used herein, and unless otherwise required by the context, the term "Atlantica" refers to Atlantica Tender Drilling Ltd., and the terms "Company," "we," "our," and words of similar import refer to Atlantica and its subsidiaries. The use herein of such terms as "we," "us," "our" and "its," or references to specific entities, is not intended to be a precise description of corporate relationships.

2. Summary of Significant Accounting Policies

The unaudited interim consolidated financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim periods on a basis consistent with the annual consolidated financial statements. All such adjustments are of a normal recurring nature.

The accompanying consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and notes thereto as of and for the years December 31, 2017 and 2016.

Principles of Consolidation

The consolidated financial statements include the assets and liabilities of Atlantica and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and requires management to disclose contingent assets and liabilities at the date of the consolidated financial statements. While management believes current estimates are reasonable and appropriate, actual results could differ from those estimates.

Fair Value of Financial Instruments

Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820, *Fair Value Measurements*, establishes a common definition for fair value to be applied to existing GAAP that require the use of fair value measurements, establishes a framework for measuring fair value and expands disclosure about such fair value measurements. GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy categorizes assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. The three levels are defined as follows:

Level 1 – Observable inputs such as quoted prices in active markets at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Other inputs that are observable directly or indirectly such as quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 – Unobservable inputs for which there is little or no market data and which the Company makes its own assumptions about how market participants would price the assets and liabilities.

The Company's fair value of financial instruments disclosure is based upon information available to management as of September 30, 2018 and December 31, 2017. Considerable judgment is necessary to interpret market data and develop estimated fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize on disposition of the financial instruments. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The Company's financial instruments consist mainly of cash and cash equivalents, restricted cash, accounts receivable, accounts payable, accrued liabilities, interest rate swaps and long-term debt. The carrying values for cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities approximate their fair value, principally due to the short-term nature of these instruments. The carrying value of the Senior Secured Term Loan approximates fair value as the interest rate is re-determined regularly based on current interest rates. The fair value of the Senior Secured Bonds at September 30, 2018 and December 31, 2017 was approximately $121.4 million and $94.9 million, respectively, based on quoted market prices, Level 1 in the fair value hierarchy.

Revenue

Contract Drilling: Contract drilling revenue is recognized as services are performed based on contracted day-rates and the number of operating days during the period. These revenues are netted for commissions based on a percentage of the contract drilling revenue.

Amortization of Mobilization and Demobilization Revenue: In connection with a customer contract, the Company may receive lump-sum fees for the mobilization of equipment offset by any liquidated damages incurred due to late delivery of the rig. The Company may also receive lump-sum fees for demobilization of equipment and personnel upon completion or termination of the contract. Mobilization fees and costs incurred to mobilize a rig from one geographic market to another are deferred and recognized on a straight-line basis over the initial term of such contract, excluding any option periods. Effective January 1, 2018, demobilization fees are recorded as revenue over the initial term of the contract. See *Recently Adopted Accounting Standards* below. Costs incurred to mobilize a rig without a contract are expensed as incurred. The costs of capital improvements are capitalized and depreciated over the useful lives of the assets.

The Company recognized amortization of mobilization revenue related to the *BassDrill Beta* of approximately $-0- million and $2.8 million for the three months ended September 30, 2018 and 2017, respectively, and $3.6 million and $8.4 million for the nine months ended September 30, 2018 and 2017, respectively. The Company recognized amortization of mobilization and demobilization revenue related to the *Atlantica Delta* of approximately $2.4 million and $2.2 million for the three months ended September 30, 2018 and 2017, respectively, and $6.7 million and $6.6 million for the nine months ended September 30, 2018 and 2017, respectively.

Equity Method Investment

The Company evaluates its investments in unconsolidated companies under ASC 323, *Investments – Equity Method and Joint Ventures*. Investments in which the Company has significant influence, but not a controlling interest, are accounted for under the equity method of accounting. Under the equity method, equity investments are increased by additional investments and equity in earnings, and decreased by equity losses and dividends received or may be carried at fair value. The Company reviews its equity investments for impairment whenever events and circumstances indicate a loss in investment value is other than a temporary decline. If an impairment charge is recorded, subsequent recoveries in fair value are not reflected in earnings until the investee is sold. No such impairment was recognized for the three and nine months ended September 30, 2018 and 2017.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Restricted Cash

The Senior Secured Term Loan and Senior Secured Bonds (see Note 5) require the Company to maintain a debt service account, into which one-third of the next quarterly interest and installment payments are to be paid each month.

Accounts Receivable and Allowance for Doubtful Accounts

The Company's revenue and related customer receivables are generated from services to international oil companies and government-owned or government-controlled companies. The Company does not require collateral or other security to support customer receivables.

The Company establishes an allowance for doubtful accounts on a specific identification method, considering changes in the financial position of a customer, when the Company believes the payment of a receivable is unlikely to occur. There was no allowance for doubtful accounts at September 30, 2018 and December 31, 2017.

Accounts receivable also include estimates of the Company's contract drilling revenue earned during the period, but unbilled at the end of the period. At September 30, 2018 and December 31, 2017, accounts receivable included $13.2 million and $6.8 million, respectively, of accrued revenues.

Concentrations of Credit Risk

The Company's customer concentration may impact its overall credit risk, either positively or negatively, in that customers may be similarly and concurrently affected by changes in economic or other conditions affecting the drilling industry. The Company's percent of revenue by major customer is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	**2017**	**2018**	**2017**
Total	57%	52%	57%	54%
Petrobras	43%	48%	43%	46%

The Company is subject to concentrations of credit risk with respect to cash and cash equivalents, which the Company attempts to minimize by maintaining cash and cash equivalents with major, high-credit quality financial institutions. At times cash and cash equivalents balances may exceed limits federally insured by the United States Federal Deposit Insurance Corporation or other similar government institutions in other countries. Additionally, certain of the Company's cash and cash equivalents balances are maintained in foreign banks, which are not covered by deposit insurance. The Company has not experienced any losses on its cash and cash equivalents.

Foreign Exchange Transactions

The Company's functional currency is the United States (U.S.) dollar as the Company primarily contracts with contractors, finances capital, and purchases equipment and services using the U.S. dollar. Transactions that are completed in a foreign currency are translated into U.S. dollars, and any gain or loss is recorded in the consolidated statements of income.

Inventory

The Company implemented a change in accounting policy for inventory effective January 1, 2018 (see *Change in Accounting Principle* below). Inventory is carried at the average purchase price less an allowance for obsolescence. The allowance for obsolescence is based on historical experience and expectations for future use of inventory. At September 30, 2018, the allowance for obsolescence was $4.3 million.

Property and Equipment

Property and equipment is carried at cost less accumulated depreciation and amortization. The Company capitalizes expenditures for renewals, replacements and improvements, and expenses costs of maintenance and repairs as incurred. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets. Depreciation and amortization expense was $6.7 and $7.0 million for the three months ended September 30, 2018 and 2017, respectively, and $20.2 million and $20.7 million for the nine months ended September 30, 2018 and 2017, respectively.

The estimated useful lives are defined below:

Drilling rigs and equipment:	
Barge and related marine equipment	30 years
Mast equipment package, spare parts and related equipment	3 - 15 years
Leasehold improvements	Remaining life of lease
Furniture and office equipment	3 - 5 years
Computer hardware and software	3 years
Vehicles	5 years

Capital Spares

Capital spares are not subject to depreciation until put into use on the rigs.

Impairment of Long-lived Assets

Long-lived assets, such as property, plant, and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset be tested for possible impairment, the Company first compares undiscounted cash flows expected to be generated by an asset to the carrying value of the asset in accordance with ASC 360, *Property, Plant and Equipment*. If the carrying value of the long-lived asset is not recoverable on an undiscounted cash flow basis, impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques, including undiscounted cash flow models, quoted market values and third party appraisals, as considered necessary.

Income Taxes

The Company is a Bermuda limited liability company. Bermuda does not impose corporate income taxes unless activities are carried out in Bermuda. No activities were carried out in Bermuda during the three and nine months ended September 30, 2018 and 2017. Consequently, the Company has provided for income taxes based on the laws and rates in effect in the countries in which operations are conducted, or in which the Company and/or its subsidiaries are considered resident for income tax purposes. The Company and or/or its subsidiaries operate in multiple countries under different legal forms. As a result, the Company is subject to the jurisdiction of numerous domestic and foreign tax authorities, as well as to tax agreements and treaties among these governments. The Company's operations in these different jurisdictions are taxed on various bases including, actual income before taxes, deemed profits (which are generally determined by applying a tax rate to revenues rather than profits) and withholding taxes based on revenue. Determination of taxable income in any jurisdiction requires the interpretation of the related tax laws and regulations and the use of estimates and assumptions regarding significant future events, such as the amount, timing and character of deductions, permissible revenue recognition methods under the tax law and the sources and character of income and tax credits. Changes in tax laws, regulations, agreements and treaties, foreign currency exchange restrictions or the Company's level of operations or profitability in each tax jurisdiction could have an impact upon the amount of income taxes that the Company provides during any given year.

Below are the components of the Company's income tax expense for the three and nine months ended September 30, 2018 and 2017:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Current income tax expense	$ 2,973,442	$ 2,570,518	$ 8,607,851	$ 7,404,837
Deferred income tax benefit	-	-	-	-
Income tax expense, net	$ 2,973,442	$ 2,570,518	$ 8,607,851	$ 7,404,837

The Company accounts for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences. Deferred tax assets and liabilities are based on temporary differences that arise between the carrying value of the financial statements and tax bases of assets and liabilities. At September 30, 2018 and December 31, 2017, the deferred tax liability of $3.7 million represents the tax effect of the temporary difference related to assets owned by subsidiaries in Malta based on tax rates due on distributable earnings.

The Company follows guidance issued by the FASB which clarifies accounting for uncertainty in income taxes by prescribing the minimum recognition threshold an income tax position is required to meet before being recognized in the consolidated financial statements and applies to all income tax positions. Each income tax position is assessed using a two-step process. A determination is first made as to whether it is more likely than not that the income tax position will be sustained, based upon technical merits, upon examination by the taxing authorities. If the income tax position is expected to meet the more likely than not criteria, the benefit recorded in the financial statements equals the largest amount that is greater than 50% likely to be realized upon its ultimate settlement.

The Company believes that it has no uncertain income tax positions and that there are no tax positions taken or expected to be taken that would significantly increase or decrease unrecognized tax benefits within the next twelve months.

In accordance with this guidance, the Company will record income tax related interest and penalties, if applicable, as a component of the provision for income tax expense. However, there were no amounts recognized for income tax related interest and penalties in the consolidated statements of income for the three and nine months ended September 30, 2018 and 2017.

Share-Based Compensation

The Company has established an employee share ownership plan under which certain of its officers and board members have been and may be allocated options to acquire shares in Atlantica Tender Drilling Ltd. The compensation cost for stock options is recognized as an expense over the service period based on the fair value of the options granted.

The fair value of the share options issued under the Company's share option plan is determined at grant date taking into account the terms and conditions upon which the options are granted, and using a valuation technique that is consistent with generally accepted valuation methodologies for pricing financial instruments, and that incorporates all factors and assumptions that knowledgeable, willing market participants would consider in determining fair value. The fair value of the share options is recognized as personnel expenses within operating expenses with a corresponding increase in stockholders' equity over the period during which the employees become vested.

Stock compensation expense is initially recognized based upon options expected to vest with appropriate adjustments to reflect actual forfeitures.

Earnings Per Share

Basic earnings per share ("EPS") is calculated based on the income (loss) for the period available to common stockholders divided by the weighted average number of shares outstanding for basic EPS for the period. Diluted EPS includes the effect of the assumed conversion of potentially dilutive instruments, which for the Company includes share options. The determination of dilutive earnings per share requires the Company to potentially make certain adjustments to the weighted average shares outstanding used to compute basic earnings per share unless anti-dilutive.

Change in Accounting Principle

The Company changed its accounting treatment for inventory effective January 1, 2018. Prior to 2018, the Company accounted for its inventory as part of property and equipment subject to depreciation. Effective January 1, 2018, the Company began accounting for its inventory as prescribed under Accounting Standard Codification 330, *Inventory* ("ASC 330"). Inventory is carried at the average purchase price less an allowance for obsolescence. The allowance for obsolescence is based on historical experience and expectations for future use.

Accounting for inventory as prescribed by ASC 330 is a preferable method because it is a better reflection of the Company's assets and a more accurate allocation of costs of physical assets to periods in which the assets are consumed. Because procedures around inventory were not fully implemented until 2018, the Company cannot produce reasonable inventory reports prior to January 1, 2018. Due to this impracticability, the Company has adopted the change in accounting principle effective January 1, 2018 and increased retained earnings for $11.6 million at January 1, 2018 to reflect the cumulative effect on prior periods.

Recently Adopted Accounting Pronouncement

The Company elected to adopt Accounting Standards Update 2014-09, *Revenue from Contracts with Customers* ("ASU 409"), effective January 1, 2018. Under the new accounting guidelines in ASU 409, demobilization fees are not distinct within the context of the contract and are amortized over the initial term of the contract as the demobilization fees. The Company used a modified retrospective approach upon adoption of ASU 409 and increased retained earnings by $0.5 million at January 1, 2018 for prior period recording of demobilization revenue. For the three and nine months ended September 30, 2018, the Company recorded $0.2 million of additional revenue associated with demobilization fees.

Subsequent Events

The Company evaluated all activity through December 21, 2018, the date the consolidated financials were available for issuance, and concluded that no subsequent events, other than those already disclosed, have occurred that would require recognition on the consolidated financial statements of disclosures in the notes to the consolidated financial statements.

3. Property and Equipment

Property and equipment consisted of the following:

	September 30, 2018	December 31, 2017
Drilling rigs and equipment	$ 581,900,930	$ 591,795,695
Leasehold improvements	172,576	172,576
Furniture and office equipment	188,318	165,702
Computer hardware and software	896,723	834,886
Vehicles	181,261	181,261
	583,339,808	593,150,120
Less: accumulated depreciation	96,802,229	77,503,695
	486,537,579	515,646,425
Inventory - capital spares	4,042,297	4,593,284
Property and equipment, net	$ 490,579,876	$ 520,239,709

In September 2018, the Company impaired $1.1 million of capital spares as they were deemed unusable in current operations.

4. Investments

The Company holds an indirect investment in BassDrill Alpha Ltd. ("BDA") which is accounted for under the equity method of accounting.

In June 2017, the Company subscribed, in proportion to the Company's ownership interest, to $2.5 million of BDA's Super Senior Bonds (see Note 11). In accordance with ASC 323 – *Equity Method – Recognition of losses in excess of Investment*, the Company recognized its share of previously suspended loss of BDA up to the amount of this additional investment. Accordingly, the Company reflected $-0- on its balance sheet for the Super Senior Bonds at September 30, 2018 and December 31, 2017.

After an extended period in which the BDA's tender assist barge (BDA's sole material asset) was warm stacked in the Congo, the stakeholders of BDA entered into an agreement to sell the barge for approximately $1.0 million. The sale was completed in June 2018.

5. Long-Term Debt

Long-term debt consisted of the following:

	September 30, 2018	December 31, 2017
Senior Secured Term Loan	$ 153,750,003	$ 176,666,669
Senior Secured Bonds, Net	135,600,000	135,600,000
Debt Issuance Costs, Net	(2,704,877)	(4,946,106)
Total Long-Term Debt	$ 286,645,126	$ 307,320,563
Less Current Portion	(164,346,087)	(30,555,552)
Long-Term Debt, Net	$ 122,299,039	$ 276,765,011

Senior Secured Bonds are presented net of $14.4 million bonds repurchased by the Company as of September 30, 2018 and December 31, 2017.

Senior Secured Term Loan

In October 2014, the Company entered into Senior Secured Term Loan (“Term Loan”), maturing in October 2019, collateralized by a first lien mortgage on *BassDrill Beta* and *Atlantica Delta*; the shares of BDB, BDB-BV, BBB, AG and AD; the AM management agreements; all credit rights arising from the Company’s drilling contracts; and rights in connection with the investments made with amounts deposited in the debt service reserve account (see Restricted Cash in Note 2). The Term Loan amount was available for drawdown independently in tranches up until March 31, 2016. The first tranche of $53.0 million was drawn down on October 6, 2014 with the delivery of *BassDrill Beta*; the second tranche of $177.0 million was drawn down December 8, 2015 with the delivery of *Atlantica Delta*. The Term Loan tranches bear interest at 3.25% plus LIBOR, payable quarterly (4.5% at September 30, 2018).

The Company entered into (i) a swap agreement with LIBOR fixed at 1.36% for $53.0 million for a period of four years that commenced November 2014, (ii) a swap agreement with LIBOR fixed at 1.31% initially for $130.0 million for a period of seven years that commenced February 2016 and (iii) a swap agreement with LIBOR fixed at 1.11% initially for $33.4 million for a period of seven years commencing July 2016. The Term Loan requires quarterly principal payments ranging from $1.5 million to $7.6 million that commenced February 2015, with a balloon payment of $123.2 million at final maturity. The Term Loan further requires the Company to comply with certain financial covenants as noted below. These covenants are required to be tested and reported quarterly:

- Interest coverage ratio of not less than 2.5 : 1.0
- Debt service coverage ratio of not less than 1.1 : 1.0
- Book equity minimum of $155.0 million
- Equity ratio of minimum 0.3 : 1.0
- Liquidity, measured as freely available and unencumbered cash, the higher of $25.0 million or 6% of the outstanding interest-bearing
- The market value of the vessels is at least 150% of the aggregated outstanding amount of the Term Loan.

At September 30, 2018, the Company was in compliance with all financial covenants.

Senior Secured Bonds

In September 2014, the Company issued $75.0 million of Senior Secured Bonds ("Bonds") originally maturing in April 2018 and collateralized by *BassDrill Beta*. The Bonds bore interest at 8.5%, with semiannual interest payments that commenced October 24, 2013, with principal due at maturity.

On September 23, 2014, the Company issued an additional $75.0 million of Senior Secured Bonds ("New Bonds"), maturing in September 2019 that is collateralized by *BassDrill Beta* and *Atlantica Delta*; the shares of BDB, BDB-BV, BBB, AG and AD; the AM management agreements; all credit rights arising from the Company's drilling contracts; and rights in connection with the investments made with amounts deposited in the debt service reserve account (see Restricted Cash in Note 2). Concurrent with the issuance of these New Bonds, the holders of the Bonds agreed to amend and restate the bond agreement to be consistent with the bond agreement of the New Bonds. The Bonds and New Bonds bear interest at 8.0%, with quarterly interest payments that commenced December 23, 2014, and principal due at maturity. The New Bonds are subordinated to the Term Loan.

In January 2017, the Company acquired $3.5 million of the New Bonds for $2.5 million, resulting in a $0.9 million gain on acquisition of debt, net of $0.1 million related to deferred financing costs.

In September 2017, the Company acquired $2.2 million of New Bonds for $1.6 million, resulting in a $0.6 million gain on acquisition of debt, net of $0.1 million related to deferred financing costs.

The Company has acquired a total of $14.4 million of the New Bonds at September 30, 2018 and December 31, 2017.

The New Bonds further require the Company to comply with certain financial covenants as noted below. These covenants are required to be tested and reported quarterly:

- Interest coverage ratio of not less than 2.5 : 1.0
- Debt service coverage ratio of not less than 1.1 : 1.0
- Book equity minimum of $155.0 million
- Equity ratio of minimum 0.3 : 1.0
- Liquidity, measured as freely available and unencumbered cash, of $20.0 million
- The market value of the vessels is at least 140% of the aggregated outstanding amount of the Term Loan through October 2016 and 150% of the aggregated outstanding amount of the Term Loan thereafter.

At September 30, 2018, the Company was in compliance with all financial covenants.

The New Bonds are due in full September 2019. Accordingly, the Company classified the entire $135.6 million of New Bonds as a current liability at September 30, 2018. While the Company currently does not have the liquid funds to meet this obligation, the Company believes it is probable that a new financing arrangement will be in place prior to September 2019. The Company believes its profitability; long-term drilling contracts; debt compliance with the current debt instruments; and the recent adverse development notwithstanding, prospects of improving oil and gas markets in the medium to long-term are indicators that the Company will successfully refinance this debt and the Term Loan maturing in October 2019.

Deferred Financing Costs

Amortization of debt issuance costs and other related financing costs totaled $0.7 million and $0.8 million for the three months ended September 30, 2018 and 2017, respectively, and $2.2 million and $2.5 million for the nine months ended September 30, 2018 and 2017, respectively.

6. Stockholders' Equity

At September 30, 2018 and December 31, 2017, 9,124,045 shares of the Company's common stock at a cost of approximately $2.3 million were held as treasury stock.

7. Earnings Per Share

The components of the numerator and denominator for the calculation of basic and diluted earnings per share are as follows:

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Numerator:				
Net income	$ 8,758,087	$ 11,223,628	$ 630,497	$ 27,634,491
Denominator:				
Weighted-average shares outstanding	252,199,264	252,199,264	252,199,264	252,199,264
Effect of stock options	-	-	-	-
Weighted-average shares for per share calculation	252,199,264	252,199,264	252,199,264	252,199,264
Earnings per share - basic and diluted	$ 0.03	$ 0.04	$ 0.00	$ 0.11

For the three and nine months ended September 30, 2018 and 2017, all share-based awards (see Note 9) were excluded from the calculation since the effect would have been anti-dilutive under the treasury stock method.

8. Commitments and Contingencies

Construction Obligations

In October 2012, AG entered into a turn-key construction contract with Dalian Shipyard Building Industry Co.; and Dalian Shipbuilding Industry Offshore Co.; Ltd (together "DSIC") for a tender support barge (*Atlantica Gamma*). AG made a refundable 15% installment payment of $18.6 million in October 2012. *Atlantica Gamma* was to be delivered on or before July 15, 2015 (the "Delivery Date"), and if the delivery was delayed beyond 180 days from the Delivery Date, absent any permissible delays as defined in the construction contract, AG was *inter alia* entitled to terminate the contract.

In January 2016, AG cancelled the contract and submitted a claim for the refund of the $18.6 million down payment made to the shipyard in 2012. DSIC refuted AG's cancellation of the contract and in March 2016 cancelled the construction contract citing breach of contract by the Company. As required by the construction contract terms, the dispute was heard by an arbitration tribunal in London (UK) in February / March of 2018. In May 2018, the arbitration tribunal's award fell in favor of DSIC, ruling that AG did not have the right to cancel the construction contract and was not entitled to the refund of the $18.6 million down payment. Accordingly, the Company recognized $18.6 million as a loss on cancellation of construction contract in the consolidated statement of income for the nine months ended September 30, 2018. At December 31, 2017, the $18.6 million down payment was presented as long term deposits in the consolidated balance sheet.

In the fourth quarter of 2018, DSIC filed an additional claim in arbitration against AG for an additional $82.7 million related to the cancelled *Atlantica Gamma* construction contract. AG is a special purpose entity that is in the process of being voluntarily liquidated and has no significant assets to pay any such claim. Neither the Company or any of its subsidiaries have issued any guarantee to DSIC or any other company in relation to the AG construction contract, and as a result, the Company does not believe that this claim will have a significant impact on the financial condition or results of operations of the Company.

Contingencies

The Company may in the future be party to various legal proceedings that are incidental to the ordinary course of business. The Company regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. As of September 30, 2018, there were no threatened or pending legal matters that would have a material impact on the Company's consolidated financial statements.

9. Share Option Plan

The Atlantica Share Option Plan (the "Plan") permits the Board of Directors, at its discretion, to grant options to acquire shares in the Company to employees and directors of the Company or its subsidiaries. The options granted are not transferable, and the subscription price is set at $1.706 per share adjusted upwards by 12% per annum from the date of grant until the date the option is exercised. Options granted under the plan will vest three years after the date of the grant and may be exercised up to five years after the grant date. The maximum number of shares authorized for awards of equity share options was amended in 2015 to 6,484,000. The Company, at its discretion, may buy shares on the open market or use treasury shares to satisfy such exercised options, or it may settle the exercised options in a cash settlement.

The fair value of share options granted is recognized as operating expenses over the vesting period. The Company recognized stock compensation expense of $13,000 and $14,000 for the three months ended September 30, 2018 and 2017, respectively, and $39,000 and $43,000 for the nine months ended September 30, 2018 and 2017, respectively. There was no effect on income taxes in the consolidated financial statements related to the options. However, if the options are exercised, a tax benefit will be recorded if the gain is recorded as deductible in any jurisdiction for tax purposes. If the Company has to expense social security taxes related to the benefit of options exercised, such expenses will be recorded at the exercise date.

The following is an analysis of stock options issued and outstanding as of September 30, 2018 and December 31, 2017:

	Number of Options	Weighted Average Exercise Price Per Share *	Weighted Average Remaining Contractual Term (Years)
Outstanding at January 1, 2017	2,763,334	$ 3.28	
Expired	(730,000)	3.23	
Outstanding at December 31, 2017	2,033,334	3.30	
Expired	(683,334)	2.87	
Outstanding at September 30, 2018	1,350,000	$ 3.52	1.3
Vested and Exercisable at September 30, 2018	1,350,000	$ 3.52	1.3

* Stock options were granted with an exercise price based on a 12% escalation each year. The exercise prices presented in the table are based on the expected exercise price.

10. Defined Contribution Retirement Plan

The Company maintains a defined contribution plan for all employees based in the United States. Under the plan, the Company contributes to the employee's retirement plan amounts ranging between one and five percent of the employee's annual salary. Such contributions were $38,000 and $27,000 for the three months ended September 30, 2018 and 2017, respectively, and $102,000 and $95,000 for the nine months ended September 30, 2018 and 2017, respectively.

11. Related Party Transactions

The Company transacts business with the following related parties:

- BassInvest AS
- BDA
- AXON Energy Products, AXON Drilling Products, AXON Pressure Products ("AXON")
- HitecVision Advisory AS ("HitecVision")
- Bassoe Offshore AS ("BassOff AS")
- Bassoe Offshore USA ("BassOff USA")
- BassDrill Alpha Two (Cyrus) Limited ("BDA2")

Management Fees

AM had a management services agreement with BDA to provide management services for the operation of *BassDrill* Alpha based on a daily rate. The agreement ended upon the sale of the *BassDrill Alpha* in June 2018 (see Note 4). Fees for such services were $-0- and $92 for the three months ended September 30, 2018 and 2017, respectively, and $181 and $273 for the nine months ended September 30, 2018 and 2017, respectively.

In November 2016, the Company agreed to temporarily reduce the management fees in exchange for an additional indirect 49.9% ownership interest in BDA. As a result of this transaction, the Company recognized deferred revenue of $136,000 which was being amortized over 24 months. For the three months ended September 30, 2018, the Company recognized income of $11,000 and $85,000, respectively, related to the deferred management fees. For the nine months ended September 30, 2018, the Company recognized income of $45,000 and $51,000, respectively, related to the deferred management fees.

Congo Shared Services

AD had a shared services arrangement with BDA in regards to certain shore-based costs in the Republic of Congo. Fees for shared, shore-based costs billed between BDA and AD were $20,000 billed from BDA and $0.1 million billed to BDA for the three months ended September 30, 2018 and 2017, respectively, and $0.2 million and $0.3 million billed to BDA for the nine months ended September 30, 2018 and 2017, respectively. After the sale of BDA's sole asset in the Republic of Congo in June 2018, this shared services agreement ended.

***BassDrill Alpha* Sale**

For the three and nine months ended September 30, 2018, the Company was reimbursed by BDA2 for $105,000 related to rig personnel and certain operating expenses associated with sale of the *BassDrill Alpha.*

Commission Fees

The Company paid a commission of 1.25% of the revenue received from Petrobras to various Bassoe entities. Fees and reimbursements for such services were approximately $0.2 million and $0.3 million for the three months ended September 30, 2018 and 2017, respectively, and $0.5 million and $0.7 million for the nine months ended September 30, 2018 and 2017, respectively. This agreement was terminated when the Petrobras contract was amended in August 2018.

Rig Services and Products

The Company received products and services from AXON for the *BassDrill Beta* of $67,000 and $52,000 for the three months ended September 30, 2018 and 2017, respectively, and $399,000 and $109,000 for the nine months ended September 30, 2018 and 2017, respectively.

AXON Note Receivable

In October 2013, the Company loaned AXON, a company with common ownership, $1.4 million to assist AXON with completion of the mast equipment package (MEP) needed for the construction of *BassDrill Beta*. This loan earned interest at 0.5% and was to mature three days after AXON received payment in full from DSIC for the equipment AXON constructed for *BassDrill Beta*. In November 2014, the Company and AXON agreed to terminate this loan and replace it with a non-interest bearing loan for $2.2 million due December 31, 2015. In December 2015, AXON repaid approximately

$1.0 million of the loan. Subsequent to this payment, the note was amended to bear interest of 5.0% per annum and extended the final payment of $1.2 million to no later than December 31, 2016. Axon filed for bankruptcy. Because of this, the Company recorded an allowance against the note receivable in 2016 and 2017. In early 2018, the Company agreed on a final settlement of this note receivable. The settlement included (i) delivery of inventory and equipment to the Company with an estimated fair value of $0.3 million and (ii) forgiveness of payable balances due to Axon of $0.1 million. In the first quarter of 2018, the Company finalized the settlement of the note receivable and recorded an additional $31,000 in bad debt expense.

Super Senior Bonds

In June 2017, the Company subscribed to $2.5 million of BDA's Super Senior Bonds as required by the November 2016 BDA restructure agreement. The Super Senior Bonds bore interest at 7% per annum payable annually (beginning June 2018) and are due in June 2019. The Company recorded approximately $22,000 of interest income associated with the Super Senior Bonds for each of the three months ended September 30, 2018 and 2017, respectively, and $66,000 and $25,000 for the nine months ended September 30, 2018 and 2017, respectively. The Super Senior Bonds were carried at $-0- at September 30, 2018 and December 31, 2017 due to additional equity losses recorded in 2017.

Accounts Receivable and Accounts Payable

The Company had the following receivable and payable balances with related parties:

	September 30, 2018	December 31, 2017
BDA2	$ 105,055	$ -
BDA	7,594	119,929
Employees receivables	-	47,213
Accounts receivable - related parties	$ 112,649	$ 167,142

	September 30, 2018	December 31, 2017
Bassoe	$ 142,011	$ 143,567
AXON	14,213	-
Hitec Vision	6,121	-
Other	1,517	-
Accounts payable - related parties	$ 163,862	$ 143,567

12. Risk Management and Financial Instruments

The majority of the Company's revenue transactions, assets and liabilities are denominated in U.S. dollars, the functional currency of the Company. However, the Company has operations and assets in a number of countries worldwide and incurs expenditures in other currencies, causing its results from operations to be affected by fluctuations in currency exchange rates, primarily relative to the U.S. dollar. The Company is also exposed to changes in interest rates on floating interest rate debt. There is, thus, a risk that currency and interest rate fluctuations will have a negative effect on the value of the Company's cash flows.

Interest Rate Risk Management

The Company's exposure to interest rate risk relates mainly to its floating interest rate debt and balances of surplus funds placed with financial institutions. The Company's intention is to obtain the most favorable interest rate available without increasing its foreign currency exposure. Surplus funds are generally placed in deposits in banks. Such deposits are available daily in order to provide the Company with flexibility to meet all requirements for working capital and capital investments. The extent to which the Company plans to utilize interest rate swaps and other derivatives to manage its interest rate risk will be determined by the net debt exposure and its views on future interest rates.

The objective of the interest rate swaps is to manage interest rate risk exposure on variable interest rate debt arrangements such as the Term Loan debt arrangement (see Note 5). The interest rate swap agreements effectively modify the Company's exposure to interest rate risk by converting a portion of the variable-rate debt to a fixed rate, thus reducing the impact of the interest rate changes on future interest expense. The Company has not designated these interest rate swaps as hedges and does not apply hedge accounting to its interest rate derivative instruments. At September 30, 2018 and December 31, 2017, the Company had interest rate swaps with total notional amounts of $156.2 and $177.3 million, respectively, that fixed the variable rate on the Term Loan to approximately between 1.11% and 1.36%.

At September 30, 2018 and December 31, 2017, the Company valued the interest rate swaps as a net asset of $5.7 million and $3.7 million, respectively. The Company determined the fair value of the interest rate swaps based on indirect market prices, and accordingly classified such fair value measurement as Level 2. For the three and nine months ended September 30, 2018, the Company recognized an increase of $16,000 and a reduction of $1.5 million, respectively, of interest expense associated with the mark to market on its. For the three and nine months ended September 30, 2017, the Company recognized a decrease of $0.1 million and an increase of $0.5 million, respectively, in interest expense associated with the mark to market on its derivatives.