

Ship Finance International LTD  
Form 20-F  
April 13, 2017

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, 2016

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)

Georgina Sousa

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(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
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.

101,504,575 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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted 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 and post such files).  
 Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. 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

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 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 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 impact on the Company of a potential comprehensive restructuring by Seadrill Limited or Seadrill;
- 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;  
timely delivery of vessels under construction within the contracted price;  
    changes in governmental rules and regulations or actions taken by regulatory  
    authorities;  
potential liability from pending or future litigation;

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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.

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## 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, 2016, 2015 and 2014 and our selected balance sheet data with respect to the fiscal years ended December 31, 2016 and 2015 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, 2013 and 2012 and the selected balance sheet data for the fiscal years ended December 31, 2014, 2013 and 2012 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,				
	2016	2015	2014	2013	2012
	(in thousands of dollars except common share and per share data)				
Income Statement Data:					
Total operating revenues	412,954	406,740	327,487	270,860	319,692
Net operating income	168,089	166,046	145,146	117,366	207,620
Net income	146,406	100,832	122,815	89,206	185,836
Earnings per share, basic	\$ 1.57	\$ 2.15	\$ 1.32	\$ 1.00	\$ 2.31
Earnings per share, diluted	\$ 1.30	\$ 1.88	\$ 1.24	\$ 0.99	\$ 2.22
Dividends declared	168,289	162,594	152,152	109,114	152,009
Dividends declared per share	\$ 1.80	\$ 1.74	\$ 1.63	\$ 1.17	\$ 1.86



	Year Ended December 31,				
	2016	2015	2014	2013	2012
	(in thousands of dollars except common share and per share data)				
<b>Balance Sheet Data (at end of period):</b>					
Cash and cash equivalents	62,382	70,175	50,818	58,641	60,542
Vessels and equipment, net (including newbuildings)	1,770,616	1,681,466	1,464,700	1,215,624	1,110,301
Investment in direct financing and sales-type leases (including current portion)	556,035	511,443	746,531	903,408	1,143,859
Investment in associated companies (including loans and receivables)	330,877	495,479	399,488	571,702	454,775
Total assets	2,937,377	3,032,554	3,041,554	3,045,983	2,973,089
Short and long term debt (including current portion)	1,552,874	1,634,205	1,732,459	1,736,879	1,831,200
Share capital	1,015	93,468	93,404	93,260	85,225
Stockholders' equity	1,134,095	1,241,810	1,153,492	1,191,933	994,768
Common shares outstanding (1)	101,504,575	93,468,000	93,404,000	93,260,000	85,225,000
Weighted average common shares outstanding (1)	93,496,744	93,449,904	93,330,622	89,508,233	80,594,399
<b>Cash Flow Data:</b>					
Cash provided by operating activities	230,073	258,401	132,401	140,124	86,570
Cash provided by (used in) investing activities	39,399	(205,782 )	(21,940 )	(73,982 )	34,309
Cash used in financing activities	(277,265 )	(33,262 )	(118,284 )	(68,043 )	(155,252 )

Note 1: The number of common shares outstanding at December 31, 2016, includes 8,000,000 shares issued as part of a share lending arrangement relating to the issue in October 2016 of senior unsecured convertible bonds. These shares are owned by the Company and will be returned on or before maturity of the bonds in 2021. Accordingly, they are not included in the weighted average number of common shares outstanding at December 31, 2016.

#### 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 cargos, 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 April 13, 2017.

## 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.

The current state of the world financial markets and current economic conditions may result in a general reduction in the availability of loan finance, which would have a material adverse impact on our results of operations, financial condition and cash flows, and could cause the market price of our common shares to decline.

Global financial markets and economic conditions have been, and continue to be, volatile. The amount of available capital from commercial lenders remains below levels seen before the global financial crisis. There has been a general decline in the willingness by banks and other financial institutions to extend credit, particularly in the shipping and offshore industries, due to the historically volatile asset values of vessels and drilling units. As the shipping and offshore industries are highly dependent on the availability of credit to finance and expand operations, it has been and may continue to be negatively affected by this decline.

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 credit markets has become more difficult as 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. 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.

The uncertainty surrounding the future of the credit markets in the United States, Europe and the rest of the world has resulted in reduced access to credit worldwide. As of December 31, 2016, we had total outstanding indebtedness of \$2.5 billion under our various credit facilities and bond loans, including our equity-accounted subsidiaries.

The instability of the euro or the inability of countries to refinance their debts could have a material adverse effect on our revenue, profitability and financial position.

As a result of the credit crisis in Europe, the European Commission created the European Financial Stability Facility, or the EFSF, and the European Financial Stability Mechanism, or the EFSM, to provide funding to Eurozone countries in financial difficulties that seek such support. In 2012, the European Council established a permanent stability mechanism, the European Stability Mechanism, or the ESM, to assume the role of the EFSF and the EFSM in providing external financial assistance to Eurozone countries. Despite these measures, concerns persist regarding the debt burden of certain Eurozone countries and their ability to meet future financial obligations, and the overall stability of the euro. An extended period of adverse development in the outlook for European countries could reduce the overall demand for dry bulk and containerized cargoes, and for our services. These potential developments, or market perceptions concerning these and related issues, could affect our financial position, results of operations and cash flow.

Volatile economic conditions throughout the world could have an adverse impact on our operations and financial results.

The world economy continues to face a number of challenges, including turmoil and hostilities in the Middle East and other geographic areas and continuing economic weakness in the European Union and Asia Pacific Region. There has historically been a strong link between development of the world economy and demand for energy, including oil and gas, and other materials and finished products transported on our vessels. An extended period of deterioration in the outlook for the world economy could reduce the overall demand for oil and gas and for our services. We cannot predict how long the current market conditions will last. However, recent and developing economic and governmental factors, together with the concurrent decline in charter rates and vessel values for some of our asset classes, have had a negative effect on our results of operations, financial condition and cash flows, have caused the price of our common shares to decline and could cause the price of our common shares to decline further.

The European Union continues to experience relatively slow growth. Since the beginning of the financial crisis in 2008, the credit markets in Europe have experienced significant contraction, de-leveraging and reduced liquidity. While credit conditions are beginning to stabilize, global financial markets have been, and continue to be, disrupted and volatile.

Continued economic slowdown in the Asia Pacific region, especially in China, may exacerbate the effect on us of the recent slowdown in the rest of the world. In recent history, China has had one of the world's fastest growing economies in terms of gross domestic product, or GDP, which had a significant impact on shipping demand. The growth rate of China's GDP for the year ended December 31, 2016, is estimated to be around 6.7%, the slowest

growth rate in twenty-five years. China and other countries in the Asia Pacific region may continue to experience slowed or even negative economic growth in the future. In addition, the charters we enter into with Chinese customers, including existing charters with Chinese customers, may be subject to new regulations in China which may require us to incur new or additional compliance or other administrative costs, and may require us to pay new taxes or other fees to the Chinese government. Our financial condition and results of operations, as well as our future prospects, would likely be impeded by a continuing or worsening economic downturn in any of these countries.

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 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.

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

Acts of piracy have historically affected ocean-going vessels trading in regions of the world such as the South China Sea, the Indian Ocean and in the Gulf of Aden off the coast of Somalia. Sea piracy incidents continue to occur, particularly in the Gulf of Aden off the coast of Somalia and increasingly in the Gulf of Guinea, with dry bulk vessels and tankers particularly vulnerable to such attacks. Some sources, however, report that there was a decline in the number of incidents of piracy in 2016. Acts of piracy could result in harm or danger to the crews that man our vessels. In addition, if these piracy attacks occur in regions in which our vessels are deployed that are characterized by insurers as "war risk" zones or by the Joint War Committee as "war and strikes" listed areas, premiums payable for insurance coverage could increase significantly and such coverage may be more difficult to obtain. In addition, crew costs, including costs which may be incurred to the extent we employ onboard security guards, could increase in such circumstances. We may not be adequately insured to cover losses from these incidents, which could have a material adverse effect on us. In addition, detention hijacking as a result of an act of piracy against our vessels, or an increase in cost, or unavailability of insurance for our vessels, could have a material adverse impact on our business, results of operations, cash flows, financial condition and ability to pay dividends and may result in loss of revenues, increased costs and decreased cashflows to our customers, which could impair their ability to make payments to us under our charters.

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.

From time to time on charterers' instructions, our vessels may call and have called on ports located in countries subject to sanctions and embargoes imposed by the U.S. government and countries identified by the U.S. government as state sponsors of terrorism, such as Iran, Sudan and Syria. The U.S. sanctions and embargo laws and regulations vary in their application, as they do not all apply to the same covered persons or proscribe the same activities, and such sanctions and embargo laws and regulations may be amended or strengthened over time. With effect from July 1, 2010, the U.S. enacted the Comprehensive Iran Sanctions Accountability and Divestment Act, or CISADA, which expanded the scope of the Iran Sanctions Act. Among other things, CISADA expands the application of the prohibitions to companies such as ours, and introduces limits on the ability of companies and persons to do business or trade with Iran when such activities relate to the investment, supply or export of refined petroleum or petroleum products. In addition, on May 1, 2012, President Obama signed Executive Order 13608 which prohibits foreign persons from violating or attempting to violate, or causing a violation of any sanctions in effect against Iran or facilitating any deceptive transactions for or on behalf of any person subject to U.S. sanctions. Any persons found to be in violation of Executive Order 13608 will be deemed a foreign sanctions evader and will be banned from all contacts with the United States, including conducting business in U.S. dollars. Also in 2012, President Obama signed into law the Iran Threat Reduction and Syria Human Rights Act of 2012, or the Iran Threat Reduction Act, which created new sanctions and strengthened existing sanctions. Among other things, the Iran Threat Reduction Act intensifies existing sanctions regarding the provision of goods, services, infrastructure or technology to Iran's petroleum or petrochemical sector. The Iran Threat Reduction Act also includes a provision requiring the President of the United States to impose five or more sanctions from Section 6(a) of the Iran Sanctions Act, as amended, on a person the President determines is a controlling beneficial owner of, or otherwise owns, operates, or controls or insures a vessel that was used to transport crude oil from Iran to another country and (1) if the person is a controlling beneficial owner of the vessel, the person had actual knowledge the vessel was so used or (2) if the person otherwise owns, operates, or controls, or insures the vessel, the person knew or should have known the vessel was so used. Such a person could be subject to a variety of sanctions, including exclusion from U.S. capital markets, exclusion from financial transactions subject to U.S. jurisdiction, and exclusion of that person's vessels from U.S. ports for up to two years.

On November 24, 2013, the P5+1 (the United States, United Kingdom, Germany, France, Russia and China) entered into an interim agreement with Iran entitled the "Joint Plan of Action", or JPOA. Under the JPOA it was agreed that, in exchange for Iran taking certain voluntary measures to ensure that its nuclear program is only used for peaceful purposes, the U.S. and EU would voluntarily suspend certain sanctions for a period of six months. On January 20, 2014, the U.S. and EU indicated that they would begin implementing the temporary relief measures provided for under the JPOA. The JPOA was subsequently extended twice.

On July 14, 2015, the P5+1 and the EU announced that they had reached a landmark agreement with Iran titled the Joint Comprehensive Plan of Action Regarding the Islamic Republic of Iran's Nuclear Program, or the JCPOA, to significantly restrict Iran's ability to develop and produce nuclear weapons for 10 years while simultaneously easing sanctions directed towards non-U.S. persons for conduct involving Iran, but taking place outside of U.S. jurisdiction and not involving U.S. persons. On January 16, 2016, or Implementation Day, the United States joined the EU and the UN in lifting a significant number of their nuclear-related sanctions on Iran following an announcement by the International Atomic Energy Agency, or IAEA, that Iran had satisfied its respective obligations under the JCPOA.

U.S. sanctions prohibiting certain conduct that is now permitted under the JCPOA have not actually been repealed or permanently terminated at this time. Rather, the U.S. government has implemented changes to the sanctions regime by: (1) issuing waivers of certain statutory sanctions provisions; (2) committing to refrain from exercising certain discretionary sanctions authorities; (3) removing certain individuals and entities from the sanctions lists of the Office of Foreign Assets Control; and (4) revoking certain Executive Orders and specified sections of Executive Orders. These sanctions will not be permanently “lifted” until the earlier of “Transition Day,” set to occur on October 20, 2023, or upon a report from the IAEA stating that all nuclear material in Iran is being used for peaceful activities.

In addition to the sanctions against Iran, subject to certain exceptions, U.S. law continues to restrict U.S. owned or controlled entities from doing business with Cuba and various U.S. sanctions have certain other extraterritorial effects that need to be considered by non-U.S. companies. Moreover, any U.S. person who serves as an officer, director or employee of our subsidiaries would be fully subject to U.S. sanctions. It should also be noted that other governments are more frequently implementing sanctions regimes.

We do not currently have any shipping or drilling contracts or plans to initiate any shipping or 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. However, we may 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 we 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. While entering into such contracts would not violate U.S. law, it could potentially negatively affect our ability to obtain investors. In some cases, U.S. investors would be prohibited from investing in an arrangement in which the proceeds could directly or indirectly be transferred to or may benefit a sanctioned entity. Moreover, even though the investment would not violate U.S. law, potential investors could view such shipping and drilling contracts negatively, which could adversely affect our reputation and the market for our shares.

Certain of our charterers or other parties that we have entered into contracts with may be affiliated with persons or entities that are subject to sanctions imposed by the U.S. administration, the European Union and/or other international bodies as a result of the annexation of Crimea by Russia in March 2014. If we determine that such sanctions require us to terminate existing charters or if we are found to be in violation of such applicable sanctions, our results of operations may be adversely affected or we may suffer reputational harm.

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 will be in compliance in the future, particularly as the scope of certain laws may be unclear and may be subject to changing interpretations. Any such violation could result in fines, penalties or other sanctions that could severely 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. Many of our loan agreements include obligations to comply with applicable sanctions, and any violation could result in accelerated repayment of borrowings and severely impact our ability to access loan finance. 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 common stock may adversely affect the price at which our common stock trades. 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 addition, our reputation and the market for our securities may be adversely affected if we engage in certain other activities, such as entering into charters with individuals or entities in countries subject to U.S. sanctions and embargo laws that are not controlled by the governments of those countries, or engaging

in operations associated with those countries pursuant to contracts with third parties that are unrelated to those countries or entities controlled by their governments. Investor perception of the value of our common stock may be adversely affected by the consequences of war, the effects of terrorism, civil unrest and governmental actions in these and surrounding countries.

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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.

An over-supply of vessel capacity may lead to further 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 further reduction of charter hire rates. If such a reduction continues in the future, upon the expiration or termination of our vessels' current charters, we may only be able to re-charter our vessels at reduced or unprofitable rates or we may not be able to charter our vessels at all, which would have a material adverse effect on our revenues and profitability.

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.

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.

Recent declines in 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 may lead to a reduction in day-rates and therefore may adversely affect 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. Following the 2008 peak in the oil price of around \$140 per barrel, there was a period of high utilization and high dayrates, which prompted industry participants to increase the supply of drilling units by ordering the construction of new drilling units. The reduction in oil prices since 2014 has resulted in reduced demand for drilling units, which may adversely affect the Seadrill Charterers' ability to secure drilling contracts and, therefore, their ability to make lease payments to us, and may cause them to terminate or renegotiate their charter agreements to our detriment. Two of the rigs leased to the Seadrill Charterers, the West Hercules and the West Taurus, are 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. We also have one jack-up drilling rig, the Soehanah, which is currently



idle, following the previous charterer's inability to pay charter hire, which occurred in the first quarter of 2016.

In addition, the new construction of high-specification units, as well as changes in the Seadrill Charterers' competitors' drilling rig fleets, could cause our drilling units to become less competitive.

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. For example, on December 20, 2016, the United States President invoked a law that banned offshore oil and gas drilling in large areas of the Arctic and the Atlantic Seaboard. It is presently unclear how long this ban will remain in effect. An additional ban on new drilling in Canadian Arctic waters was announced simultaneously. 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.

Charter hire rates for dry bulk vessels may decrease in the future, which may adversely affect our earnings.

The dry bulk shipping industry is cyclical with attendant volatility in charter hire rates and profitability. The degree of charter hire rate volatility among different types of dry bulk vessels has varied widely, and charter hire rates for dry bulk vessels have declined significantly from historically high levels. Fluctuations in charter rates result from changes in the supply and demand for vessel capacity and changes in the supply and demand for the major commodities carried by water internationally. We cannot assure you that we will be able to successfully charter our vessels in the future or renew existing charters at rates sufficient to allow us to meet our obligations. The supply of and demand for shipping capacity strongly influence charter rates. Because the factors affecting the supply and demand for vessels are outside our control and are unpredictable, the nature, timing, direction and degree of changes in industry conditions are also 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 or production of energy resources, commodities, semi-finished and finished consumer and industrial products;
- the location of regional and global exploration, 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 and 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
- the weather.

Factors that influence the supply of vessel capacity include:

- number of newbuilding deliveries;
- port and canal congestion;
- scrapping of older vessels;
- vessel casualties; and
- number of vessels that are out of service.

Demand for our dry bulk vessels is dependent upon economic growth in the world's economies, seasonal and regional changes in demand, changes in the capacity of the global dry bulk fleet and the sources and supply of dry bulk cargo transported by sea. Adverse economic, political, social or other developments could have a material adverse effect on our business and operating results.

The continued downturn in the dry bulk carrier charter market has had and may continue to have an adverse effect on our earnings.

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. While the BDI has since increased, climbing to 1,240 in March 2017, there can be no assurance that the dry bulk charter market will recover, and the market could continue to decline further.

This downturn in dry bulk charter rates and their volatility has had a number of adverse consequences for dry bulk shipping, including, among other things:

- an absence of financing for vessels;
- no active second-hand market for the sale of vessels;
- extremely low charter rates, particularly for vessels employed in the spot market;
- widespread loan covenant defaults in the dry bulk shipping industry; and
- declaration of bankruptcy by some operators 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. There can be no assurance that the dry bulk charter market will recover and the market could continue to decline further.



Dry bulk carrier values have also declined both as a result of a slowdown in the availability of global credit and the significant deterioration in charter rates. Charter rates and vessel values have been affected in part by the lack of availability of credit to finance both vessel purchases and purchases of commodities carried by sea, resulting in a decline in cargo shipments, and the excess supply of iron ore in China, which resulted in falling iron ore prices and increased stockpiles in Chinese ports. There can be no assurance as to how long spot charter rates and vessel values will remain at their currently low levels. Charter rates may remain at low levels for some time, which may adversely affect our results and financial condition and our ability to pay dividends in the future.

In addition, because the market value of the Company's vessels may fluctuate significantly, we may incur losses when the Company sells 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, 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 casualty to a vessel 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.

Maritime claimants could arrest 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. 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.

As our fleet ages, the risks associated with older vessels could adversely affect our operations.

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.

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## 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. In particular, Seadrill's potential comprehensive restructuring (see below), may have a significant impact on the amount of charter hire we receive from the Seadrill Charterers, if any, which constitutes a significant portion of our contracted future charter hire payments. 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 Frontline Shipping, the Seadrill Charterers and the Golden Ocean Charterer, which are companies affiliated with us, for our operating cash flows and for our ability to pay dividends to our shareholders and repay our outstanding borrowings.

Most of the tanker vessels in our fleet are chartered to a subsidiary of Frontline Ltd., or Frontline, namely Frontline Shipping Limited, or 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. 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 guaranteed by Seadrill. The performance under the lease with North Atlantic Linus was originally guaranteed by NADL, but following an amendment to the charter in February 2015, Seadrill has replaced NADL as guarantor under the lease. 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. In particular, with the severe downturn in the demand for drilling units and Seadrill's potential comprehensive restructuring (see below), there is a significant risk that the leases with the Seadrill Charterers will be renegotiated at lower levels, or terminated. A significant portion of our net income and operating cash flows are generated from our leases with the Seadrill Charterers, and a renegotiation or termination of these leases may have a material adverse effect on our earnings and profitability, and our ability to pay dividends to our shareholders.

Recently Seadrill announced that they continue to be engaged in ongoing negotiations regarding the terms of a comprehensive restructuring and that they expect the implementation of a comprehensive restructuring plan will likely involve schemes of arrangement or chapter 11 proceedings. Although Seadrill has confirmed that its business operations remain unaffected by its restructuring efforts at this time, we may be adversely impacted if Seadrill or the

Seadrill Charterers are unable to meet their contractual obligations with us.

As of April 13, 2017, we have three bareboat leases with the Seadrill Charterers for the West Taurus, West Hercules and West Linus. The performance of the Seadrill Charterers under the leases is fully guaranteed by Seadrill. In their recent filings, Seadrill announced that they continue to be engaged in ongoing negotiations with their banks, potential new money investors and the advisers to an ad hoc committee of bondholders regarding the terms of a comprehensive restructuring which may include the infusion of new capital. Seadrill also announced that it expects the implementation of a comprehensive restructuring plan will likely involve schemes of arrangement or chapter 11 proceedings.

Seadrill have indicated that a comprehensive restructuring would involve concessions from their secured lenders, including maturity extensions, substantial debt amortization relief and the waiver of certain covenants under the agreements. While no definitive terms have been reached, based on stakeholder and new money investor feedback, as well as Seadrill's existing leverage, Seadrill currently believes that a comprehensive restructuring plan will require a substantial impairment or conversion of its bonds as well as impairment, losses or substantial dilution for other stakeholders. Seadrill has also proposed changes to our leases with the

Seadrill Charterers, which they indicate would be in line with the concessions proposed to the secured lenders. Although we have not agreed to any of the proposed changes, we expect that a comprehensive restructuring will require concessions from us with respect to the leases to the Seadrill Charterers, which may significantly reduce the amount of lease payments we receive under the leases. Any reduction of lease payments under the Seadrill Leases, or other concessions we may give, will require consents or waivers from the lenders under our credit facilities relating to the West Taurus, West Hercules and West Linus, or the Rig Credit Facilities, which we may not be able to obtain.

If support for a comprehensive restructuring is not reached within certain deadlines, Seadrill are preparing various contingency plans, including schemes of arrangement and chapter 11 proceedings. A chapter 11 filing by Seadrill or the Seadrill Charterers could trigger events of default under the Rig Credit Facilities. There is a significant risk that such proceedings will result in the leases with the Seadrill Charterers for some, or all, of the drilling units being significantly modified or terminated, which may have a material adverse effect on our earnings and profitability, and our ability to pay dividends to our shareholders. Such potential modifications or termination could also trigger events of default under the Rig Credit Facilities, or our other credit facilities and bond agreements, as further described below.

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

Most 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 Deep Sea Supply Shipowning II AS, or the Deep Sea Charterer, a wholly-owned subsidiary of Deep Sea Supply PLC., or Deep Sea. These charter contracts provide for base charterhire and additional profit sharing payments when the Deep Sea Charterer's earnings from deploying our vessels exceed certain levels. Our vessels chartered to the Deep Sea Charterer are currently idle, or sub-chartered by them in the spot market, which is subject to greater volatility than the long-term charter market. 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.

During the period a vessel or drilling unit is subject to a charter, we will not be permitted to sell it to take advantage of increases in vessel or drilling unit values without the charterers' agreement. 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 dayrates, 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.

We are subject to certain risks with respect to our counterparties on contracts, and failure of such counterparties to meet their obligations 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, 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 its obligations under a contract with us will depend on a number of factors that are beyond our control and may include, among other things, general economic conditions, the condition of the maritime and offshore industries, the overall financial condition of the counterparty, charter rates and dayrates received for specific types of vessels and drilling units, and various expenses. 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.

Volatility in the international shipping and offshore markets may cause our customers to be unable to pay charterhire to us.

Our customers are subject to volatility in the shipping and offshore markets that affects their ability to operate the vessels and rigs they charter from us at a profit. Our customers' successful operation of our vessels and rigs in the charter market will depend on, among other things, their ability to obtain profitable charters. We cannot assure you that future charters will be available to our customers at rates sufficient to enable them to meet their obligations to make charterhire payments to us. 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.

We depend on directors who are associated with affiliated companies which may create conflicts of interest.

Our principal shareholders Hemen Holding Ltd. and Farahead Investment Inc., which we refer to jointly as Hemen, are indirectly controlled by trusts established by Mr. John Fredriksen for the benefit of his immediate family. Hemen, and companies associated with Hemen, also have significant shareholdings in Frontline, Seadrill, Golden Ocean and Deep Sea, which are all our customers and/or suppliers. In addition, North Atlantic Linus, which is one of our customers, is a wholly-owned subsidiary of NADL, itself a subsidiary of Seadrill. Currently, one of our directors, Kate Blankenship, is also a director of Frontline, Golden Ocean, Seadrill and NADL. Paul Leand, another of our directors, is also a director of Seadrill and NADL. Hans Petter Aas, another of our directors, is also a director of Golden Ocean, Seadrill and Deep Sea. Harald Thorstein, another of our directors, is also Chairman of the board of directors of Deep Sea. These four directors owe fiduciary duties to the shareholders of each company and may have conflicts of interest in matters involving or affecting us and our customers. In addition, due to any ownership they may have in common shares of Frontline, Golden Ocean, Deep Sea, Seadrill or NADL, they may have conflicts of interest when faced with decisions that could have different implications for Frontline, Golden Ocean, Deep Sea, Seadrill or NADL than they do for us. We cannot assure you that any of these conflicts of interest will be resolved in our favor.

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, or TCE, rates realized by Frontline Shipping and the Golden Ocean Charterer exceed specified levels. Under our charter agreements with the Deep Sea Charterer, we are entitled to receive quarterly profit sharing payments to the extent that the average TCE rates realized by the Deep Sea Charterer for the relevant vessel exceed specified levels. Because Frontline, Golden Ocean and Deep Sea 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, Golden Ocean and Deep Sea 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 (Bermuda) Ltd., or Frontline Management, Frontline, the Golden Ocean Charterer, Golden Ocean, the Deep Sea Charterer, Deep Sea, 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 the 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 Group Management (Bermuda) Ltd, or 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 2016 taxable year. Nevertheless, for the 2017 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. 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, Hemen owned approximately 36% of our common shares as of April 13, 2017. There is therefore a risk that we could no longer qualify for exemption under Section 883 of the Code for a particular taxable year if other shareholders with a five percent or greater interest in our common shares were, in combination with Hemen, to own 50% or more of our outstanding common shares on more than half the days during the 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.

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 16 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 vessels chartered to Frontline Shipping and the Golden Ocean Charterer, we currently operate seven dry bulk carriers, seven container vessels, two car carriers and one Suezmax tanker under time charters and one Suezmax tanker and seven dry bulk carriers employed in the spot 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.

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

As of December 31, 2016, the Company and its consolidated subsidiaries had approximately \$1.2 billion in floating rate debt outstanding under our credit facilities, and a further \$0.9 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, 2016, 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 \$1.4 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, 2016, was approximately \$0.7 billion, including our equity-accounted subsidiaries. A one percentage change in interest rates would at most increase or decrease interest expense by approximately \$7 million per year as of December 31, 2016. The maximum 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, 2016, \$0.9 billion of our floating rate debt was subject to such interest adjustment clauses, including our equity-accounted subsidiaries. Of this amount, a total of \$0.2 billion was subject to interest rate swaps and the balance of \$0.7 billion remained on a floating rate basis, effectively reducing our exposure to floating rate debt to \$5 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 Ship Finance Management AS and Ship Finance Management (Bermuda) Ltd.

We intend to continue to expand our fleet. 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 Norwegian kroner, or NOK, 600 million senior unsecured bonds due 2017, our 3.25% senior unsecured convertible notes due 2018, our NOK 900 million senior unsecured bonds due 2019, and our 5.75% senior unsecured convertible notes due 2021. 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.

Due to Seadrill's potential comprehensive restructuring we may not be in compliance with the covenants contained in our debt agreements.

The Rig Credit Facilities, which are secured by mortgages over the rigs in favor of the lenders under the respective Rig Credit Facilities, require that Seadrill, the respective Seadrill Charterers and in the case of West Linus, NADL, remain solvent.

If Seadrill or the Seadrill Charterers, along with NADL in the case of West Linus, were to enter into chapter 11 proceedings, or similar arrangements, it could be deemed a breach of the covenants under the respective Rig Credit Facilities, and would prevent us from borrowing additional money under the Rig Credit Facilities, which, unless cured within the grace period set forth under the credit facility, if applicable, or waived or modified by our lenders, may provide our lenders with the right to, among other things, call on the guarantees provided, require us to enhance our equity and liquidity, increase our interest payments and accelerate our indebtedness and foreclose their liens on our assets securing the credit facilities, which would impair our ability to continue to conduct our business.

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 guarantees from Ship Finance International Limited under the Rig Credit Facilities are currently limited to \$75 million for West Hercules, \$75 million for West Taurus and \$90 million for West Linus. In the event that the guarantees are called upon, we may have to draw under our available revolving credit facilities in order to fulfil our obligations under the guarantees, which may not be available for drawdown at the time. The Rig Credit Facilities also contain cross-default provisions with respect to Seadrill, the respective Seadrill Charterers, along with NADL in the case of



West Linus, which could be triggered if any financial indebtedness above certain threshold levels in these entities is not paid when due, or within any applicable grace period, which could trigger an event of default under the respective Rig Credit Facilities.

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 as described above. 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, 2016, the closing market price of our common shares ranged from a high of \$16.57 on January 1, 2016, to a low of \$10.31 on February 11, 2016. 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, 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 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. 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.

Our major shareholder, Hemen, may be able to influence us, including the outcome of shareholder votes, with interests that may be different from yours.

As at April 13, 2017, Hemen owned approximately 36% of our outstanding common shares. As a result of its ownership of our common shares, Hemen may influence our business, including the outcome of any vote of our shareholders. Hemen, and companies associated with Hemen, also currently beneficially own substantial stakes in Frontline, Golden Ocean, Seadrill (and indirectly its subsidiary NADL) and Deep Sea. The interests of Hemen may be different from your interests.

#### 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 April 13, 2017, our assets consist of 14 crude oil tankers, 22 dry bulk carriers, 22 container vessels (including two chartered-in 19,200 TEU vessel), two car carriers, two jack-up drilling rigs, two ultra-deepwater drilling units, five offshore support vessels, two chemical tankers and two newbuilding oil product tankers. Our oil tankers, chemical tankers and oil product tankers are all double-hull vessels.

Our customers currently include Frontline Shipping, Golden Ocean, Seadrill, Sinochem Shipping Co. Ltd. ("Sinochem"), China National Chartering Co Ltd ("Sinchart"), Heung-A Shipping Co. Ltd. ("Heung-A"), Hyundai Glovis Co. Ltd. ("Hyundai Glovis"), Maersk Line A/S ("Maersk"), Rudolf A. Oetker KG ("Hamburg Süd"), Phillips 66 Company ("P66"), MSC Mediterranean Shipping Company S.A. ("MSC"), and Deep Sea.

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, Very Large Crude Carriers, or VLCCs, and oil/bulk/ore carriers, or OBOs.

Since 2004, we have diversified our asset base and now have eight asset types, which comprise crude oil tankers, chemical tankers, container vessels, car carriers, dry bulk carriers, jack-up drilling rigs, ultra-deepwater drilling units and offshore support vessels. In addition, we have two newbuilding oil product tankers which are scheduled for delivery in 2017.

Most of our crude oil tankers are chartered to Frontline Shipping under longer term time charters that have remaining terms ranging from four to 10 years. Frontline Shipping, in turn, charters our vessels to third parties. Under the original charter agreements, the daily base charter rates payable to us were fixed in advance and decreased as our vessels aged. In December 2011, in response to a restructuring of Frontline necessitated by an extended period of low charter rates for oil tankers and OBOs, amendments were made to the original charter agreements with Frontline Shipping and Frontline Shipping II Limited, or Frontline Shipping II, together the Frontline Charterers, relating to 28 double-hull vessels, whereby we received a compensation payment of \$106 million and agreed to temporarily reduce by \$6,500 per day the base charter rates payable on each vessel. The temporary reduction originally applied from January 1, 2012, until December 31, 2015, and thereafter the base charter rates were to revert to the original agreed levels. For the duration of the temporary reduction, we were entitled to receive 100% of any excess above the reduced charter rates earned by the Frontline Charterers on our vessels, calculated annually on an average daily TCE basis and subject to a maximum excess of \$6,500 per day per vessel. Amounts received under this arrangement were classified as "cash sweep" income.

In June 2015, further amendments were made to the charter agreements with the Frontline Charterers, whereby we agreed to reduce time charter rates from July 1, 2015, to fixed non-decreasing rates of \$20,000 per day for each of the VLCCs and \$15,000 per day for each of the Suezmax tankers until the charter expiry dates, which remain as in the original charters. The charters for three of the vessels were transferred from Frontline Shipping II to Frontline Shipping, which is now the charter counterpart for all of the vessels. As part of the amended agreement, Frontline was released from its guarantee obligations under the charters and in exchange a cash reserve of \$2 million per vessel has been built up in Frontline Shipping as security for its obligations under the charters. As part compensation for the amendments to the charters, we received 55 million shares in Frontline. Since December 2011, 16 vessels have been sold, including all of the OBOs and the VLCC Front Century delivered to its new owner in March 2017, leaving 12 crude oil tankers currently chartered to Frontline Shipping. In February 2016, Frontline enacted a 1-for-5 reverse stock split and our shareholding in Frontline now consists of 11 million ordinary shares.

In addition to the base charter rates, with effect from July 1, 2015, Frontline Shipping will pay us a profit sharing amount equal to 50% of the charter revenues they realize above the revised fixed time charter rates, payable quarterly and calculated on an average daily TCE basis. Previously, from January 1, 2012 to June 30, 2015, the profit sharing rate was 25% of the charter revenues realized above specified threshold levels, of which \$50 million was prepaid in December 2011, and before that until December 31, 2011, the profit sharing rate was 20%. The cash sweep arrangement, originally set to expire on December 31, 2015, was superseded by the amended agreements effective from July 1, 2015.

We have also entered into agreements with Frontline Management to provide fixed rate operation and maintenance services for the vessels on time charter to Frontline Shipping, and for administrative support services. These agreements enhance the predictability and stability of our cash flows, by fixing substantially all of the operating expenses of our crude oil tankers. As part of the amendments to the agreements made in June 2015, the fixed daily management fee per vessel payable to Frontline Management was increased from \$6,500 per day to \$9,000 per day with effect from July 1, 2015.

The charters for one jack-up drilling rig, two ultra-deepwater drilling units, five offshore support vessels, two chemical tankers and 13 of the container vessels are all on bareboat terms, under which the respective charterer bears all operating and maintenance expenses.

#### Acquisitions and Disposals

Acquisitions

In the year ended December 31, 2016, we took delivery of the following vessels:

In February 2016, we took delivery of the 9,500 TEU Maersk Skarstind, the second of the three newbuilding container vessels announced in June 2015. Immediately upon delivery the vessel commenced a five year time charter to Maersk.

In May 2016, we took delivery of the 9,300 TEU Maersk Shivling, the third of the three newbuilding container vessels announced in June 2015. Immediately upon delivery the vessel commenced a five year time charter to Maersk.

In December 2016, the 19,200 TEU newbuilding container vessel MSC Anna was delivered by the shipyard and, in terms of agreements entered into in October 2015, commenced a bareboat charter to us for a period of 15 years. The vessel simultaneously commenced a 15 year bareboat charter to MSC.

Since January 1, 2017, we have taken delivery of the following vessel:

In March 2017, the 19,200 TEU newbuilding container vessel MSC Viviana was delivered by the shipyard and, in terms of agreements entered into in October 2015, commenced a bareboat charter to us for a period of 15 years. The vessel simultaneously commenced a 15 year bareboat charter to MSC.

#### Disposals

In the year ended December 31, 2016, we entered into agreements for the disposal of vessels, as follows:

In February 2016, we sold the offshore support vessel Sea Bear to an unrelated third party. Net cash proceeds of approximately \$4.9 million were received and additionally compensation for early termination of the charter was received from Deep Sea in the form of loan notes with a face value of \$14.6 million, bearing interest at a rate of 7.25% and redeemable over a period of six years. An impairment adjustment of \$8.1 million had been recorded against this vessel in 2015 and a gain of \$14,000 was recorded on its disposal in 2016.

In July 2016, we sold the VLCC Front Vanguard to an unrelated third party. Net sales proceeds of approximately \$24.2 million were received, including compensation of \$0.3 million from Frontline for early termination of the charter. A loss of \$181,000 was recorded on disposal.

Since January 1, 2017, we have disposed of the following vessel:

In March 2017, the VLCC Front Century was delivered to its new owner. The sale of this vessel had been agreed in November 2016, and an impairment adjustment of \$0.5 million was recorded against it in the year ended December 31, 2016. Net sales proceeds were approximately \$23.8 million, including compensation receivable from Frontline for early termination of the charter.

## 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 new and modern (1) second-hand vessels and entering into medium or long-term charter arrangements. 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 modern second-hand vessels or rigs we can provide for long-term growth of our assets and continue to decrease the average age of our fleet.

Diversify our asset base. Since 2004, we have diversified our asset base and now have eight asset types, which comprise of crude oil tankers, chemical tankers, container vessels, car carriers, dry bulk carriers, jack-up drilling rigs, ultra-deepwater drilling units and offshore support vessels. In addition, we have two newbuilding oil product tankers which are scheduled for delivery in 2017. We believe that there are other attractive markets that could (2) 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.

(3)



Expand and diversify our customer relationships. Since 2004, we have increased our customer base from one to 12 customers. Of these 12 customers, Frontline Shipping, Deep Sea, Seadrill and Golden Ocean are related 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

The Frontline Charterers have been our principal customers since we were spun-off from Frontline in 2004. However, in 2008 and 2013 we made substantial investments in offshore drilling units which are chartered to the Seadrill Charterers, and the percentage of our business attributable to the Frontline Charterers has decreased following the sale of several of the vessels chartered by them and the delivery and commencement of the charters of the drilling units. We anticipate that the percentage of our business attributable to both Frontline Shipping and the Seadrill Charterers will decrease as we continue to expand our business and our customer base.

#### 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 Deep Sea Charterer are subject to profit sharing agreements, which will be affected by competition experienced by the charterers.

#### Risk of Loss and Insurance

Our business is affected by a number of risks, including mechanical failure, collisions, property loss to the vessels, cargo loss or damage, and business interruption due to political circumstances in foreign countries, hostilities and labor strikes. In addition, the operation of any ocean-going vessel is subject to the inherent possibility of catastrophic marine disaster, including oil spills and other environmental mishaps, and the liabilities arising from owning and operating vessels in international trade.

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.

#### Environmental Regulation and Other Regulations

Government regulations and laws significantly affect the ownership and operation of our crude oil tankers, oil product tankers, dry bulk carriers, chemical tankers, drilling units, container vessels, car carriers and offshore support vessels. We are subject to various international conventions, laws and regulations in force in the countries in which our vessels and drilling units may operate or are registered. Compliance with such laws, regulations and other requirements entails significant expense, including vessel and drilling unit modification and implementation of certain operating procedures.

A variety of governmental, quasi-governmental and private organizations subject our assets to both scheduled and unscheduled inspections. These organizations include the local port authorities, national authorities, harbor masters or equivalent, classification societies, flag states and charterers, terminal operators, oil companies and dry bulk and commodity owners. Some of these entities require us to obtain permits, licenses and certificates for the operation of our assets. Our failure to maintain necessary permits or approvals could require us to incur substantial costs or temporarily suspend operation of one or more of the assets in our fleet.

We believe that the heightened levels of environmental and quality concerns among insurance underwriters, regulators and charterers have led to greater inspection and safety requirements on all vessels, and may accelerate the scrapping of older vessels throughout the industry, particularly older tankers. Increasing environmental concerns have created a demand for tankers that conform to the stricter environmental standards. We are required to maintain operating standards for all of our vessels emphasizing operational safety, quality maintenance, continuous training of our officers and crews, and compliance with applicable local, national and international environmental laws and 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 are frequently changed 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. The United Nations' International Maritime Organization, or IMO, adopted the International Convention for the Control and Management of Ship's Ballast Water and Sediments, or the BWM Convention, in February 2004, which was ratified in September 2016 and expected to enter into force on September 8, 2017, and will require investment in new equipment on board our vessels. It is not possible to quantify the costs of such modifications at this time. In addition, a

future serious marine incident that results in significant oil pollution or otherwise causes significant adverse environmental impact, such as the 2010 Deepwater Horizon oil spill in the Gulf of Mexico, could result in additional legislation or regulation that could negatively affect our profitability.

Recent action by the IMO's Maritime Safety Committee and U.S. 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. This might cause companies to adopt additional procedures for monitoring cybersecurity, which could require additional expenses and/or capital expenditures. However, the impact of such regulations is hard to predict at this time.

The laws and regulations discussed below may not constitute a comprehensive list of all such laws and regulations that are applicable to the operation of our vessels and drilling units.

## 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, and Norway.

## International Maritime Organization

The IMO has adopted the International Convention for the Prevention of Marine Pollution from Ships, 1973, as modified by the Protocol of 1978 relating thereto, collectively referred to as MARPOL 73/78, or MARPOL. MARPOL Annexes I and II entered into force on October 2, 1983, and have been adopted by over 150 nations, including many of the jurisdictions in which our vessels operate. MARPOL sets forth pollution prevention requirements applicable to all vessels, and is broken into six Annexes, each of which regulates a different source of pollution. Annex I relates to oil leakage or spill; Annexes II and III relate to harmful substances carried in liquid bulk or packaged form, respectively; Annexes IV and V relate to sewage and garbage management, respectively; and lastly, Annex VI relates to air emissions. Annex VI was separately adopted by the IMO in September 1997.

Non-compliance with IMO regulations may subject a shipowner or bareboat charterer to increased liability, may lead to loss of or decreases in available insurance coverage for affected vessels and may result in denial of access to, or detention in, some ports including United States, or U.S., and European Union, or EU, ports.

## Air Emissions

In September 1997, the IMO adopted Annex VI to MARPOL to address air pollution. Effective May 2005, Annex VI sets limits on nitrogen oxide emissions from ships whose diesel engines were constructed, or underwent major conversions, on or after January 1, 2000. It also prohibits "deliberate emissions" of "ozone depleting substances", defined to include certain halons and chlorofluorocarbons. "Deliberate emissions" are not limited to times when the ship is at sea; they can for example include discharges occurring in the course of the ship's repair and maintenance. The emission of "volatile organic compounds" from certain tankers, and the shipboard incineration of certain substances, such as polychlorinated biphenyls, using incinerators installed after January 1, 2000 is also prohibited. Annex VI also includes a global cap on the sulphur content of fuel oil and allows for special areas to be established with more stringent controls on sulfur emissions, known as Emission Control Areas, or ECAs.

The IMO's Maritime Environment Protection Committee, or MEPC, adopted amendments to Annex VI on October 10, 2008, 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 ships. As of January 1, 2012, the amended Annex VI requires that fuel oil contain no more than 3.50% sulfur, a reduction from the previous cap of 4.50%. On October 27, 2016, at MEPC's 70<sup>th</sup> session, or MEPC 70, MEPC announced its decisions concerning the implementation of regulations mandating a reduction in sulfur emissions from the current 3.50% to 0.50% by the beginning of 2020. By 2020 ships will have to either remove sulfur from emissions through the use of emission scrubbers or buy fuel with low sulfur content.

Sulfur content standards are even stricter within certain ECAs. As of January 1, 2015, ships operating within an ECA may not use fuel with sulfur content in excess of 0.10%. The Baltic Sea and the North Sea have been designated

ECAs, and amended Annex VI establishes procedures for designating new ECAs. Effective August 1, 2012, certain coastal areas of North America were designated ECAs, and effective January 1, 2014, the U.S. Caribbean Sea was designated an ECA. Ocean-going vessels in these areas will be subject to stringent emissions controls, which may cause us to incur additional costs. 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 EPA, or the states where we operate, compliance with these regulations could entail significant capital expenditures or otherwise increase the costs of our operations.

As of January 1, 2013, all ships must comply with mandatory requirements adopted by MEPC in July 2011 relating to greenhouse gas emissions. The requirements mandate that by 2025 all new ships built must be 30% more energy efficient than those built in 2014, and all ships must follow the Ship Energy Efficiency Management Plan. The minimum energy efficiency levels per capacity mile, as outlined in the Energy Efficiency Design Index, will apply to all new ships. These requirements could cause us to incur additional compliance costs.

Amended Annex VI also establishes new tiers of stringent nitrogen oxide emissions standards for new marine engines, depending on their date of installation. At MEPC 70, MEPC approved the North Sea and the Baltic Sea as ECAs for nitrogen oxides, effective January 1, 2021. It is expected that these areas will be formally designated after draft amendments are presented at MEPC's next session. The EPA promulgated equivalent, and in some cases stricter, emissions standards in 2009.

As of January 1, 2010, the Directive 2005/33/EC of the European Parliament and of the Council of July 6, 2005, amending Directive 1999/32/EC, came into force. The objective of the directive is to reduce emission of sulfur dioxide and particulate matter caused by the combustion of certain petroleum derived fuels. The directive imposes limits on the sulfur content of such fuels as a condition of their use within a Member State territory. As of January 1, 2010, marine fuels used by inland waterway vessels and ships at berth in ports in EU countries must have a maximum sulfur content of 0.10% by mass. On July 15, 2011, the European Commission adopted a proposal for an amendment of Directive 1999/32/EC, which would align requirements with those imposed by the revised MARPOL Annex VI which introduced stricter sulfur limits. Directive 2012/33/EU, also amending Directive 1999/32/EC, was published in the Official Journal of the EU in November 2012. The deadline for bringing member states' legislation into compliance was June 18, 2014. As of January 1, 2015, all vessels operating within ECAs worldwide, which includes the North Sea, the Baltic Sea and the English Channel, must comply with 0.10% sulfur content requirements.

#### Safety Requirements

The IMO has adopted the International Convention for the Safety of Life at Sea, or SOLAS, and the International Convention on Load Lines, or LL Convention, which impose a variety of standards that regulate the design and operational features of ships. The IMO periodically revises the SOLAS and LL Convention standards, and amendments to SOLAS made in May 2012 entered into force on January 1, 2014. Recent amendments to the Convention on Limitation of Liability for Maritime Claims of 1976, as amended, or LLMC, became effective on June 8, 2015. The amendments alter the limits of liability for loss of life or personal injury claims and property claims against ship-owners.

The operation of our ships is also affected by the requirements contained in Chapter IX of SOLAS, which sets forth the IMO's International Management Code for the Safe Operation of Ships and Pollution Prevention, or the ISM Code. The ISM Code requires ship owners and bareboat charterers to develop and maintain an extensive Safety Management System, or SMS, that includes the adoption of a safety and environmental protection policy, setting forth instructions and procedures for safe operation and describing procedures for dealing with emergencies. We intend to rely upon the safety management system that the appointed ship managers have developed.

The ISM Code requires that vessel operators obtain a Safety Management Certificate, or SMC, for each vessel they operate. This certificate evidences compliance by a vessel's operators with the ISM Code requirements for a SMS. No vessel can obtain a SMC under the ISM Code unless its manager has been awarded a Document of Compliance, or DOC, issued in most instances by the vessel's flag state. As of the date of this report, our appointed ship managers have obtained DOCs for their office and SMCs for all of our vessels for which such certificates are required by the IMO, and these are renewed as required.

Non-compliance with the ISM Code or other IMO regulations may subject the ship owner or bareboat charterer to increased liability, lead to loss of or decreases in available insurance coverage for affected vessels, and result in the denial of access to, or detention in, some ports. As of the date of this report, each of our vessels is ISM Code certified. However, there can be no assurance such certificates will be maintained.





## Ballast Water Requirements

The IMO adopted the BWM Convention in February 2004. 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. Additionally, all ships will have to carry a ballast water record book and an International Ballast Water Management Certificate. The BWM Convention only became effective 12 months after the date on which no less than 30 states, and the combined merchant fleets of which constitute no less than 35% of the gross tonnage of the world's merchant shipping, have either signed it without reservation as to ratification, acceptance or approval, or have deposited the requisite instruments of ratification, acceptance, approval or accession. On September 8, 2016, the BWM Convention received the requisite approvals from 52 countries making up 35.14% of global tonnage. Many of the implementation dates originally written in the BWM Convention have already passed, so that once it enters into force the period for installation of mandatory ballast water exchange requirements would be extremely short, with several thousand ships each year needing to install ballast water management systems, or BWMS. For this reason, on December 4, 2013, the IMO Assembly passed a resolution revising the application dates of the BWM Convention so that they are triggered by the entry into force date and not the dates originally in the BWM Convention. This in effect makes all vessels constructed before the entry into force date "existing vessels", and allows for the installation of a BWMS on such vessels at the first renewal survey following entry into force of the convention. MEPC 70 adopted updated "guidelines for approval of ballast water management systems (G8)". Once mid-ocean ballast exchange or ballast water treatment requirements become mandatory, the cost of compliance could increase for ocean carriers and the costs of ballast water treatments may be material. 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 United States, for example, requires vessels entering its waters from another country to conduct mid-ocean ballast exchange or undertake some alternative measure, and to comply with certain reporting requirements. Although we do not believe that the costs of such compliance would be material, it is difficult to predict the overall impact of such requirements on our operations.

## Oil Pollution Liability

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 has adopted the International Convention on Civil Liability for Oil Pollution Damage of 1969, as amended by Protocols in 1976, 1984 and 1992, and further amended in 2000, or the CLC (of which the United States is not a party). 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 is 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 of Special Drawing Rights. The limits on liability have since been amended so the compensation limits on liability were raised. The right to limit liability is forfeited under the CLC where the spill is caused by the ship-owner's personal fault, and under the 1992 Protocol where the spill is caused by the ship-owner's personal act or omission by intentional or reckless conduct, where the ship-owner knew pollution damage would probably result. A state that is a party to the CLC may not allow a ship under its flag to trade unless that ship has a certificate of insurance or something equivalent. In jurisdictions where the CLC has not been adopted, various legislative schemes or common law govern, and liability is imposed either on the basis of fault or in a manner similar to that of the CLC. The CLC requires ships 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 believe that our insurance will cover the liability under the plan adopted by the IMO.

The IMO has adopted the International Convention on Civil Liability for Bunker Oil Pollution Damage of 2001, or the Bunker Convention, to impose strict liability on ship-owners 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 ships' bunkers is typically determined by the national or other domestic laws in the jurisdiction where the events or damages occur.

The IMO continues to review and introduce new conventions, laws and regulations. Although it is difficult to accurately predict what additional regulations, if any, may be passed by the IMO in the future and what effect, if any, such additional regulations may have on our operations, they could limit our ability to do business and have a material adverse effect on our business and results of operations.

## United States Requirements

The U.S. Oil Pollution Act of 1990, or OPA, established an extensive regulatory and liability regime for the protection and cleanup of the environment following oil spills. OPA affects all "owners and operators" whose vessels trade with the United States, its territories and possessions, or whose vessels operate in U.S. waters, which include the U.S. territorial sea and its 200 nautical mile exclusive economic zone around the United States. The United States has also enacted the Comprehensive Environmental Response, Compensation and Liability Act, or 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, other than an agent or employee of, or a person acting pursuant to a contractual relationship with, the responsible 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. OPA contains statutory caps on liability and damages, which include:

- injury to, destruction or loss of, or loss of use of, natural resources and related assessment costs;
- injury to, or economic losses resulting from, the destruction of real and personal property;
- net loss of taxes, royalties, rents, fees or net profit revenues resulting from injury to, or destruction or loss of, real or personal property or natural resources;
- loss of subsistence use of natural resources that are injured, destroyed or lost;
- loss of profits or impairment of earnings capacity due to injury to, or destruction or loss of, real or personal property or natural resources by any claimant, whether or not such claimant has a proprietary interest in the property; and
- 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 limits the liability of responsible parties with respect to single-hull tankers over 3,000 gross tons to the greater of \$3,500 per gross ton or \$25,845,600, while for all other tankers over 3,000 gross tons the liability is limited to the greater of \$2,200 per gross ton or \$18,796,800. For non-tank vessels, such as dry bulk carriers, edible oil tank vessels and any spill response vessels, liability is limited to the greater of \$1,100 per gross ton or \$939,800, subject to periodic adjustment for inflation. For offshore facilities, except deepwater ports, liability is capped at the total of all removal costs plus \$75 million. 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 with the responsible party, or by 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 Pollution Act (Section 311 (c) and (e)) or the Intervention on the High Seas Act.

OPA permits individual states to impose their own liability regimes with regard to oil pollution incidents occurring within their boundaries. Some states have enacted legislation providing for unlimited liability for discharge of pollutants within their waters, which may include charterers and cargo owners and operators of vessels.

The 2010 Deepwater Horizon oil spill in the Gulf of Mexico may also result in additional regulatory initiatives or statutes, including the raising of liability caps under OPA. For example, on August 15, 2012, the U.S. Bureau of Safety and Environment Enforcement, or the BSEE, released a final drilling safety rule for offshore oil and gas operations that strengthens the requirements for safety equipment, well control systems, and blowout prevention

practices. In April 2015, it was announced that new regulations are expected to be imposed in the United States relating to offshore oil and gas drilling, and the BSEE announced a new pilot inspection program for offshore facilities in December 2015 and a new Well Control Rule in April 2016. Compliance with any new requirements of OPA may substantially impact our cost of operations or require us to incur additional expenses to comply with any new regulatory initiatives or statutes. Additional legislation or regulations applicable to the operation of our vessels that may be implemented in the future could adversely affect our business.

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 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 non-contractual 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 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 refuses to provide all reasonable cooperation and assistance as requested in connection with response activities where the vessel is subject to OPA.

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. An owner or operator of more than one tanker is required to demonstrate evidence of financial responsibility for the entire fleet in an amount equal only to the financial responsibility requirement relating to the vessel with the greatest maximum liability. 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 with the USCG's financial responsibility regulations by procuring a Certificate of Financial Responsibility provided by Maritime Insurance Solutions Ltd.

We have and expect to maintain pollution liability insurance coverage 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 a material adverse effect on our business, financial condition, results of operations and cash flows.

Owners or operators of vessels and facilities operating in the waters of the United States must file vessel and facility response plans with the USCG, and their vessels and facilities are required to operate in compliance with their USCG approved plans. These response plans must, among other things, describe response activities for a discharge, identify response resources, describe crew training and drills, and identify a qualified individual with full authority to implement removal actions.

We have obtained vessel response plans approved by the USCG for our vessels operating in the waters of the United States.

#### Other Environmental Initiatives

The U.S. Clean Water Act, or 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. Furthermore, 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.

The EPA and USCG have 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 cost, or which may otherwise restrict our

vessels from entering U.S. waters.

The EPA regulates the discharge of ballast and bilge water and other substances in U.S. waters under the CWA. EPA regulations require vessels 79 feet in length or longer (other than commercial fishing vessels and recreational vessels) to comply with a Vessel General Permit for Discharges Incidental to the Normal Operation of Vessels, or VGP, authorizing ballast and bilge water discharges and other discharges incidental to the operation of vessels. The VGP imposes technology and water-quality based effluent limits for certain types of discharges and establishes specific inspection, monitoring, record-keeping and reporting requirements to ensure the effluent limits are met. On March 28, 2013, the EPA re-issued the VGP for another five years, effective from December 19, 2013. The 2013 VGP focuses on authorizing 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, more stringent requirements for exhaust gas scrubbers, and the use of environmentally acceptable lubricants.

In addition, under §401 of the CWA, the VGP must be certified by the state where the discharge is to take place. Certain states have enacted additional discharge standards as conditions to their certification of the VGP. These local standards bring the VGP into compliance with more stringent state requirements, such as those further restricting ballast water discharges and preventing the introduction of non-indigenous species considered to be invasive. The VGP and its state-specific regulations and any similar restrictions enacted in the future will increase the costs of operating in the relevant waters.

The USCG regulations adopted under the U.S. National Invasive Species Act also impose mandatory ballast water management practices for all vessels equipped with ballast water tanks entering or operating in U.S. waters, which require the installation of equipment to treat ballast water before it is discharged in U.S. waters, or alternatively the implementation of other port facility disposal arrangements or procedures. Vessels not complying with these regulations are restricted from entering U.S. waters. The USCG must approve any technology before it is placed on a vessel.

Although vessels were technically subject to the phasing-in of these standards with effect from January 1, 2014, it was not until October 2016 that the USCG first approved the relevant technology. As a result, the USCG previously provided waivers to vessels which were unable to install the as-yet unapproved technology. However, any vessel continuing to require a waiver will need to show why they cannot now install the approved technology. The EPA, on the other hand, has taken a different approach to enforcing ballast discharge standards under the VGP. On December 27, 2013, the EPA issued an enforcement response policy in connection with the new VGP in which the EPA indicated that it would take into account the reasons why vessels do not have the requisite technology installed, but will not grant any waivers.

It should also be noted that in October 2015, the Second Circuit Court of Appeals issued a ruling that directed the EPA to redraft the sections of the 2013 VGP that address ballast water. However, the Second Circuit stated that 2013 VGP will remain in effect until the EPA issues a new VGP. Towards the end of 2016, the EPA was reported to be working on a new VGP. It presently remains unclear how the ballast water requirements set forth by the EPA, the USCG, and the BWM Convention, some of which are in effect and some which are pending, will co-exist.

The U.S. Clean Air Act of 1970, including its amendments of 1977 and 1990, or the 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. Our vessels that operate in such port areas with restricted cargoes are equipped with vapor recovery systems that satisfy these requirements. 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 relating to emissions resulting from vessel loading and unloading operations by requiring the installation of vapor control equipment. As indicated above, our vessels operating in covered port areas are already equipped with vapor recovery systems that satisfy these existing requirements.

Compliance with future EPA and USCG regulations could require the installation of certain engineering equipment and water treatment systems to treat ballast water before it is discharged or the implementation of other port facility disposal arrangements or procedures at potentially substantial cost, or may otherwise restrict our vessels from entering U.S. waters.

Our vessels carry cargoes to U.S. waters regularly, and we believe that all of our vessels are suitable to meet OPA and other U.S. environmental requirements and that they would also qualify for trade if chartered to serve U.S. ports.

#### European Union Regulations

In October 2009, the EU 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 if the discharges individually or in aggregate result in deterioration of the quality of water. Aiding and abetting the discharge of a polluting substance may also lead to criminal penalties. Member states were required to enact laws or regulations to comply with the directive by the end of 2010. Criminal liability for pollution may result in substantial



penalties or fines and increased civil liability claims. 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.

The EU has adopted several regulations and directives requiring, among other things, more frequent inspections of high-risk ships, as determined by type, age, flag, and the number of times the ship has been detained. The EU also adopted and then extended a ban on substandard ships and enacted a minimum ban period and a definitive ban for repeated offenses. The regulation also provided the EU 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.

## Greenhouse Gas Regulation

Currently, 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. The United Nations Convention on Climate Change conference held in Paris in 2015 resulted in the Paris Agreement, which entered into force on November 4, 2016, but this agreement does not directly limit greenhouse gas emissions for ships.

The IMO is planning to implement market-based mechanisms to reduce greenhouse gas emissions from ships at an upcoming MEPC session. The EU has indicated that it intends to propose an expansion of the existing EU emissions trading scheme to include emissions of greenhouse gases from marine vessels, and in January 2012 the EU launched a public consultation on possible measures to reduce greenhouse gas emissions from ships. In April 2015, a regulation was adopted requiring large ships (over 5,000 gross tons) calling at EU ports from January 2018 to collect and publish data on carbon dioxide emissions and other information. In the United States, the EPA has issued a finding that greenhouse gases endanger the public health and safety, and has adopted regulations to limit greenhouse gas emissions from certain mobile sources and large stationary sources. Although the mobile source emissions regulations do not apply to greenhouse gas emissions from vessels, such regulation of vessels is foreseeable, and the EPA has received petitions from the California Attorney General and various environmental groups seeking such regulation. Moreover, individual states in the United States can also enact environmental regulations. For example, California introduced caps for greenhouse gas emissions and towards the end of 2016, signaled that it may take additional actions regarding climate change. Any passage of climate control legislation or other regulatory initiatives adopted by the IMO, the EU, the United States or other countries where we operate, or any treaty adopted at the international level to succeed the Kyoto Protocol or the Paris Agreement, that restrict emissions of greenhouse gases could require us to make significant financial expenditures, including capital expenditures to upgrade our vessels, which we cannot predict with certainty at this time.

## International Labour Organization

The International Labour Organization, which is a specialized agency of the United Nations, has adopted the Maritime Labour Convention 2006, or the MLC 2006. A Maritime Labour Certificate and a Declaration of Maritime Labour Compliance are required to ensure compliance with the MLC 2006 for all ships above 500 gross tons in international trade. The MLC 2006 entered into force on August 20, 2013, and amendments to it were adopted in 2014 and 2016. The MLC 2006 requires us to develop new procedures to ensure full compliance with its requirements. Our Protection & Indemnity Clubs have, with effect from August 20, 2013, amended their insurance policies to cover elements from MLC 2006, including but not limited to the repatriation of crew and other crew social security provisions.

## 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 MARPOL limits on sulfur oxide and nitrogen oxide emissions, chlorofluorocarbons, and the discharge of other air pollutants, except that the MARPOL limits do not apply to emissions that are directly related to drilling, production, or processing activities.

Our drilling units are subject not only to MARPOL regulation of air emissions, but also to 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, other than discharges related to drilling.

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. It is presently unclear how long this ban will remain in effect. A ban on new drilling in Canadian Arctic waters was announced simultaneously. 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.

#### Vessel Security Regulations

Since the terrorist attacks of September 11, 2001, there have been a variety of initiatives intended to enhance vessel security. On November 25, 2002, the U.S. Maritime Transportation Security Act of 2002, or MTSA, came into effect. To implement certain portions of the MTSA, in July 2003 the USCG issued regulations requiring the implementation of certain security requirements aboard vessels operating in waters subject to the jurisdiction of the United States. The regulations also impose requirements on certain ports and facilities, some of which are regulated by the EPA.

Similarly, in December 2002, amendments to SOLAS created a new chapter of the convention dealing specifically with maritime security. The new Chapter XI-2 became effective in July 2004 and imposes various detailed security obligations on vessels and port authorities, and mandates compliance with the International Ship and Port Facility Security Code, or 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, or ISSC, from a recognized security organization approved by the vessel's flag state. Among the various requirements, some of which are found in SOLAS, are:

- 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.

A ship operating without a valid certificate may be detained at port until it obtains an ISSC, or it may be expelled from port or refused entry.

The USCG, intended to align with international maritime security standards, exempts from MTSA vessel security measures those non-U.S. vessels that have on board a valid ISSC attesting to the vessel's compliance with SOLAS security requirements and the ISPS Code.

We have implemented the various security measures addressed by MTSA, SOLAS and the ISPS Code, and our fleet is in compliance with applicable security requirements.

### Inspection by Classification Societies

Classification Societies are independent organizations that establish and apply technical standards in relation to the design, construction and survey of marine facilities including ships and offshore structures. Every ocean-going vessel must be "classed" by a classification society. The classification society certifies that the vessel is "in class", signifying that the vessel has been built and maintained in accordance with the rules of the classification society and complies with applicable rules and regulations of the vessel's country of registry and the international conventions of which that country is a member. In addition, where surveys are required by international conventions and corresponding laws and ordinances of a flag state, the classification society will undertake them on application or by official order, acting on behalf of the authorities concerned.

The classification society also undertakes on request other surveys and checks that are required by regulations and requirements of the flag state. These surveys are subject to agreements made in each individual case and/or to the regulations of the country concerned.

For maintenance of the class certification, regular and extraordinary surveys of hull and machinery, including the electrical plant and any special equipment classed, are required to be performed as follows:

**Annual Surveys:** For seagoing ships, annual surveys are conducted for the hull and the machinery, including the electrical plant, and where applicable for special equipment classed, within three months before or after each anniversary of the date of commencement of the class period indicated in the certificate.

**Intermediate Surveys:** Extended annual surveys are referred to as intermediate surveys and typically are conducted thirty months after commissioning and each class renewal. Intermediate surveys are to be carried out at or between the occasion of the second or third annual survey.

**Class Renewal Surveys:** Class renewal surveys, also known as special surveys, are carried out for the ship's hull, machinery, including the electrical plant, and for any special equipment classed, at the intervals indicated by the character of classification for the hull. At the special survey the vessel is thoroughly examined, including audio-gauging to determine the thickness of the steel structures. Should the thickness be found to be less than class requirements, the classification society would prescribe steel renewals. The classification society may grant a one year grace period for completion of the special survey. Substantial amounts of money may have to be spent for steel renewals to pass a special survey if the vessel experiences excessive wear and tear. In lieu of the special survey every four or five years, depending on whether a grace period was granted, a vessel owner has the option of arranging with the classification society for the vessel's hull or machinery to be on a continuous survey cycle, in which every part of the vessel would be surveyed within a five-year cycle. Upon a vessel-owner's request, the surveys required for class renewal may be split according to an agreed schedule to extend over the entire period of class. This process is referred to as continuous class renewal.

All areas subject to survey as defined by the classification society are required to be surveyed at least once per class period, unless shorter intervals between surveys are prescribed elsewhere. The period between two subsequent surveys of each area must not exceed five years.

### Seasonality

Most 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 Deep Sea 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 seven Handysize dry bulk carriers trading in the spot 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.

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## D. PROPERTY, PLANTS AND EQUIPMENT

We own a substantially modern fleet of vessels. The following table sets forth the fleet that we own, charter-in or have contracted for delivery as of April 13, 2017. All of the VLCCs, Suezmaxes, product tankers and chemical tankers are double-hull vessels.

Vessel	Approximate Built	Dwt.	Flag	Lease Classification	Charter Termination Date	
<b>VLCCs</b>						
Front Circassia	1999	306,000	MI	Capital lease	2021	
Front Scilla	2000	303,000	MI	Capital lease	2023	
Front Ariake	2001	299,000	BA	Capital lease	2023	
Front Serenade	2002	299,000	LIB	Capital lease	2024	
Front Hakata	2002	298,500	BA	Capital lease	2025	
Front Stratus	2002	299,000	LIB	Capital lease	2025	
Front Falcon	2002	309,000	BA	Capital lease	2025	
Front Page	2002	299,000	LIB	Capital lease	2025	
Front Energy	2004	305,000	MI	Capital lease	2027	
Front Force	2004	305,000	MI	Capital lease	2027	
<b>Suezmaxes</b>						
Front Ardenne	1997	153,000	MI	Capital lease	2020	
Front Brabant	1998	153,000	MI	Capital lease	2021	
Glorycrown	2009	156,000	MI	n/a	n/a	(4)
Everbright	2010	156,000	MI	n/a	2018	(4)
<b>Product Tankers</b>						
Hull 5015 (NB)	2017	114,000	MI	n/a	2024	
Hull 5016 (NB)	2017	114,000	MI	n/a	2024	
<b>Chemical Tankers</b>						
Maria Victoria V	2008	17,000	PAN	Operating lease	2018	(1)
SC Guangzhou	2008	17,000	PAN	Operating lease	2018	(1)
<b>Capesize Dry Bulk Carriers</b>						
Belgravia	2009	170,000	MI	Operating lease	2025	(1)
Battersea	2009	170,000	MI	Operating lease	2025	(1)
Golden Magnum	2009	180,000	HK	Operating lease	2025	(1)
Golden Beijing	2010	176,000	HK	Operating lease	2025	(1)
Golden Future	2010	176,000	HK	Operating lease	2025	(1)
Golden Zhejiang	2010	176,000	HK	Operating lease	2025	(1)
Golden Zhoushan	2011	176,000	HK	Operating lease	2025	(1)
KSL China	2013	180,000	MI	Operating lease	2025	(1)
<b>Kamsarmax Dry Bulk Carriers</b>						
Sinochart Beijing	2012	82,000	HK	Operating lease	2022	
Min Sheng 1	2012	82,000	HK	Operating lease	2022	





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Handysize Dry Bulk Carriers

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)

Supramax Dry Bulk Carriers

SFL Hudson	2009	57,000	MI	Operating lease	2020
SFL Yukon	2010	57,000	HK	Operating lease	2018
SFL Sara	2011	57,000	HK	Operating lease	2019
SFL Kate	2011	57,000	HK	Operating lease	2021
SFL Humber	2012	57,000	HK	Operating lease	2022

Container vessels

MSC Margarita	2001	5,800	TEU LIB	Operating lease	2019(1)
MSC Vidhi	2002	5,800	TEU LIB	Operating lease	2019(1)
MSC Vaishnavi R.	2002	4,100	TEU LIB	Operating lease	2019(1)
MSC Julia R.	2002	4,100	TEU LIB	Operating lease	2019(1)
MSC Arushi R.	2002	4,100	TEU LIB	Operating lease	2019(1)
MSC Katya R.	2002	4,100	TEU LIB	Operating lease	2019(1)
MSC Anisha R.	2002	4,100	TEU LIB	Operating lease	2020(1)
MSC Vidisha R.	2002	4,100	TEU LIB	Operating lease	2020(1)
MSC Zlata R.	2002	4,100	TEU LIB	Operating lease	2020(1)
SFL Europa	2003	1,700	TEU MI	n/a	n/a (7)
Heung-A Green	2005	1,700	TEU MAL	Operating lease	2020(1)
Green Ace	2005	1,700	TEU MAL	Operating lease	2020(1)
SFL Avon	2010	1,700	TEU MI	n/a	n/a (4)
San Felipe	2014	8,700	TEU MI	Operating lease	2021
San Felix	2014	8,700	TEU MI		2021

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					Operating lease	
San Fernando	2015	8,700	TEU	MI	Operating lease	2022
San Francisca	2015	8,700	TEU	MI	Operating lease	2022
Maersk Sarat	2015	9,500	TEU	LIB	Operating lease	2020
Maersk Skarstind	2016	9,500	TEU	LIB	Operating lease	2021
Maersk Shivling	2016	9,300	TEU	LIB	Operating lease	2021
MSC Anna	2016	19,200	TEU	LIB	Capital lease	2031 (5)
MSC Viviana	2017	19,200	TEU	LIB	Capital lease	2032 (5)
Car Carriers						
Glovis Composer	2005	6,500	CEU	HK	Operating lease	2017
Glovis Conductor	2006	6,500	CEU	PAN	Operating lease	2017
Jack-Up Drilling Rigs						
Soehanah	2007	375	ft.	PAN	n/a	(6)
West Linus	2014	450	ft.	NOR	Capital lease	2029 (1)

Ultra-Deepwater Drill Units

West Hercules	2008	10,000ft.	PAN	Capital lease	2023(1)
West Taurus	2008	10,000ft.	PAN	Capital lease	2023(1)

Offshore support vessels

Sea Leopard	1998	AHTS (2)	CYP	Capital lease	2023(1)
Sea Cheetah	2007	AHTS (2)	CYP	Operating lease	2022(1)
Sea Jaguar	2007	AHTS (2)	CYP	Operating lease	2022(1)
Sea Halibut	2007	PSV (3)	CYP	Operating lease	2022(1)
Sea Pike	2007	PSV (3)	CYP	Operating lease	2022(1)

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

Notes:

- (1)Charterer has purchase options during the term of the charter.
- (2)Anchor handling tug supply vessel (AHTS).
- (3)Platform supply vessel (PSV).
- (4) Currently employed on a short-term charter, trading in the spot market, or idle and being marketed for a new charter.
- (5)Vessel chartered-in.  
The charter for the jack-up drilling rig Soehanah has been canceled and the vessel is currently being marketed for new charters in South-East Asia and the Middle East. The rig was redelivered to us from the previous charterer, PT Apexindo Pratama Duta TBK, or Apexindo, in April 2017, following completion of a special periodic survey. The
- (6) Company received a \$6 million non-amortizing loan note from Apexindo which bears an interest rate of 2.25% per annum if paid in cash and 4.5% per annum if capitalized. The loan note has a term of approximately six years and became effective upon the redelivery of the rig to the Company.
- (7) The SFL Europa was detained in the port of Chittagong, Bangladesh, in November 2016 due to monies owed to the port by the previous charterer Hanjin Shipping, but has now been released and is being marketed for a new charter.

Substantially, all of the above vessels and rigs are pledged under mortgages, excluding three of the 1,700 TEU container vessels, the jack-up drilling rig Soehanah, the newbuilding vessels not yet delivered and the two chartered-in 19,200 TEU container vessels.

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.

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 one chartered-in 19,200 TEU container vessel:

Vessel type	Total fleet December 31, 2014	Additions/ Disposals 2015	Total fleet December 31, 2015	Additions/ Disposals 2016	Total fleet December 31, 2016
Oil Tankers	19	-3	16	-1	15
Chemical tankers	2		2		2
Dry bulk carriers	14	+8	22		22
Container vessels	20	+3 -5	18	+3	21
Car carriers	2		2		2
Jack-up drilling rigs	2		2		2
Ultra-deepwater drill units	2		2		2
Offshore support vessels	6		6	-1	5
<b>Total Active Fleet</b>	<b>67</b>	<b>+11 -8</b>	<b>70</b>	<b>+3 -2</b>	<b>71</b>

The following deliveries have taken place or are scheduled to take place after December 31, 2016:

- The VLCC Front Century was delivered to its new owner in March 2017.
- A second chartered-in newbuilding 19,200 TEU container vessel was delivered to us in March 2017.
- Two newbuilding oil product tankers are scheduled for delivery to us in 2017.

## 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 Deep Sea Charterer, including the previous arrangement with the Frontline Charterers whereby during the period of the temporary reduction in charter rates they paid us 100% of any earnings above the temporarily reduced rates, subject to a maximum of \$6,500 per day (see Revenues below);
- 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 expenses;
- administrative expenses;
- interest expenses; and
- mark-to-market adjustments to the valuation of our interest rate swaps and other derivative financial instruments.

## Revenues

Our revenues derive primarily from our long-term, fixed-rate charters. The vessels that we acquired from Frontline are chartered to Frontline Shipping under long-term time charters that are generally accounted for as direct financing leases. On December 30, 2011, amendments were made to the charter agreements with the Frontline Charterers relating to 28 double-hull tanker vessels, all of which were accounted for as direct financing leases. Four of these vessels were sold in 2012, another four were sold in 2013, and a further three sold in 2014. In terms of the amended agreements, we received a compensation payment of \$106 million and agreed to a \$6,500 per day reduction in the time charter rate for each vessel for the four year period from January 1, 2012, to December 31, 2015. Thereafter, the charter rates were to revert to the previously agreed daily amounts. The leases were amended to reflect the compensation payment received and the reduction in future minimum lease payments to be received. The amendments affected direct financing lease interest income from January 1, 2012, onwards.

On June 5, 2015, further amendments were made to the charter agreements with the Frontline Charterers, relating to the 17 remaining vessels, which following the amendments are all chartered to Frontline Shipping. The amendments, which were effective from July 1, 2015, and did not affect the duration of the charters, 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, we received 55 million ordinary shares in Frontline, the fair value of which amounted to \$150.2 million. The leases were again amended to reflect the compensation payment received and the reduction in future minimum lease payments to be received. The amendments affect direct financing lease interest income from July 1, 2015, onwards. Three of the vessels were sold in 2015, one was sold in 2016 and a further one was sold in March 2017.

Direct financing and sales-type lease interest income reduces over the terms of our leases as progressively a lesser proportion of the lease rental payment is allocated as lease interest income, and a higher amount is treated as repayment of the lease.

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, 2016, 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.

We have profit sharing agreements with some of our charterers, in particular with Frontline Shipping, the Golden Ocean Charterer, and the Deep Sea 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. Prior to December 31, 2011, the Frontline Charterers paid the Company a profit sharing rate of 20% of their earnings above average threshold charter rates on a time-charter equivalent basis from their use of the Company's fleet each fiscal year. The amendments to the charter agreements made on December 30, 2011, increased the profit sharing percentage to 25% for earnings above those threshold levels. Additionally, the amendments provided that during the four year period of the temporary reduction in charter rates, the Frontline Charterers would pay the Company 100% of any earnings on a time-charter equivalent basis above the temporarily reduced time charter rates, subject to a maximum of \$6,500 per day. Of the \$106 million compensation payment received, \$50 million represented a non-refundable advance on profit sharing earnings relating to the 25% profit sharing agreement which took effect on January 1, 2012. The further amendments to the charter agreements effective from July 1, 2015, increased the profit sharing percentage from 25% to 50% of earnings above the new reduced 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 Deep Sea 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 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. This daily fee has been payable since July 1, 2015, when the amendments to the charter agreements became effective, before which the fixed daily fee was \$6,500. 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 Group Management, a wholly-owned subsidiary of Golden Ocean, for all technical management of the vessels.



In addition to the vessels on charter to Frontline Shipping and the Golden Ocean Charterer, we also have seven container vessels, seven dry bulk carriers, two car carriers and one Suezmax tanker employed on time charters, and one Suezmax tanker and seven dry bulk carriers employed in the spot market. We have outsourced the technical management for these vessels and we pay operating expenses for the vessels as they are incurred. 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 3.25% and 5.75% senior unsecured convertible bonds, and our NOK600 million and NOK900 million senior unsecured 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.

#### 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

Revenues are generated from time charter and bareboat charter hires, profit sharing arrangements and voyage freight billings, and are recognized on an accrual basis. Each charter agreement is evaluated and classified as an operating lease or a capital lease (see Leases below). Rental receipts from operating leases are recognized in income over the period to which the payment relates. Voyage revenues are recognized ratably over the estimated length of each voyage, and accordingly are allocated between reporting periods based on the relative transit time in each period. Voyage expenses are recognized as incurred. Probable losses on voyages are provided for in full at the time such losses can be estimated.

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.

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

Prior to December 31, 2011, the Frontline Charterers paid the Company a profit sharing rate of 20% of their earnings above average threshold charter rates on a time-charter equivalent basis from their use of the Company's fleet each fiscal year. 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. Starting on January 1, 2012, amendments to the charter agreements increased the profit sharing percentage to 25% for earnings above those threshold levels. Additionally, those amendments provided that during the four year period of the temporary reduction in charter rates, the Frontline Charterers would pay the Company 100% of any earnings on a time-charter equivalent basis above the temporarily reduced time charter rates, subject to a maximum of \$6,500 per day. Under the terms of the amendments to the charter agreements, we received a compensation payment of \$106 million, of which \$50 million represented a non-refundable advance relating to the 25% profit sharing agreement. In 2015, further amendments were made to the charter agreements reducing the charter rates and increasing the profit sharing percentage to 50% for earnings above the new time-charter rates with effect from July 1, 2015. The Company did not recognize any income under the 25% profit sharing agreement, as the cumulative share of earnings did not attain the starting level of \$50 million over the three and a half years of the agreement's duration. The new 50% profit sharing agreement with Frontline Shipping is not subject to any such constraints, and is payable on a quarterly basis.

In the third quarter of 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 each vessel's earnings above average threshold charter rates, calculated quarterly on a time-charter equivalent basis.

In September 2016, the charter agreements relating to five offshore support vessels chartered to the Deep Sea Charterer on a bareboat basis were amended and restated, including provisions whereby we will receive a profit sharing rate of 50% of each vessels' 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.

#### Available-for-sale securities

Available-for-sale securities held by the Company consist of share investments and interest-earning listed and unlisted corporate bonds. Any premium paid on their acquisition is amortized over the life of the bond.

Available-for-sale securities are recorded at fair value, with unrealized gains and losses recorded as a separate component of other comprehensive income. 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.

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

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.

## Leases

Leases (charters) of our vessels where we are the lessor are classified as either operating leases or capital leases, based on an assessment of the terms of the lease. For charters classified as capital 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 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 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 values 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, as defined in ASC Topic 840-10-20. 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 capital 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, 2012, reviews of the carrying value of long-lived assets indicated that the Company's long-term investments in shares in a container vessel owner/operator and warrants to purchase shares in a U.S. company were impaired, and charges were taken against these assets. No impairment charge was required in 2013. In the year ended December 31, 2014, reviews of the carrying value of long-lived assets indicated that five 2,800 TEU container vessels were impaired, and charges were taken against these assets. In the year ended December 31, 2015, reviews of the carrying value of long-lived assets indicated that two offshore support vessels and two container vessels were impaired, and charges were taken against these assets. 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.

#### 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, 2016, we owned 70 vessels and rigs, and had contracted to acquire a further two newbuilding oil product tankers. Taking into account the \$76 million scheduled remaining payments for the newbuildings, and

including the two ultra-deepwater drilling units and the harsh-environment jack-up drilling rig which are owned by equity accounted subsidiaries and the VLCC which is held for sale, the aggregate carrying value of these 72 assets at December 31, 2016, was \$3.5 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 owned vessels	Aggregate carrying value at December 31, 2016 (\$ millions)
Tanker vessels (1)	19	651
Dry bulk carriers (2)	22	601
Liners (3)	22	846
Offshore units (4)	9	1,391
	72	3,489

Includes 18 vessels with an aggregate carrying value of \$627 million, which we believe exceeds their aggregate (1) charter-free market value by approximately \$123 million, and one vessel classified as held for sale and carried at net realizable value.

(2) Includes 22 vessels with an aggregate carrying value of \$601 million, which we believe exceeds their aggregate charter-free market value by approximately \$279 million.

Includes 19 vessels with an aggregate carrying value of \$782 million, which we believe exceeds their aggregate (3) charter-free market value by approximately \$141 million, and 3 vessels with an aggregate carrying value of \$64 million, which we believe is approximately \$15 million less than their aggregate charter-free market value.

Includes 6 vessels with an aggregate carrying value of \$582 million, which we believe exceeds their aggregate (4) charter-free market value by approximately \$83 million, and 3 vessels with an aggregate carrying value of \$809 million, which we believe is approximately \$115 million less than their aggregate charter-free market value.

The above aggregate carrying value of \$3,489 million at December 31, 2016, is made up of (a) \$411 million investments in capital leases (excluding the chartered-in container vessel MSC Anna), (b) \$1,737 million vessels and equipment, (c) \$33 million newbuildings, (d) \$76 million cost to complete newbuildings (e) \$24 million asset held for sale and (f) \$1,208 million carrying value of two ultra-deepwater drilling units and one jack-up drilling rig owned by equity accounted subsidiaries.

#### 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 May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 "Revenue from Contracts with Customers" which will replace almost all existing revenue recognition guidance in U.S. GAAP and is intended to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. The core principle of ASU 2014-09 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. ASU 2014-09 was effective for reporting periods and interim periods beginning on or after December 15, 2016. In August 2015, the FASB issued ASU 2015-14 "Deferral of the Effective Date" to delay the implementation of ASU 2014-09 by one year, in response to feedback from preparers, practitioners and users of financial statements. Accordingly, ASU 2014-09 is now effective for reporting periods and interim periods beginning on or after December 15, 2017. The Company is in the process of considering the impact of the standard on its consolidated financial statements and expects to complete the assessment during fiscal year 2017. For vessels operating on voyage charters, we expect to continue recognizing revenue over time. The time period over which revenue will be recognized is still being determined and, depending on the final conclusion, each period's voyage results could differ materially from the same period's voyage results recognized based on the present revenue recognition guidance. However, the total voyage results recognized over all periods would not change. The adoption of the standard is not expected to have a material impact on other income, primarily income earned from the commercial management of related party and third party vessels and newbuilding supervision fees derived from related parties and third parties.

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 is effective for fiscal years and interim periods beginning after December 15, 2017. Early adoption is only permitted for certain particular amendments within ASU 2016-01, where financial statements have not yet been issued. ASU 2016-01 will require the Company to recognize any changes in the fair value of certain equity investments in net income. These changes are currently recognized in other comprehensive income.

In February 2016, the FASB issued 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 ASU 2014-09 (see above). ASU 2016-02 is effective for fiscal years and interim periods beginning after December 15, 2018. Early adoption is permitted. The Company is currently assessing the impact of ASU 2016-02 on its consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU 2016-07 "Investments - Equity Method and Joint Ventures" to simplify the transition to the equity method of accounting. ASU 2016-07 eliminates the requirement that when an investment qualifies for the use of the equity method as a result of an increase in the level of ownership, the investor must adjust the investment, results of operations and retained earnings retrospectively as if the equity method had been in effect during all previous periods in which the investment had been held. ASU 2016-07 is effective for fiscal years and interim periods beginning after December 15, 2016. 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 March 2016, the FASB issued ASU 2016-09 "Compensation - Stock Compensation" to introduce improvements to employee share-based payment accounting. ASU 2016-09 simplifies several aspects of the accounting for share-based payment award transactions, including the income tax consequences, the classification of awards as either equity or liabilities and the classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years and interim periods beginning after December 15, 2016. 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 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, the 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 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 Company is currently assessing the impact of ASU 2016-15 on its statement of consolidated 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 will be effective for the Company beginning January 1, 2018. The impact on the consolidated financial statements of the Company will depend on the facts and circumstances of any specific future transactions.

## Market Overview

### The Oil Tanker Market

In 2014 and 2015, the tanker freight rates experienced an increase from the low levels in 2013. This increase was abruptly halted in 2016. Spot charter rates for VLCCs averaged over \$100,000 per day in December 2015, the highest level since 2008, but by September 2016 had fallen to below \$17,000 per day as a result of significant capacity increases following delivery of newbuilding vessels. In December 2016, spot rates recovered to an average of \$54,000 per day.

Since 2013, global oil production has increased by more than 5%, average trading distances have increased and oil tankers are increasingly being used as floating storage. Overall, tonnage demand for tankers has increased by almost 7% from 2013 to 2016, with 4.5% of this growth occurring in 2016. However, on the supply side, crude oil tanker capacity has grown by more than 8% since 2013, with 6.5% of this in 2016. This increase in capacity relative to demand resulted in TCE rates for modern VLCCs and Suezmax tankers in 2016 averaging approximately \$33,000 and \$26,300 per day, respectively, lower by 20% and 23% than average rates in 2015. The reduction in rates was particularly pronounced during the summer, with a limited seasonal recovery experienced towards the end of the year.

According to industry sources, at the end of 2016 the total orderbook for new VLCCs and Suezmax tankers consisted, respectively, of 99 vessels and 87 vessels, representing approximately 14% and 17% of the existing fleet. These are lower levels than at the end of 2015, which were approximately 21% of the existing fleet at the time, reflecting relatively high levels of newbuilding orders placed in 2015, followed by low levels placed in 2016.

#### The Dry Bulk Shipping Market

The dry bulk shipping market experienced yet another difficult year in 2016, with average earnings at their lowest levels for sixteen years. Overall, industry sources indicate that fleet capacity increased by more than 2%, while tonnage demand for vessels registered growth of only 1%.

Accordingly, the market for dry bulk carriers continued to be depressed throughout 2016. The average one-year time charter rates for Capesize, Supramax and Handysize dry bulk carriers were, respectively, \$7,300 per day, \$6,000 per day and \$5,300 per day, representing decreases from 2015 of 27%, 21% and 21%, respectively.

During 2016, contracting for newbuilding dry bulk carriers decreased to 13 million dwt from 25 million dwt in 2015, while deliveries of new vessels amounted to 47 million dwt and scrapping removed some 29 million dwt. Thus, fleet capacity increased by 17 million dwt, equivalent to approximately 2% of the total fleet size. At the end of 2016, the total orderbook for new dry bulk carriers was 85 million dwt, equivalent to 11% of the existing fleet.

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

The container charter market experienced another weak year in 2016, with box freight rates and vessel charter rates remaining at historically depressed levels owing to continuing surplus capacity.

Although industry sources indicate that container trade increased by approximately 3% in 2016, new capacity of 0.9 million TEU was delivered and it required high levels of scrapping (0.7 million TEU) to restrict growth in capacity to around 1%, bringing overall fleet capacity to 20.0 million TEU. Significant overcapacity continues to affect the balance of supply and demand, and approximately 7% of the fleet was reported to be idle at the end of 2016, as was the situation at the end of 2015. Charter rates began 2016 at historically depressed levels and declined further during the first half of the year, although generally they appear to have stopped declining in the second half of the year.

Contracting for new container vessels in 2016 was extremely low with 0.2 million TEU, compared with 2.3 million TEU in 2015. At the end of the year, the ratio of outstanding orders to existing fleet capacity decreased to approximately 16% from almost 20% at the end of 2015.

The car carrier market was weaker in 2016 than in 2015, reflecting a decline in sea-borne vehicle trade and pressure from an oversupply of car carrier capacity. Although shipments to North America and Europe expanded moderately, there was a sharp decline of imports into developing countries, where low commodity prices have undermined consumer demand. Overall, the global sea-borne car trade is projected to have fallen by approximately 4% in 2016.

#### The Offshore Drilling Market

From 2011 to 2013, the oil price (Brent crude spot) averaged around \$110 per barrel, which was attractive to oil and gas companies and prompted them to substantially increase their investment in offshore exploration and development activity. This resulted in almost full utilization and record high day rates for mobile offshore drilling units in 2013, and prompted substantial contracting for new assets. 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 it has since recovered to a range of \$50 - \$55 per barrel. 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. Worldwide demand for drilling units has declined from 744 units at the end of 2013 to 431 units at the end of 2016, and asset utilizations have declined from 96% of the active supply at the end of 2013 to 64% at the end of 2016, while global average day rates have declined by more than 50% since 2013.

Industry sources indicate that no orders were placed for newbuilding drilling units in 2016 and that 127 units were cold-stacked at the end of 2016. With 61 new units scheduled to be delivered in 2017, it is clear that owners will have to adjust their fleets through delaying and cancellation of newbuildings and removals/scrapping of older units.

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, 2016, compared with year ended December 31, 2015

Net income for the year ended December 31, 2016, was \$146.4 million, a decrease of 27.1% from the year ended December 31, 2015.

(in thousands of \$)	2016	2015
Total operating revenues	412,951	406,740
Gain/(loss) on sale of assets	(167 )	7,364
Total operating expenses	(244,695)	(248,058)
Net operating income	168,089	166,046
Interest income	21,736	39,142
Interest expense	(71,843 )	(70,583 )
Other non-operating items (net)	659	32,622
Equity in earnings of associated companies	27,765	33,605
Net income	146,406	200,832

Net operating income in 2016 was \$2.0 million higher than in 2015, with the \$6.2 million increase in operating revenues (see below) and the \$3.4 million decrease in operating expenses (see below), largely offset by the net losses rather than gains on sale of vessels. However, lower interest income, other non-operating items (see below) and equity in earnings of associated companies, resulted in overall net income being \$54.4 million lower.

Three ultra-deepwater drilling units were accounted for under the equity method during 2016 and 2015. 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 \$)	2016	2015
Direct financing lease interest income	23,181	34,193
Finance lease service revenues	44,523	46,460
Profit sharing revenues	51,544	59,607
Time charter revenues	226,748	160,778
Bareboat charter revenues	45,039	68,015
Voyage charter revenues	19,329	35,783
Other operating income	2,587	1,904
Total operating revenues	412,951	406,740

Total operating revenues increased 1.5% in the year ended December 31, 2016, compared with the year ended December 31, 2015.

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. This contributed to the \$11.0 million decrease in lease interest income from 2015 to 2016. However, the decrease is, to a greater extent, due to the reduction in charter rates incorporated into the leases from July 2015 onwards (see Note 23: Related party transactions) and the sale in 2016 of the VLCC Front Vanguard and the offshore support vessel Sea Bear and in 2015 of three Suezmax tankers (Front Glory, Front Splendour and Mindanao). Apart from Sea Bear, which was bareboat chartered to Deep Sea, these direct financing lease assets were time-chartered to the Frontline Charterers. The container vessel MSC Anna, which is accounted for as a finance lease asset, was

delivered towards the end of December 2016, and made a small contribution to direct financing lease interest income in 2016.

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The reduction in finance lease service revenue associated with sales of time-chartered vessels in 2016 and 2015, as shown above, was largely offset by the increase in fixed vessel operating fees for the vessels on charter to Frontline Shipping from \$6,500 per day to \$9,000 per day from July 1, 2015 onwards (see Note 23).

Prior to December 31, 2011, the Frontline Charterers paid us profit sharing of 20% of their earnings from our vessels on a time-charter equivalent basis above average threshold charter rates each fiscal year. Amendments to the charter agreements made in December 2011, increased the profit sharing percentage to 25% for earnings above those threshold levels, and additionally provided that for the four year period of the temporary reduction in charter rates, the Frontline Charterers would pay us 100% of any earnings on a time-charter equivalent basis above the temporarily reduced time charter rates, subject to a maximum of \$6,500 per day per vessel - this latter item is called "cash sweep" income. Following further amendments to the charter agreements effective from July 1, 2015 onwards, the profit sharing percentage was increased to 50% payable on a quarterly basis and the cash sweep arrangement was terminated. In 2015 we earned \$19.9 million in cash sweep income, \$37.2 million under the 50% profit share arrangement and nothing under the 25% profit share arrangement. In 2016 we earned \$50.9 million under the 50% profit sharing agreement. We also had a profit sharing agreement relating to dry bulk carriers chartered to UFC, which earned us \$0.6 million in 2016, compared with \$2.5 million in 2015.

During 2015, time-charter revenues were earned by seven container vessels, 22 dry bulk carriers and two car carriers. In 2016, we took delivery of two additional container vessels operating under time-charters and the Suezmax tanker Everbright commenced time-charter operations, having previously operated in the spot market. The 41% increase in time-charter revenues from 2015 to 2016 is due to these three additional vessels in 2016, and a full year of income from the eight Capesize dry bulk carriers delivered in the second half of 2015 and the 9,500 TEU container vessel delivered in November 2015.

Bareboat charter revenues are earned by our vessels which are leased under operating leases on a bareboat basis. In both 2015 and 2016, these consisted of four offshore support vessels, two chemical tankers, 11 container vessels and one jack-up drilling rig. The \$23.0 million reduction in total bareboat revenues from 2015 to 2016 is due to no charter hire being received on the jack-up drilling rig since the first quarter of 2016 and agreed reductions in charter rates for the four offshore support vessels (see Note 23). Both of these adverse effects are the result of difficult trading conditions in the offshore market.

Two of our vessels, the Suezmax tankers Everbright and Glorycrown, were sold under sales-type lease agreements in 2010 and 2009, respectively. Following default by the purchaser, these vessels were returned to us in 2013, since when we have traded them both on a voyage charter basis, until Everbright commenced a two year time charter in January 2016. In addition, following the termination of their short-term charters, four handysize dry bulk carriers started operating on a voyage charter basis during 2016. The \$16.5 million reduction in voyage charter revenues from 2015 to 2016 is predominantly due to Everbright commencing its time charter in January 2016.

#### Cash flows arising from direct financing leases

The following table analyzes our cash flows from the direct financing leases with the Frontline Charterers, Deep Sea, and MSC during 2016 and 2015, and shows how they are accounted for:

(in thousands of \$)	2016	2015
Charterhire payments accounted for as:		
Direct financing and sales-type lease interest income	23,181	34,193
Finance lease service revenues	44,523	46,460
Direct financing lease repayments	30,410	35,946
Total direct financing and sales-type lease payments received	98,114	116,599

The vessels chartered on direct financing leases to Frontline Shipping, or the Frontline Charterers prior to July 1, 2015, 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 from July 1, 2015, onwards, before which the fee was \$6,500 per day for each vessel chartered to the Frontline Charterers. Accordingly, \$9,000 per day (previously \$6,500 per day) is allocated from each time charter payment received from Frontline Shipping (previously the Frontline Charterers) to cover lease executory costs, and this is classified as "finance lease service revenue". If any vessel chartered on direct financing leases 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.

## (Loss)/gain on sale of assets

In 2016, net losses totaling \$0.2 million were recorded on the disposal of the VLCC Front Vanguard and the offshore support vessel Sea Bear. In 2015 the gains totaling \$7.4 million were recorded on the disposal of three Suezmax tankers (Front Glory, Front Splendour and Mindanao) and five 2,800 TEU container vessels.

## Operating expenses

(in thousands of \$)	2016	2015
Vessel operating expenses	136,016	120,831
Depreciation	94,293	78,080
Vessel impairment charge	5,314	42,410
Administrative expenses	9,072	6,737
	244,695	248,058

Vessel operating expenses consist of payments to Frontline Management of \$9,000 per day (\$6,500 per day before July 1, 2015) for each vessel chartered to Frontline Shipping (the Frontline Charterers before July 1, 2015) and also payments to Golden Ocean Management of \$7,000 per day for each vessel chartered to the 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, car carriers and Suezmax tanker operated on a time-charter basis and managed by related and unrelated parties, and also voyage expenses for the Suezmax tanker and dry bulk carriers operating in the spot market.

Vessel operating expenses increased by 13% from 2015 to 2016, as a result of full year operating costs for the eight Capesize dry bulk carriers delivered in the second half of 2015, operating costs for five 8,700-9,500 TEU container vessels delivered in 2015 and 2016, and the agreed increase in fixed daily fees payable to Frontline Management from July 1, 2015, onwards, all partly offset by the sale of three Suezmax tankers and the disposal of five 2,800 TEU container vessels in 2015 and the sale of one VLCC in 2016.

Depreciation expenses relate to the vessels on charters accounted for as operating leases and on voyage charters. The increase from 2015 to 2016 is primarily due to the delivery of eight dry bulk carriers in the second half of 2015, the delivery of five 8,700-9,500 TEU container vessels in 2015 and 2016, partly offset by the disposal of five 2,800 TEU container vessels in 2015.

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 2015, an impairment charge was made against two of our offshore support vessels and two of our container vessels.

Administrative expenses were higher in 2016 compared with 2015 due mainly to increased salaries costs, marketing and investor relations costs and increased service administration fees.

## Interest income

Interest income decreased from \$39.1 million in 2015 to \$21.7 million in 2016, mainly due to the redemption in 2015 of Frontline loan notes, on which \$13.4 million of interest was received in 2015, and a \$5.3 million reduction in interest receivable on corporate bonds held as available-for-sale securities.



Interest expense (in thousands of \$)	2016	2015
Interest on US\$ floating rate loans	29,032	23,726
Interest on NOK floating rate bonds due 2017	4,152	4,628
Interest on NOK floating rate bonds due 2019	4,697	5,604
Interest on 3.75% convertible bonds due 2016	329	4,685
Interest on 3.25% convertible bonds due 2018	10,093	11,375
Interest on 5.75% convertible bonds due 2021	3,127	—
Swap interest	9,165	8,947
Capitalized lease interest	246	—
Other interest	30	5
Amortization of deferred charges	10,972	11,613
	71,843	70,583

At December 31, 2016, the Company and its consolidated subsidiaries had total debt outstanding of \$1.6 billion (2015: \$1.7 billion) comprised of \$65 million (NOK565 million) net outstanding principal amount of NOK floating rate bonds due 2017 (2015: \$64 million, NOK565 million), \$88 million (NOK758 million) net outstanding principal amount of NOK floating rate bonds due 2019 (2015: \$85 million, NOK758 million), \$nil net outstanding principal amount of 3.75% convertible bonds (2015: \$118 million), \$184 million net outstanding principal amount of 3.25% convertible bonds (2015: \$350 million), \$225 million net outstanding principal amount of 5.75% convertible bonds (2015: \$nil) and \$1.0 billion under floating rate secured long term credit facilities (2015: \$1.0 billion). The average three-month US\$ London Interbank Offered Rate, or LIBOR, was 0.74% in 2016 and 0.32% in 2015. Total interest expense in 2016 was \$1.3 million more than in 2015.

The decrease in interest payable on the NOK floating rate bonds due 2017 and 2019 is due to repurchases in 2015, which are being held as treasury bonds. The decrease in interest payable on the 3.75% convertible bonds is due to their redemption in February 2016. The decrease in interest payable on the 3.25% convertible bonds is due to repurchases in October 2016. The increase in interest payable on the 5.75% convertible bonds is due to their issue in October 2016.

In October 2015, we entered into agreements to charter in two newbuilding 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, the MSC Anna, was delivered towards the end of December 2016 and this vessel is accounted for as a direct financing lease asset. The above capitalized lease interest expense represents the lease interest portion of our charter payments on this vessel.

At December 31, 2016, the Company and its consolidated subsidiaries were party to interest rate swap contracts, which effectively fix our interest rates on \$1.2 billion of floating rate debt at a weighted average rate excluding margin of 2.74% per annum (2015: \$1.0 billion of floating rate debt fixed at a weighted average rate excluding margin of 3.02% per annum).

As reported above, three ultra-deepwater drilling units were accounted for under the equity method in 2016 and 2015. 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

Other non-operating items amounted to a net gain \$0.7 million in 2016 (2015: net gain of \$32.6 million). The net gain in 2016 consists of \$11.6 million dividend income received on our Frontline shares (held as available-for-sale securities) and \$4.4 million favorable mark-to-market valuation adjustments to non-designated interest rate swaps, largely offset by a loss of \$8.8 million on the repurchases of bonds, \$4.9 million cash payments on non-designated interest rate swaps and \$1.6 million other costs (mainly bank and loan commitment fees). The net gain in 2015 consisted of gains of \$44.6 million on the sale of loan notes in Horizon Lines, LLC and share warrants in Horizon Lines, Inc., \$28.9 million on the redemption of Frontline loan notes and \$1.0 million on purchases of our own bonds, offset by a \$20.6 million impairment loss on available-for-sale securities, a \$13.2 million adverse mark-to-market valuation adjustment to non-designated interest rate swaps, \$6.5 million cash payments on non-designated interest rate swaps and \$1.6 million other costs (mainly bank and loan commitment fees).

## Equity in earnings of associated companies

During 2015 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 16: Investment in associated companies). The total equity in earnings of associated companies in 2016 was \$5.8 million less than in 2015, due to the \$3.2 million reduction in earnings from the harsh environment jack-up drilling rig West Linus and the ultra-deepwater drilling units West Hercules and West Taurus, associated with reducing finance lease interest income and higher interest costs, and also the absence of income from Frontline, which contributed \$2.6 million during the period in 2015 when our shareholding was accounted for as an investment in associated companies.

## Year ended December 31, 2015, compared with year ended December 31, 2014

Net income for the year ended December 31, 2015, was \$200.8 million, an increase of 64% from the year ended December 31, 2014.

(in thousands of \$)	2015	2014
Total operating revenues	406,740	327,487
Gain/(loss) on sale of assets	7,364	(1,384 )
Gain on termination of charters	—	25,315
Total operating expenses	(248,058)	(206,272)
Net operating income	166,046	145,146
Interest income	39,142	40,451
Interest expense	(70,583 )	(86,081 )
Other non-operating items (net)	32,622	(10,198 )
Equity in earnings of associated companies	33,605	33,497
Net income	200,832	122,815

Net operating income in 2015 was \$20.9 million higher than in 2014, principally due to the \$79.3 million increase in operating revenues (see below), partly offset by the \$30.6 million increase in vessel impairment charges (see below) and the absence of gains on termination of charters. Net income was \$78.0 million higher, principally due to the increase in net operating income and the \$42.8 million improvement in other non-operating items (see below).

Four drilling units (one of which was a newbuilding delivered in February 2014 and one of which was sold in December 2014) and two container vessels chartered-in on bareboat charters (until the charters were terminated in the first quarter of 2014) were accounted for under the equity method during 2014, with the remaining three drilling units accounted for under the equity method in 2015. 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 \$)	2015	2014
Direct financing lease interest income	34,193	45,363
Finance lease service revenues	46,460	46,488
Profit sharing revenues	59,607	33,756
Time charter revenues	160,778	93,052
Bareboat charter revenues	68,015	69,771
Voyage charter revenues	35,783	34,608
Other operating income	1,904	4,449
Total operating revenues	406,740	327,487

Total operating revenues increased 24% in the year ended December 31, 2015, compared with 2014.

The \$11.2 million decrease in lease interest income from 2014 to 2015 is partly due to the inherent reduction over time in the amount of total lease receipts which are allocated to lease interest income, but also to reduced charter rates incorporated into the leases from July ,2015 onwards (see Note 23: Related party transactions) and the sale in 2015 of three Suezmax tankers (Front Glory, Front Splendour and Mindanao) and in 2014 of three VLCCs (Front Comanche, Front Commerce and Front Opalia), all of which were previously direct financing lease assets chartered to the Frontline Charterers.

The reduction in finance lease service revenue associated with the above sales of time-chartered vessels in 2015 and 2014, was offset by the increase in fixed vessel operating fees from \$6,500 per day to \$9,000 per day from July 1, 2015 onwards (see Note 23).

Prior to December 31, 2011, the Frontline Charterers paid us profit sharing of 20% of their earnings from our vessels on a time-charter equivalent basis above average threshold charter rates each fiscal year. Amendments to the charter agreements made in December 2011, increased the profit sharing percentage to 25% for earnings above those threshold levels, and additionally provided that for the four year period of the temporary reduction in charter rates, the Frontline Charterers would pay us 100% of any earnings on a time-charter equivalent basis above the temporarily reduced time charter rates, subject to a maximum of \$6,500 per day per vessel - this latter item is called "cash sweep" income. In 2014 we earned \$32.7 million under these arrangements, all of which was cash sweep income. Following further amendments to the charter agreements effective from July 1, 2015 onwards, the profit sharing percentage was increased to 50% and the cash sweep arrangement was terminated. In 2015 we earned \$19.9 million in cash sweep income, \$37.2 million under the 50% profit share arrangement and nothing under the 25% profit share arrangement. We also had a profit sharing agreement relating to five Handysize dry bulk carriers chartered to UFC in 2015, which earned us \$2.5 million, compared with \$1.1 million in 2014.

During 2014, time-charter revenues were earned by nine container vessels, 14 dry bulk carriers and two car carriers. In 2015, we disposed of five 2,800 TEU container vessels and took delivery of three additional 8,700-9,500 TEU container vessels and eight Capesize dry bulk carriers operating under time-charters. The 73% increase in time-charter revenues from 2014 to 2015 is due to these additional vessels delivered in 2015, and two 8,700 TEU container vessels delivered in the second half of 2014.

Bareboat charter revenues are earned by our vessels which are leased under operating leases on a bareboat basis. In both 2014 and 2015, these consisted of four offshore support vessels, two chemical tankers, one jack-up drilling rig, and 11 container vessels. Total bareboat revenues were more or less unchanged from 2014 to 2015.

The Suezmax tankers Everbright and Glorycrown operated on a voyage charter basis in 2014 and 2015, earning \$35.8 million in voyage charter revenues in 2015 (2014: \$34.6 million).

## Cash flows arising from direct financing leases

The following table analyzes our cash flows from the direct financing leases with the Frontline Charterers and Deep Sea during 2015 and 2014, and shows how they are accounted for:

(in thousands of \$)	2015	2014
Charterhire payments accounted for as:		
Direct financing and sales-type lease interest income	34,193	45,363
Finance lease service revenues	46,460	46,488
Direct financing and sales-type lease repayments	35,946	43,120
Total direct financing and sales-type lease payments received	116,599	134,971

## Gain/(loss) on sale of assets

In 2015, net gains totaling \$7.4 million were recorded on the disposal of three Suezmax tankers (Front Glory, Front Splendour and Mindanao) and five 2,800 TEU container vessels. In 2014, losses totaling \$1.4 million were recorded on the disposal of three VLCCs (Front Comanche, Front Commerce and Front Opalia).

## Gain on termination of charters

In 2014, compensation amounting to \$25.3 million was received in respect of the early termination of the time charters on four Handysize dry bulk carriers. The charters for these newbuilding vessels had been agreed in November 2010, with terms of five years from delivery from the yard. There was no gain on termination of charters in 2015.

## Operating expenses

(in thousands of \$)	2015	2014
Vessel operating expenses	120,831	119,470
Depreciation	78,080	67,393
Vessel impairment charge	42,410	11,800
Administrative expenses	6,737	7,609
	248,058	206,272

Vessel operating expenses increased by only 1% from 2014 to 2015. Although we took delivery of eight Capesize dry bulk carriers and three container vessels operating on time charters in 2015, and also agreed an increase in fixed daily fees payable to Frontline Management from July 1, 2015 onwards, which all served to increase vessel operating expenses, there were reductions elsewhere due to the disposal of tankers in 2014 and 2015 and also considerably lower operating and voyage expenses for the two tankers operating in the spot market.

The increase in depreciation from 2014 to 2015 is primarily due to the delivery in 2014 of two newbuilding container vessels and the delivery in 2015 of eight dry bulk carriers and three newbuilding container vessels, partly offset by the disposal of five container vessels in 2015.

During 2015, a review of the carrying value of long-lived assets indicated that the carrying values of two of our offshore support vessels and two of our container vessels were impaired and an impairment charge was taken. In 2014, an impairment charge was made against five 2,800 TEU container vessels.

Administrative expenses, which include salaries, office costs, and fees for professional and administrative services, were lower in 2015 than 2014, principally due to lower salary costs.

## Interest income

Interest income decreased from \$40.5 million in 2014 to \$39.1 million in 2015, mainly due to the absences in 2015 of \$6.5 million interest received in 2014 on the loans provided by the Company to SFL West Polaris Limited, or SFL West Polaris, which was sold in 2014, and of \$4.5 million interest received in 2014 on refunded shipyard instalment payments relating to four canceled newbuilding contracts, largely offset by a \$9.4 million increase in interest received on Frontline loan notes, additional notes having been received in November 2014 on the termination of the charters on three VLCCs.

## Interest expense

(in thousands of \$)	2015	2014
Interest on US\$ floating rate loans	23,726	25,163
Interest on NOK floating rate bonds due 2014	—	1,137
Interest on NOK floating rate bonds due 2017	4,628	6,094
Interest on NOK floating rate bonds due 2019	5,604	6,675
Interest on 3.75% convertible bonds due 2016	4,685	4,688
Interest on 3.25% convertible bonds due 2018	11,375	11,375
Swap interest	8,947	19,486
Other interest	5	192
Amortization of deferred charges	11,613	11,271
	70,583	86,081

At December 31, 2015, the Company and its consolidated subsidiaries had total debt outstanding of \$1.7 billion (2014: \$1.7 billion) comprised of \$64 million (NOK565 million) net outstanding principal amount of NOK floating rate bonds due 2017 (2014: \$76 million, NOK572 million), \$85 million (NOK758 million) net outstanding principal amount of NOK floating rate bonds due 2019 (2014: \$119 million, NOK892 million), \$118 million net outstanding principal amount of 3.75% convertible bonds (2014: \$125 million), \$350 million net outstanding principal amount of 3.25% convertible bonds (2014: \$350 million) and \$1.0 billion under floating rate secured long term credit facilities (2014: \$1.1 billion). The average three-month US\$ London Interbank Offered Rate, or LIBOR, was 0.32% in 2015 and 0.23% in 2014. Total interest expense in 2015 was \$15.5 million less than in 2014, mainly due to reduced swap interest.

The decrease in interest payable on the NOK floating rate bonds due 2014 is due to their redemption in April 2014. The decrease in interest payable on the NOK floating rate bonds due 2017 and 2019 is due to repurchases in 2015, which are being held as treasury bonds. The small decrease in interest payable on the 3.75% convertible bonds is due to repurchases in December 2015.

At December 31, 2015, the Company and its consolidated subsidiaries were party to interest rate swap contracts, which effectively fix our interest rates on \$1.0 billion of floating rate debt at a weighted average rate excluding margin of 3.02% per annum (2014: \$1.3 billion of floating rate debt fixed at a weighted average rate excluding margin of 3.41% per annum). The reductions in swap interest paid and the weighted average swap rate is substantially due to the termination of certain swaps with a fixed rate of 6%.

As reported above, four ultra-deepwater drilling units and two chartered-in container vessels were accounted for under the equity method in 2015 and 2014. 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

Other non-operating items amounted to a net gain \$32.6 million (2014: net loss of \$10.2 million). The net gain in 2015 consists of gains of \$44.6 million on the sale of loan notes in Horizon Lines, LLC and share warrants in Horizon Lines, Inc., \$28.9 million on the redemption of Frontline loan notes and \$1.0 million on purchases of our own bonds, offset by a \$20.6 million impairment loss on available-for-sale securities, a \$13.2 million adverse mark-to-market valuation adjustment to non-designated interest rate swaps, \$6.5 million cash payments on non-designated interest rate swaps and \$1.6 million other costs (mainly bank and loan commitment fees). The net loss in 2014 consists of \$7.7 million adverse mark-to-market valuation adjustments to non-designated interest rate swaps, \$7.2 million cash payments on non-designated interest rate swaps, \$1.4 million other costs, partly offset by a gain of \$6.1 million on disposal of investment in an associated company.

#### Equity in earnings of associated companies

During 2014 and 2015, the Company had certain wholly-owned subsidiaries accounted for under the equity method (see Note 16: Investment in associated companies). The total equity in earnings of associated companies in 2015 was more or less the same as in 2014, with the \$3.7 million increase in earnings from the newbuilding harsh environment jack-up drilling rig West Linus, delivered in February 2014, and the \$2.6 million share of net income from Frontline during the period in 2015 when it was an equity accounted associate, substantially offset by the \$4.6 million decrease in earnings from the drillship West Polaris, sold in December 2014, the \$0.9 million decrease in earnings from West Hercules and West Taurus, associated with reducing finance lease interest income, and the \$0.7 million decrease in earnings from two container vessels chartered in until the first quarter of 2014 (see Note 16).



## 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 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, 2016, substantially all of our vessels and drilling units are pledged as security. 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:

- 3.25% senior unsecured convertible bonds due 2018
- NOK600 million senior unsecured bonds due 2017
- NOK900 million senior unsecured bonds due 2019
- 5.75% senior unsecured convertible bonds due 2021
- \$53 million secured term loan facility due 2017
- \$49 million secured term loan and revolving credit facility due 2018
- \$54 million secured term loan facility due 2018
- \$250 million secured revolving credit facility due 2018
- \$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 2020
- \$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

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 2018
- \$375 million secured term loan and revolving credit facility due 2019
- \$475 million secured term loan and revolving credit facility due 2019

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, 2016, excluding three 1,700 TEU container vessels and a jack-up drilling rig.

At December 31, 2016, we had contractual commitments of \$76.1 million relating to agreements to acquire newbuildings. In addition, one subsidiary had a lease liability totaling \$122.4 million at December 31, 2016 related to the charter-in of a 19,200 TEU container vessel delivered in December 2016 and another subsidiary had contractual commitments totaling \$203.0 million at December 31, 2016 relating to agreements to charter-in a 19,200 TEU container vessel on a 15 year bareboat charter of which \$15.0 million represents the initial payment due on delivery of the vessel in 2017.

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, 2016, we had cash and cash equivalents of \$62 million (2015: \$70 million). In addition, we had \$204.6 million net available to draw under secured revolving credit facilities as of December 31, 2016. The availability of such amounts under the secured revolving credit facilities, which form a substantial part of our available liquidity, 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, 2016, we cannot guarantee that we will be in compliance in the future, and the amounts may therefore not be available to draw, substantially reducing our available liquidity. In the year ended December 31, 2016, we generated cash of \$230 million from operations and \$39 million net from investing activities and used \$277 million net in financing activities.

During the year ended December 31, 2016, we paid four dividends totaling \$1.80 per common share (2015: four dividends totaling \$1.74 per common share), or a total of \$168 million (2015: \$163 million). All dividends paid in 2016 and 2015 were cash payments. A substantial portion of our dividend capacity is generated from our leases with the Seadrill Charterers, and a renegotiation or termination of these leases as a result of Seadrill's potential comprehensive restructuring, may have a material adverse effect on our ability to pay dividends to our shareholders in the future.

### Borrowings

As of December 31, 2016, we had total short-term and long-term debt outstanding of \$1.6 billion (2015: \$1.7 billion). In addition, as of December 31, 2016, our wholly-owned 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 \$248 million, \$279 million, and \$356 million, respectively (2015: \$221 million, \$256 million and \$354 million, respectively). These three subsidiaries are accounted for using the equity method, as was our previously wholly-owned subsidiary SFL West Polaris 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, 2016:



(in millions of \$)	December 31, 2016	
	Outstanding balance on loan	Net amount available to draw
Unsecured borrowings:		
NOK600 million bonds due 2017	65.4	—
3.25% convertible bonds due 2018	184.2	—
NOK900 million bonds due 2019	87.8	—
5.75% convertible bonds due 2021	225.0	—
Total unsecured borrowings	562.4	—
Loan facilities secured with mortgages on vessels and rigs, including newbuildings	1,017.6	204.6
Total borrowings of Company and consolidated subsidiaries	1,580.0	204.6
Equity accounted subsidiaries: Loan facilities secured with mortgages on vessels and rigs	883.4	—
Total borrowings	2,463.4	204.6

As of December 31, 2016, there was \$204.6 million net available to draw under secured revolving credit facilities. The availability of such amounts under the secured revolving credit facilities, which form a substantial part of our available liquidity, 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, 2016, we cannot guarantee that we will be in compliance in the future, and the amounts may therefore not be available to draw, substantially reducing our available liquidity.

In March 2008, two subsidiaries entered into a \$49 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund the acquisition of two newbuilding chemical tankers. In June 2011, the facility was amended, whereby part of the facility is available on a revolving basis. In November 2015, the term loan part of the facility was prepaid and canceled, and the commitment under the revolving part of the facility was reduced to \$20 million in total. At December 31, 2016, the outstanding amount under this facility was \$nil, and the available amount under the revolving part of the facility was \$20 million. The facility bears interest of LIBOR plus a margin and has a term of ten years. The facility contains a minimum value covenant and is secured by the subsidiaries' assets. The lenders have limited recourse to Ship Finance International Limited as the holding company only guarantees 30% of the outstanding debt. The facility contains covenants that require us to maintain certain minimum levels of free cash and adjusted book equity ratios.

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, 2016, the amount outstanding under the facility was \$23 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, 2016, the amount outstanding under this facility was \$23 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 November 2010, two subsidiaries entered into a \$54 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund the acquisition of two Supramax dry bulk carriers. At December 31, 2016, the amount outstanding under this facility was \$30 million. The facility bears interest at LIBOR plus a margin and has a term of eight 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.

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, 2016, the amount outstanding under this facility was \$45 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 one 1,700 TEU container vessel and seven Handysize dry bulk carriers. At December 31, 2016, the amount outstanding under this facility was \$110 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 October 2012, we issued NOK600 million senior unsecured bonds. The bonds bear interest at the three month Norwegian Interbank Offered Rate, or NIBOR, plus a margin and are redeemable in full in October 2017. Subsequent to the issue of the bonds, we have made net purchases of bonds with principal amounts totaling NOK35 million, which are being held as treasury bonds. At December 31, 2016, the amount outstanding was NOK565 million, equivalent to \$65 million. The bonds may, in their entirety, be redeemed at our option from April 19, 2017, upon giving bondholders at least 30 business days notice and paying 100.50% of par value plus accrued interest.

In November 2012, two subsidiaries entered into a \$53 million secured term loan facility with a bank. The proceeds of the facility were used to partly fund the acquisition of two car carriers. At December 31, 2016, the outstanding amount under this facility was \$35 million. The facility bears interest at LIBOR plus a margin and has a term of five years from drawdown. 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 January 2013, we issued \$350 million senior unsecured convertible bonds due 2018. In October 2016, we made net purchases of bonds with principal amounts totaling \$166 million and at December 31, 2016, the amount outstanding was \$184 million. Interest on the bonds is fixed at 3.25% per annum. The bonds are convertible into our common shares at any time up to ten business days prior to February 1, 2018. The conversion price at the time of issuance was \$21.945 per share, representing a 33% premium on the share price at the time. Dividend distributions made since the issuance of the bonds have reduced the conversion price to \$14.3886 per share. In conjunction with the bond issue, we have loaned up to 6,060,606 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 lent by the Company were borrowed from Hemen Holding Ltd., our largest shareholder.

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, 2016, the amount outstanding was NOK758 million, equivalent to \$88 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.

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, 2016, the amount outstanding under this facility was \$36 million, and the available amount under the revolving part of the facility was \$9 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, 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, 2016, the amount outstanding under this facility is \$55 million. The facility bears interest at LIBOR plus a margin and has a term of approximately five years. 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. The facility also contains covenants that require Deep Sea to maintain certain minimum levels of liquidity, working capital, value adjusted equity and value adjusted equity ratios. One of the vessels was sold in February 2016 and the facility is now secured against the remaining five vessels.

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, 2016, the amount outstanding under this facility was \$20 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, 2016, the amount outstanding under this facility was \$109 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, 2016, the amount outstanding under this facility was \$113 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, 2016, the amount outstanding under this facility was \$32 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. Four of the tankers were sold and delivered to their new owners before December 31, 2016, and the facility was secured against the remaining 13 tankers at December 31, 2016. At December 31, 2016, the amount outstanding under this facility was \$40 million, and the amount available to draw was \$176 million. The facility bears interest at LIBOR plus a margin and has a term of three years. 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 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, 2016, the amount outstanding under this facility was \$146 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 other two were delivered in 2016. At December 31, 2016, the amount outstanding under this facility was \$200 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, all of which were outstanding at December 31, 2016. 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 58.0285, equivalent to a conversion price of approximately \$17.2329 per share. 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 Holding Ltd., our largest shareholder. In November 2016, the Company issued 8,000,000 new shares to replace the shares borrowed from Hemen Holding Ltd.

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, 2016, the amount outstanding under the facility was \$279 million, and the available amount under the revolving part of the facility was \$nil. The facility bears interest at LIBOR plus a margin, has a term of six years and is secured against the assets of SFL Hercules. The lenders have limited recourse to Ship Finance International Limited as the holding company only guarantees \$75 million of the debt. 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. The facility also contains 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, 2016, the amount outstanding under the new facility was \$248 million, and the available amount under the revolving part of the facility was \$nil. The facility bears interest at LIBOR plus a margin, has a term of five years and is secured against the assets of SFL Deepwater. The lenders have limited recourse to Ship Finance International Limited as the holding company only guarantees \$75 million of the debt. 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. The facility also contains 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, 2016, the amount outstanding under the facility was \$356 million, and the available amount under the revolving part of the facility was \$nil. The facility bears interest at LIBOR plus a margin, has a term of approximately five years and is secured against the subsidiary's assets. The lenders have limited recourse to Ship Finance International Limited as the holding company only guarantees \$90 million of the debt. 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. The facility also contains 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.

We were in compliance with all loan covenants as at December 31, 2016. Deep Sea and Seadrill were also in compliance with all applicable loan covenants in the facilities discussed above as at December 31, 2016. With Seadrill's potential comprehensive restructuring, there is a risk that the Company, and Seadrill, may not be in compliance with the applicable loan covenants in the future and we would not be able to make further borrowings under such facilities. A chapter 11 filing by Seadrill or the Seadrill Charterers could trigger an event of default under such facilities. At December 31, 2016, the three-month U.S. dollar LIBOR was 0.998% and the three-month Norwegian kroner NIBOR was 1.17%.

#### Minimum Value Covenants

Most of our loan facilities are secured with mortgages on vessels and rigs. At December 31, 2016, we had borrowings totaling \$1.2 billion with minimum value covenants which are tested on a regular basis, including \$0.9 billion borrowings in wholly-owned subsidiaries accounted for under the equity method. These borrowings were secured against 30 vessels and rigs which had combined charter-free market values totaling approximately \$1.9 billion. A reduction of 10% in charter-free market values in 2017 would not result in any material reduction in availability on revolving credit facilities, after scheduled loan repayments and prepayments in the year. In addition, at December 31, 2016, 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 23 vessels which had combined charter-free market values totaling approximately \$0.7 billion.

#### Derivatives

We use financial instruments to reduce the risk associated with fluctuations in interest rates. At December 31, 2016, the Company and its consolidated subsidiaries had entered into interest rate swap contracts with a combined notional principal amount of \$935 million, whereby variable LIBOR interest rates excluding additional margins are swapped for fixed interest rates between 0.80% per annum and 4.15% per annum. We had also entered into interest

rate/currency swap contracts, related to our bonds denominated in Norwegian kroner, with notional principal amounts of NOK600 million (\$105 million) and NOK900 million (\$151 million), respectively, whereby variable NIBOR interest rates including additional margin are swapped for fixed interest rates of 6.06% 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 NOK5.69 = \$1 and NOK5.96 = \$1, respectively. In addition, one equity-accounted subsidiary had entered into interest rate swaps with a combined notional principal amount of \$176 million at rates excluding margin of between 1.77% and 2.01% per annum. The overall effect of our swaps is to fix the interest rate on approximately \$1.4 billion of our floating rate debt, including equity accounted subsidiaries, at December 31, 2016, at a weighted average interest rate of 4.16% 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 2016, we issued a total of 36,575 new shares in order to satisfy options exercised by two officers and three employees of the Company. The exercise price of the options averaged \$12.11 per share, resulting in a premium on issue of \$0.2 million.

In November 2006, the Board of Directors approved a share option scheme, 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 (see consolidated financial statements Note 22: Share option plan). The additional paid-in capital arising from share options granted was \$0.4 million in 2016 (2015: \$nil).

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, \$93 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 November 2016, in conjunction with the Company's issue of a senior unsecured convertible bond loan totaling \$225 million (see below), 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.

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 bond, which was valued at \$21 million and recorded in 2013 as additional paid-in capital. In October 2016, we purchased and canceled bonds with principal amounts totaling \$166 million. The equity component of these extinguished bonds was valued at \$9 million and this amount was deducted from additional paid-in capital.

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 bond, which was valued at \$5 million and recorded as additional paid-in capital. .

Following the above transactions, as of December 31, 2016, our issued and fully paid share capital balance was \$1 million, our additional paid-in capital was \$283 million and our contributed surplus balance was \$681 million.

## Contractual Commitments

At December 31, 2016, we had the following contractual obligations and commitments:

	Payment due by period				Total
	Less than 1 year	1–3 years	3–5 years	After 5 years	
	(in millions of \$)				
NOK600 million senior unsecured bonds due 2017	65.4	—	—	—	65.4
3.25% unsecured convertible bonds due 2018	—	184.2	—	—	184.2
NOK900 million senior unsecured bonds due 2019	—	87.8	—	—	87.8
5.75% unsecured convertible bonds due 2021	—	—	225.0	—	225.0
Floating rate long-term debt	109.5	317.3	404.5	186.3	1,017.6
Floating rate long-term debt in unconsolidated subsidiaries	97.7	785.7	—	—	883.4
Total debt repayments	272.6	1,375.0	629.5	186.3	2,463.4
Total interest payments (1)	111.3	152.3	66.0	7.4	337.0
Total vessel purchases (2)	76.1	—	—	—	76.1
Capital lease obligations	3.6	8.2	9.4	101.2	122.4
Interest on capital lease obligations	8.9	16.9	15.7	50.8	92.3
Charter commitments (3)	25.0	25.0	25.1	127.9	203.0
Total contractual cash obligations	497.5	1,577.4	745.7	473.6	3,294.2

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 1.9370%, the five year NOK swap of 1.45% and the exchange rate of NOK8.5948 = \$1 as of April 11, 2017, plus agreed margins. Interest on fixed rate loans is calculated using the contracted interest rates.

(1) Interest rate swaps have not been included in the calculation.

(2) Vessel purchase commitments relate to two newbuilding oil product tankers scheduled for delivery in 2017. Charter commitments relate to the agreement to charter-in a 19,200 TEU newbuilding container vessel on 15 year bareboat charters, with payments commencing on delivery of the vessel. The vessel was delivered in March 2017 and has been chartered-out on a 15 year charter.

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.

## Trend information

Vessel prices have generally declined since their peak in 2008, and newbuilding prices remain low by historical standards. Prices for second-hand vessels remained at low levels for most of 2016, with prices for modern second-hand oil tankers and container vessels decreasing, while dry bulk vessel prices remained steady at very low levels.

The oil tanker market started a cyclical upswing 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. It is expected that this imbalance will be repeated in 2017, since capacity is projected to increase by more than 5% while demand is projected to increase by less than 1%. Thereafter, the historically low levels of newbuilding orders in 2016 are expected to lead to much firmer market fundamentals. The main factor that could improve the outlook for the tanker market is a sustained higher level of growth in the world economy and, although confidence in the short-term outlook is currently fragile, it is expected that the current low oil price will encourage growth in demand while it persists. 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 daily rates from our vessels that exceed certain levels. If rates for vessels chartered on the spot market increase, our profit sharing revenues will likewise increase for those vessels operated by Frontline Shipping in the spot market. We also have one Suezmax tanker currently employed in the spot market, which will benefit directly from any strength in spot charter rates.

For dry bulk carriers, 2016 was even weaker than 2015, with charter rates and asset values at all-time lows. Capacity supply continued to grow well in excess of demand. Charter rates are expected to remain at very low levels in 2017, with both fleet capacity and demand forecast to increase by around 2%. Although dry bulk trade has increased at an average rate in excess of 4% per annum over the past ten years, fleet capacity has grown by more than 8% per annum over the same period, as expectations of growth in China and other developing countries, coupled with optimism over the speed of economic recovery in Europe, led to excessive ordering from shipyards. China accounts for a substantial proportion of world tonnage demand, and the market for 2017 will depend critically on China's economic growth rate, which in turn is significantly dependent on worldwide economic growth.

Charter rates for container vessels remained at low levels throughout 2016. With capacity growth in 2017 predicted to be approximately 3% and growth in demand expected to be around 4%, surplus capacity is expected to persist and result in 2017 being another difficult year for the containership industry. Again, it is a return to higher economic growth rates which is needed before demand levels can rise sufficiently to reduce the current excess capacity and enable charter rates to increase. In this regard, there is particular uncertainty over how both "Brexit" and the trade policies of the recently inaugurated President Trump will affect patterns of world trade.

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 past three years, and are expected to continue declining in 2017. Many offshore exploration activities are not viable at the current price of between \$50 and \$55 per barrel, and if the price stays at this level it is inevitable that demand and day rates for drilling units will continue to decline. As a result, some owners/operators of drilling units have experienced financial difficulties in the past year, including breaking banking covenants and restructuring, and this is expected to continue. Three of our drilling units are employed under leases with the Seadrill Charterers, fully guaranteed by Seadrill. With the severe downturn in the demand for drilling units and Seadrill's potential comprehensive restructuring, there is a significant risk that the leases with the Seadrill Charterers will be renegotiated at lower levels, or terminated. A significant portion of our net income and operating cash flows are generated from our leases with the Seadrill Charterers, and a renegotiation or termination of these leases may have a material adverse effect on our revenues, profitability and liquidity. Nevertheless, it is thought that the price of oil will have to increase over the coming years, and stabilize at a level which will encourage the replacement of reserves and enable OPEC countries to generate more revenue.

Interest rates have been at historically low levels since 2009, although indications are that U.S. dollar interest rates may continue the slow and moderate increase which began in 2016. We have effectively hedged most of our interest exposure on our floating rate debt through swap agreements with banks. 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.

Off balance sheet arrangements

At December 31, 2016, we were not party to any arrangements which may be considered to be off balance sheet arrangements.

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ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. DIRECTORS AND SENIOR MANAGEMENT

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

Name	Age	Position
Hans Petter Aas	71	Director, Chairman of the Board and Audit Committee member
Kate Blankenship	52	Director of the Company and Chairperson of the Audit Committee
Paul Leand	51	Director of the Company
Harald Thorstein	37	Director of the Company
Bert Bekker	78	Director of the Company
Gary Vogel	51	Director of the Company
Ole B. Hjertaker	50	Chief Executive Officer of Ship Finance Management AS
Harald Gurvin	42	Chief Financial Officer of Ship Finance 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 executive officers is set forth below.

Hans Petter Aas has served as a director of the Company since August 2008 and as Chairman of the Board since January 2009. He has served on the Audit Committee since 2010. Mr. Aas has a long career as banker in the international shipping and offshore market, and retired from his position as Global Head of the Shipping, Offshore and Logistics Division of DnB NOR in August 2008. He joined DnB NOR (then Bergen Bank) in 1989, and has previously worked for the Petroleum Division of the Norwegian Ministry of Industry and the Ministry of Energy, as well as for Vesta Insurance and Nevi Finance. Mr. Aas is also a director of Deep Sea, Golden Ocean, Seadrill, Knutsen NYK Offshore Partners, Solvang ASA and Gearbulk Holding Limited.

Kate Blankenship has served as a director of the Company since October 2003. Mrs. Blankenship served as the Company's Chief Accounting Officer and Company Secretary from October 2003 to October 2005. Mrs. Blankenship has served as a director of Frontline since August 2003, Golar LNG Limited from July 2003 until September 2015, Golden Ocean since November 2004, Seadrill since May 2005, Archer Limited since August 2007, Golar LNG Partners LP from September 2007 until September 2015, Independent Tankers Corporation Limited since February 2008, NADL since February 2011, Seadrill Partners LLC since 2012 and Avance Gas Holdings Limited since October 2013. Mrs. Blankenship is a member of the Institute of Chartered Accountants in England and Wales.

Paul Leand has served as a director of the Company since 2003. Mr. Leand is the Chief Executive Officer and Director of AMA Capital Partners LLC, or AMA, an investment bank specializing in the maritime industry. From 1989 to 1998, Mr. Leand served at the First National Bank of Maryland where he managed the Bank's Railroad Division and its International Maritime Division. He has worked extensively in the U.S. capital markets in connection with AMA's restructuring and mergers and acquisitions practices. Mr. Leand serves as a member of American Marine Credit LLC's Credit Committee and served as a member of the Investment Committee of AMA Shipping Fund I, a private equity fund formed and managed by AMA. Mr. Leand serves as Chairman of Eagle Bulk Shipping Inc. and is also a director of Seadrill, NADL, Lloyd Fonds AG and Golar LNG Partners LP.

Harald Thorstein has served as a director of the Company since September 2011. Mr. Thorstein is currently employed by Seatankers Consultancy Services (UK) Limited (previously Frontline Corporate Services) 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 and as Chairman of the Board of Directors of Deep Sea since May 2013.

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 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 capital markets, and was previously the Chief Executive Officer of Clipper Group in Denmark.

Ole B. Hjertaker has served Ship Finance 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 Ship Finance 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. Mr. Hjertaker also serves as a director of NorAm Drilling Company AS, or NorAm Drilling.

Harald Gurvin was appointed as Chief Financial Officer of Ship Finance Management AS in March 2012, prior to which he served as Senior Vice President from August 2008. Before joining Ship Finance in July 2006, Mr. Gurvin spent seven years with the global shipping group of Fortis Bank, specializing in shipping and offshore finance. Mr. Gurvin has an MSc in Shipping, Trade and Finance from the CASS Business School in London and an MSc in Marine Engineering and Naval Architecture from the Norwegian University of Science and Technology.

## B. COMPENSATION

During the year ended December 31, 2016, we paid to our directors and executive officers aggregate cash compensation of \$2.5 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 2016 we also recognized an expense of \$0.4 million relating to stock options issued to certain of our directors, officers and employees. During 2016, all of the 125,000 options outstanding at December 31, 2015, were exercised and 279,000 new options were issued. The new options vest over a three year period, with the first of them vesting in March 2017, and expire in March 2021. The exercise price of the options is currently \$12.58 per share, and shall be reduced from time to time by the amount of any future dividend declared with respect to the common shares.

## 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 six 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.

Kate Blankenship is the Chairperson of the Audit Committee and the Audit Committee Financial Expert. Hans Petter Aas is also a member of the Audit Committee.

We currently have a Compensation Committee, which is responsible for establishing and reviewing the executive officers' and managements' compensation and benefits. Hans Petter Aas is the Chairperson of the Compensation Committee. Paul Leand and Harald Thorstein are also 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 as soon as possible 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, and during the year ended December 31, 2016, employed, nine 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 April 13, 2017, are as follows:

Director or Officer	Beneficial interest in Common Shares of \$1.00 each	Additional interest in options to acquire Common Shares which have vested	Percentage of Common Shares Outstanding
Hans Petter Aas	25,000	7,500	*
Paul Leand	60,334	5,833	*
Kate Blankenship	12,711	5,833	*
Harald Thorstein	—	5,833	*
Bert Bekker	—	3,333	*
Gary Vogel	—	—	*
Ole B. Hjertaker	91,840	26,333	*
Harald Gurvin	3,946	11,667	*

\* Less than one percent.

#### Share Option Scheme

In November 2006, our Board of Directors approved the Ship Finance International Limited Share Option Scheme. 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, we issued 36,575 new shares to satisfy 125,000 options expiring in March 2016. The exercise price was \$12.11 per share. In March 2016, 279,000 options were awarded to employees and board members 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 will be exercisable from March 2017.

Details of options to acquire common shares in the Company by our Directors and officers as of April 13, 2017, were as follows:

Director or Officer	Number of options		Exercise price	Expiration Date
	Total	Vested		
Hans Petter Aas	22,500	7,500	\$ 12.58	March 2021
Paul Leand	17,500	5,833	\$ 12.58	March 2021
Kate Blankenship	17,500	5,833	\$ 12.58	March 2021
Harald Thorstein	17,500	5,833	\$ 12.58	March 2021
Bert Bekker	10,000	3,333	\$ 12.58	March 2021
Ole B. Hjertaker	79,000	26,333	\$ 12.58	March 2021
Harald Gurvin	35,000	11,667	\$ 12.58	March 2021

In addition, as of April 13, 2017, Georgina Sousa, the Company Secretary, has options to acquire 10,000 shares in the Company at an exercise price of \$12.58 per share, of which 3,333 options have vested. The options expire in March 2021. Ms. Sousa has been Company Secretary since December 2006 and also served as a Director of the Company from May 2015 until the Annual General Meeting held in September 2016, when she did not stand for re-election.



ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY  
TRANSACTIONS

A. MAJOR SHAREHOLDERS

Ship Finance International Limited is indirectly controlled by another corporation (see below). The following table presents certain information as at April 13, 2017, 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 Ltd. (1)	28,679,293	30.67%
Farahead Investment Inc. (1)	5,400,000	5.77%

(1) Hemen Holding Ltd. is a Cyprus holding company and Farahead Investment Inc. is a Liberian company, both indirectly controlled by trusts established by Mr. John Fredriksen for the benefit of his immediate family. Mr. Fredriksen disclaims beneficial ownership of the above shares of our common stock, except to the extent of his voting and dispositive interests in such shares of common stock. Mr. Fredriksen has no pecuniary interest in the above shares of common stock. Related to our issue in January 2013 of \$350 million of 3.25% convertible senior unsecured bonds due 2018, Hemen Holding Ltd. has loaned us up to 6,060,606 of its holding in our shares, so that we can in turn lend them to an affiliate of one of the underwriters of the bond issue in order to assist investors in those bonds to hedge their position. These loaned shares are included in the holdings presented in the above table.

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

As at April 11, 2017, the Company had 430 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 had a total of 101,504,575 Common Shares outstanding as of April 11, 2017. In calculating the above percentages of common shares held by Hemen Holdings Ltd. and Farahead Investments Inc. we have excluded the 8,000,000 shares issued as part of a share lending arrangement relating to the October 2016 issue of 5.75% convertible bonds. These shares are owned by the Company and will be returned on or before the maturity of the bonds in 2021.

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 significant proportion of our assets were acquired from Frontline in 2004. The majority 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 (including Frontline Shipping and Frontline Shipping II, collectively the Frontline Charterers) (1)
- Frontline 2012 Limited ("Frontline 2012") (1)
- Seadrill
- NADL
- Golden Ocean (2)

- United Freight Carriers ("UFC", which is a joint venture approximately 50% owned by Golden Ocean)
- Deep Sea
- Golar Management UK Limited ("Golar") (3)
- Seatankers
- Arcadia Petroleum Limited ("Arcadia")
- NorAm Drilling

- (1) On November 30, 2015, Frontline and Frontline 2012 merged, leaving Frontline as the surviving legal entity and Frontline 2012 becoming a wholly-owned subsidiary of Frontline.
- (2) In March 2015, Golden Ocean merged with Knightsbridge Tankers Limited, leaving Knightsbridge Tankers Limited as the surviving legal entity and changing its name to Golden Ocean Group Limited.
- (3) From September 2014, Golar ceased to be a related party to the Company, following disassociation through the sale of shares held by a company associated with Hemen.

As of April 13, 2017, we charter 12 double-hull vessels to Frontline Shipping under long-term capital leases, most of which were given economic effect from January 1, 2004. At December 31, 2016, the balance of net investments in capital leases to Frontline Shipping was \$391 million (2015: \$467 million) of which \$26 million (2015: \$28 million) represented short-term maturities. As of December 31, 2016, we also chartered one double-hull vessel (Front Century) to Frontline Shipping, which was recorded as a held-for-sale asset, since we agreed in November 2016 to sell it to an unrelated party and terminate the charter on delivery of the vessel to its new owner, which occurred in March 2017. This vessel had a carrying value of \$24 million at December 31, 2016.

On December 30, 2011, amendments were made to the original charter agreements relating to vessels then chartered to the Frontline Charterers, in terms of which we received a compensation payment of \$106 million and agreed to a \$6,500 per day reduction in the time charter rate of each vessel for the period from January 1, 2012, to December 31, 2015. Thereafter, the charter rates were to revert to the previously agreed daily amounts. On June 5, 2015, further amendments were made to the charter agreements, permanently reducing the daily time-charter rates to \$20,000 per day for VLCCs and \$15,000 per day for Suezmax tankers from July 1, 2015, onwards. The charters for three of the vessels were transferred from Frontline Shipping II to Frontline Shipping, which is now the charter counterparty for all of the vessels. As part of the amended agreement, Frontline was released from its guarantee obligations under the charters, and in exchange a cash reserve of \$2 million per vessel has been built up in Frontline Shipping as security for their obligations under the charters. 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 million. Following the amendments effective from January 1, 2012, and then again 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, 2016, the Company received dividend income totaling \$11.6 million on these shares. As disclosed in Note 16 to the Consolidated Financial Statements ("Investment in Associated Companies") the dividend of \$2.8 million received from Frontline in December 2015 was recorded against the carrying value of this investment.

Prior to December 31, 2011, the Frontline Charterers paid us a profit sharing rate of 20% of their earnings above average threshold charter rates on a TCE basis from their use of our fleet each fiscal year. The amendments to the charter agreements made on December 30, 2011, increased the profit sharing percentage to 25% for future earnings above those threshold levels. Of the \$106 million compensation payment received, \$50 million represented a non-refundable advance relating to the 25% profit sharing agreement. We earned and recognized no revenue under the 25% profit sharing arrangement during the three and a half years of its duration, as the cumulative share of earnings did not attain the starting level of \$50 million.

The amendments to the charter agreements made on June 5, 2015, further increased the profit sharing percentage to 50% for earnings above the new time-charter rates with effect from July 1, 2015, and this arrangement is not subject to any constraints. Following the amendments, the profit share is calculated and payable on a quarterly basis. We

earned \$51 million under the 50% profit sharing agreement in 2016 (2015: \$37 million; 2014: \$nil).

The amendments to the charter agreements made on December 30, 2011, additionally provided that during the temporary reduction in charter rates, the Frontline Charterers would pay the Company 100% of any earnings on a TCE basis above the temporarily reduced time charter rates, subject to a maximum of \$6,500 per day per vessel. This arrangement was discontinued from July 1, 2015, when the amendments agreed in June 2015 became effective. In the year ended December 31, 2015, we earned and recognized \$20 million revenue under this arrangement, which is also reported under "Profit sharing revenues" (2016: \$nil, 2014: \$33 million).

As of April 13, 2017, we charter two of our drilling units to two of the Seadrill Charterers under long-term capital leases, these units being owned by equity-accounted subsidiaries. At December 31, 2016, the balance of net investments in capital leases to the two Seadrill Charterers was \$725 million (2015: \$788 million), of which \$63 million (2015: \$64 million) represents short-term maturities.

As of April 13, 2017, 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 capital lease, this rig being owned by an equity-accounted subsidiary. At December 31, 2016 the balance of the net investment in the capital lease to the subsidiary was \$483 million (2015: \$530 million) of which \$50 million (2015: \$47 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 April 13, 2017, we charter five offshore support vessels on long-term bareboat charter to the Deep Sea Charterer. In July 2016, we 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 have been temporarily reduced until May 2018, in exchange for extending the 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. No profit sharing revenue was recognized under this arrangement in the year ended December 31, 2016 (2015: \$nil). The previous charter guarantor was Deep Sea Supply AS, which was a joint venture owned 50% by Deep Sea and 50% by the Brazilian company BTG Pactual. In September 2016, Deep Sea acquired BTG Pactual's share in the joint venture and Deep Sea joined Deep Sea Supply AS as charter guarantor under the amended charter agreements. One of these vessels is accounted for as a capital lease, as was the offshore support vessel Sea Bear chartered to a subsidiary of Deep Sea before it was sold in February 2016. The other four offshore support vessels are operating lease assets. At December 31, 2016, the balance of net investments in capital leases to Deep Sea was \$20 million (2015: \$44 million), of which \$3 million (2015: \$9 million) represented short-term maturities. At December 31, 2016, the net book value of operating assets leased to Deep Sea was \$79 million (2015: \$88 million).

In the third quarter of 2015, we took delivery of eight Capesize dry bulk carriers, which we had acquired in the second quarter of 2015 from subsidiaries of Golden Ocean for a total cost of \$272 million. The vessels were immediately chartered back to the Golden Ocean Charterer on ten year time charters, at rates of \$17,600 per day for the first seven years and \$14,900 per day thereafter. The performance under the charters is fully guaranteed by Golden Ocean. We will also receive a 33% profit share of revenues above these rates, although no profit sharing revenue was recognized under this arrangement in the year ended December 31, 2016 (2015: \$nil). The charters for these vessels are classified as operating leases and at December 31, 2016, the net book value of these vessels was \$250 million (2015: \$266 million)

Until their short-term charters ended on the relevant dates during the year, we had up to six dry bulk carriers operating on time charters to UFC during 2016, which included profit sharing arrangements. In the year ended December 31, 2016, we earned \$1 million under this arrangement (2015: \$3 million; 2014: \$1 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. We also have nine container vessels, 14 dry bulk carriers, two car carriers and two Suezmax tankers operating on time-charters 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, 2016, management fees paid to Frontline Management amounted to \$46 million (2015: \$48 million; 2014: \$48 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 Golden Ocean. We also have nine 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, 2016, fees payable to Golden Ocean Management amounted to approximately \$21 million (2015: \$9 million; 2014: \$1 million).

We have an administrative services agreement with Frontline Management under which they provide us with certain administrative support services, for which we pay our allocation of the actual costs they incur on our behalf, plus a margin. In the year ended December 31, 2016, we paid Frontline Management \$0.6 million for these services (2015: \$0.5 million; 2014: \$0.5 million).

In the year ended December 31, 2016, the Company paid \$0.3 million to Seatankers Management Norway AS (2015: \$0.4 million to Frontline Management AS; 2014: \$0.4 million to Frontline Management AS) for the provision of office facilities in Oslo, and \$0.2 million to Frontline Corporate Services Ltd (2015: \$0.1 million to Arcadia; 2014: \$0.1 million to Golar) for the provision of office facilities in London. Golar ceased to be a related party in September 2014.

We also have an agreement with Seatankers under which they provide us with certain advisory and support services. In the year ended December 31, 2016, we paid Seatankers \$0.3 million for such services (2015: \$nil; 2014: \$nil).

We pay Frontline a management fee of 1.25% of chartering revenues relating to the Suezmax tankers Glorycrown and Everbright. In the year ended December 31, 2016, \$0.4 million was paid to Frontline Management pursuant to this arrangement (2015: \$0.4 million; 2014 \$0.3 million).

We pay fees to Frontline Management for the management supervision of some of our newbuildings, which in 2016 amounted to \$nil (2015: \$0.1 million; 2014: \$2.9 million).

In July 2016, we sold the VLCC Front Vanguard to an unrelated third party and received \$0.3 million from Frontline 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 loan notes 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.

On October 5, 2016, we issued a senior unsecured convertible bond loan totaling \$225.0 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 Holding Ltd., 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 Holding Ltd., and received \$80,000 from Hemen Holding Ltd.

In November 2016, we acquired approximately 12 million shares in NorAm Drilling for a consideration of approximately \$0.7 million. This investment, on which no dividend was received in the year ended December 31, 2016, is included in "Available-for-sale securities". We also hold within "Available-for-sale securities" 5.7 million \$1 senior secured corporate bonds in NorAm Drilling due 2019, on which interest amounting to \$0.5 million was earned in the year ended December 31, 2016 (2015: \$0.6 million; 2014: \$0.7 million).

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. 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, 2016, the Company received interest income on these loans of \$6.5 million from SFL Deepwater (2015: \$6.5 million; 2014: \$6.5 million), \$6.5 million from SFL Hercules (2015: \$6.5 million; 2014: \$6.5 million) and \$5.6 million from SFL Linus (2015: \$5.6 million, 2014: \$4.9 million) totaling \$18.7 million. As at December 31, 2016, the combined bank borrowings of SFL Deepwater, SFL Hercules and SFL Linus amounted to \$883.4 million and the Company guaranteed \$240.0 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 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.

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## 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, including Seadrill's potential comprehensive restructuring.

We have paid the following cash dividends in 2012, 2013, 2014, 2015 and 2016:

Payment Date	Amount per Share
2012	
March 28, 2012	\$ 0.30
June 28, 2012	\$ 0.39
September 28, 2012	\$ 0.39
December 28, 2012	\$ 0.39
December 28, 2012	\$ 0.39 (1)
2013	
June 28, 2013	\$ 0.39
September 27, 2013	\$ 0.39
December 30, 2013	\$ 0.39
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

(1) This dividend was an accelerated dividend in respect of the fourth quarter of 2012.

On February 28, 2017, our Board of Directors declared a dividend of \$0.45 per share which was paid in cash on March 30, 2017.

B. SIGNIFICANT CHANGES

None

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## 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".

The following table sets forth, for each of the five most recent full financial years, the high and low closing prices for the common shares on the NYSE.

Fiscal year ended December 31,	High	Low
2016	\$16.57	\$10.31
2015	\$17.69	\$13.89
2014	\$19.82	\$13.11
2013	\$17.78	\$14.35
2012	\$17.56	\$9.34

The following table sets forth, for each full financial quarter for the two most recent fiscal years, the high and low closing prices for the common shares on the NYSE.

Fiscal year ended December 31, 2017	High	Low
First quarter	\$15.95	\$14.25

Fiscal year ended December 31, 2016	High	Low
First quarter	\$16.57	\$10.31
Second quarter	\$16.17	\$13.39
Third quarter	\$15.78	\$13.86
Fourth quarter	\$15.00	\$12.30

Fiscal year ended December 31, 2015	High	Low
First quarter	\$16.01	\$13.89
Second quarter	\$17.38	\$14.80
Third quarter	\$17.10	\$14.43
Fourth quarter	\$17.69	\$15.19

The following table sets forth, for the most recent six months, the high and low closing prices for the common shares on the NYSE.

	High	Low
March 2017	\$15.15	\$14.25
February 2017	\$15.00	\$14.25
January 2017	\$15.95	\$14.80
December 2016	\$15.00	\$14.30
November 2016	\$14.55	\$12.30
October 2016	\$14.74	\$12.65
September 2016	\$15.45	\$14.13

## 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.

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, 2016, other than those entered in the ordinary course of business.

Attached as exhibits to this annual report are the contracts we consider to be both material and outside the ordinary course of business, to which the Company or any of its subsidiaries is a party, for the two-year period immediately preceding the date of this annual report.





### Frontline Charter Ancillary Agreement

We previously entered into charter ancillary agreements with respect to the vessels leased to the Frontline Charterers under which the Frontline Charterers paid us a profit sharing payment equal to 20% of the charter revenues earned by the Frontline Charterers in excess of specified threshold levels. On December 30, 2011, amendments were made to the original agreements with the Frontline Charterers, relating to 28 double-hull vessels at the time, whereby we agreed to temporarily reduce by \$6,500 per day the base charter rates payable on each vessel. The temporary reduction originally applied from January 1, 2012, until December 31, 2015, and thereafter the base charter rates were to revert to the original agreed levels. For the duration of the temporary reduction, we were entitled to receive 100% of any excess above the reduced charter rates earned by the Frontline Charterers on our vessels, calculated annually on an average daily TCE basis and subject to a maximum excess of \$6,500 per day per vessel. Amounts received under this arrangement were classified as "cash sweep" income. For the year ended December 31, 2015, we received cash sweep income of \$19.9 million (2014: \$32.7 million). The amendments to the charter agreements made on December 30, 2011, increased the profit sharing percentage to 25% for future earnings above the threshold levels. We were paid up front compensation of \$106.0 million on December 30, 2011, of which \$50 million represented a non-refundable advance relating to the 25% profit sharing agreement. We earned and recognized no revenue under the 25% profit sharing arrangement during the three and a half years of its duration, as the cumulative share of earnings did not attain the starting level of \$50 million.

On June 5, 2015, amendments were made to the leases on the remaining 12 VLCCs and five Suezmaxes with the Frontline Charterers, the related management agreements and further amendments to the charter ancillary agreements for the remainder of the charter periods. As a result of the amendments to the charter ancillary agreements, which took effect on July 1, 2015, the daily hire payable to us was reduced to \$20,000 per day and \$15,000 per day for VLCCs and Suezmaxes, respectively. Operating cost fees paid by us were increased from \$6,500 per day per vessel to \$9,000 per day per vessel. The charters for three of the vessels were transferred from Frontline Shipping II to Frontline Shipping, which is now the charter counterpart for all of the vessels. In return for the amendments, Frontline issued 55.0 million new shares to Ship Finance and the profit share above the new daily hire rates was increased from 25% to 50%, payable quarterly and calculated on an average daily TCE basis. As part of the amended agreement, Frontline was released from its guarantee obligations under the charters, and in exchange a cash reserve of \$2 million per vessel has been built up in Frontline Shipping as security for its obligations under the charters.

Other than as set forth above, there are no material contracts to which the Company or any its subsidiaries is a party for the two-year period immediately preceding the date of this annual report, other than those entered into in the ordinary course of business.

### 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:

- (i) It is organized in a "qualified foreign country," which is one that grants an equivalent exemption from tax to 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, Panama, the Isle of Man, Singapore, 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 2016 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 2016 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 approximately 36% of our outstanding common shares as of December 31, 2016. 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 currently imposed at rates of up to 35%. 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 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 2016 taxable year. For the 2017 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.

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## 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.

At December 31, 2016, the Company had entered into combined currency and interest rate swap contracts with a total notional principal of NOK600 million (\$105 million), to hedge against fluctuations in interest and exchange rates on our NOK600 million floating rate unsecured bonds due 2017. Under these contracts, variable NIBOR interest rates including additional margin is swapped for fixed interest at an average of 6.06%, and both the payment of interest and eventual settlement of the bonds will have an effective exchange rate of NOK5.69 = \$1. These contracts expire in October 2017 and we estimate that we would pay \$39 million to terminate them as of December 31, 2016 (2015: pay \$43 million).

Similarly, at December 31, 2016, the Company had entered into combined currency and interest rate swap contracts with a total notional principal of NOK900 million (\$151 million), to hedge against fluctuations in interest and exchange rates on our NOK900 million floating rate 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. These contracts expire in March 2019 and we estimate that we would pay \$50 million to terminate them as of December 31, 2016 (2015: pay \$56 million).

At December 31, 2016, the Company and its consolidated subsidiaries had entered into interest rate swap contracts with a combined notional principal amount of \$935 million at rates excluding margin over LIBOR of between 0.80% per annum and 4.15% per annum. In addition, one equity-accounted subsidiary had entered into interest rate swaps with a combined notional principal amount of \$176 million at rates excluding margin over LIBOR of between 1.77% per annum and 2.01% per annum. The swap agreements mature between December 2017 and April 2023, and we estimate that we would pay \$7 million to terminate these agreements as of December 31, 2016 (2015: pay \$16 million).

The overall effect of our swaps is to fix the interest rate on approximately \$1.4 billion of our floating rate debt at December 31, 2016, at a weighted average interest rate of 4.16% per annum including margin.

Several of our charter contracts contain interest adjustment clauses, whereby the charter rate is adjusted to reflect the actual interest paid on the outstanding loan, effectively transferring the interest rate exposure to the counterparty under the charter contract. At December 31, 2016, 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, 2016, our net exposure, including equity-accounted subsidiaries, to interest rate fluctuations on our outstanding debt was \$5 million, compared with \$98 million at December 31, 2015. Our net exposure to interest fluctuations is based on our total of \$2.1 billion floating rate debt outstanding at December 31, 2015, less the \$1.4 billion notional principle of our interest rate swaps and the \$0.7 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 interest expense by approximately \$50,000 per year as of December 31, 2016 (2015: \$1.0 million).

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

The Company may in the future enter into short-term TRS arrangements relating to our own shares and bonds or securities in other companies.

Apart from our NOK600 million and NOK900 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.

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, 2016. 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, 2016. 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, 2016.

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, 2016. 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. Kate Blankenship 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 2016 and 2015 was MSPC. The following table sets forth the fees related to audit and other services provided by MSPC.

	2016	2015
Audit Fees (a)	\$540,000	\$540,000
Audit-Related Fees (b)	\$117,000	\$117,000
Tax Fees (c)	—	—
All Other Fees (d)	\$50,367	\$41,221
Total	\$707,367	\$698,221

(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.



(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 2016 and 2015 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 two independent members 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.



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-45 are filed as part of this annual report:

Financial Statements: Ship Finance International Limited

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<u>Consolidated Statements of Operations for the years ended December 31, 2016, 2015 and 2014</u>	<u>F-3</u>
<u>Consolidated Statements of Comprehensive Income for the years ended December 31, 2016, 2015 and 2014</u>	<u>F-4</u>
<u>Consolidated Balance Sheets as of December 31, 2016 and 2015</u>	<u>F-5</u>
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<u>Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2016, 2015 and 2014</u>	<u>F-7</u>
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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.

- 4.16\* Bond Agreement relating to Ship Finance International Limited Callable Senior Unsecured Bond Issue 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.
- 4.17\* Bond Agreement relating to Ship Finance International Limited Callable Senior Unsecured Bond Issue 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.
- 4.18\* 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.
- 4.19\* Base Indenture relating to Ship Finance International Callable Senior Unsecured Bond Issue 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.
- 4.20\* First Supplemental Indenture to Ship Finance International Callable Unsecured Bond Issue 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.
- 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.
- 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

\* Incorporated herein by reference.



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: April 13, 2017 By: /s/ Harald Gurvin  
Harald Gurvin  
Principal Financial Officer

Ship Finance International Limited  
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders  
Ship Finance International Limited

We have audited the accompanying consolidated balance sheets of Ship Finance International Limited and subsidiaries (the "Company") as of December 31, 2016 and 2015, 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, 2016. We also have audited the Company's internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control— Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. 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 conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the consolidated financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall consolidated financial statement presentation. 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.

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.

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.

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, 2016 and 2015, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the

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Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control—Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ MSPC

Certified Public Accountants and Advisors,

A Professional Corporation

New York, New York

April 13, 2017

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## Ship Finance International Limited

## CONSOLIDATED STATEMENTS OF OPERATIONS

for the years ended December 31, 2016, 2015 and 2014

(in thousands of \$, except per share amounts)

	2016	2015	2014
Operating revenues			
Direct financing lease interest income - related parties	22,850	34,193	45,363
Direct financing and sales-type lease interest income - other	331	—	—
Finance lease service revenues - related parties	44,523	46,460	46,488
Profit sharing revenues - related parties	51,470	59,607	33,756
Profit sharing revenues - other	74	—	—
Time charter revenues - related parties	55,265	30,319	10,039
Time charter revenues - other	171,483	130,459	83,013
Bareboat charter revenues - related parties	10,075	12,596	16,364
Bareboat charter revenues - other	34,964	55,419	53,407
Voyage charter revenues - other	19,329	35,783	34,608
Other operating income	2,587	1,904	4,449
Total operating revenues	412,951	406,740	327,487
(Loss)/gain on sale of assets and termination of charters, net	(167 )	7,364	23,931
Operating expenses			
Vessel operating expenses - related parties	67,221	56,939	49,170
Vessel operating expenses - other	68,795	63,892	70,300
Depreciation	94,293	78,080	67,393
Vessel impairment charge	5,314	42,410	11,800
Administrative expenses - related parties	1,443	1,032	965
Administrative expenses - other	7,629	5,705	6,644
Total operating expenses	244,695	248,058	206,272
Net operating income	168,089	166,046	145,146
Non-operating income / (expense)			
Interest income – related parties, associated companies	18,675	18,672	24,464
Interest income – related parties, other	897	13,395	4,029
Interest income - other	2,164	7,075	11,958
Interest expense - other	(71,843)	(70,583)	(86,081)
(Loss)/gain on purchase of bonds	(8,802 )	1,007	(21 )
Gain on sale of investment in associated company	—	—	6,055
Gain on redemption of loan notes - related parties	—	28,904	—
Gain on sale of loan notes and share warrants - other	—	44,552	—
Available-for-sale securities impairment charge	—	(20,552)	—
Dividend income - related parties	11,550	—	—
Other financial items, net	(2,089 )	(21,289)	(16,232)
Net income before equity in earnings of associated companies	118,641	167,227	89,318
Equity in earnings of associated companies	27,765	33,605	33,497
Net income	146,406	200,832	122,815
Per share information:			
Basic earnings per share	\$ 1.57	\$ 2.15	\$ 1.32
Weighted average number of shares outstanding, basic	93,497	93,450	93,331
Diluted earnings per share	\$ 1.50	\$ 1.88	\$ 1.24
Weighted average number of shares outstanding, diluted	108,040	119,008	116,747

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Cash dividend per share declared and paid	\$ 1.80	\$ 1.74	\$ 1.63
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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, 2016, 2015 and 2014

(in thousands of \$)

	2016	2015	2014
Comprehensive income, net of tax			
Net income	146,406	200,832	122,815
Fair value adjustments to hedging financial instruments	9,702	27,154	(351 )
Fair value adjustments to hedging financial instruments in associated companies	1,150	158	(5 )
Reclassification into net income of previous fair value adjustments to hedging financial instruments	—	(1,348 )	(4,504 )
Fair value adjustments to available-for-sale securities	(93,406 )	981	(8,355 )
Reclassification into net income of previous fair value adjustments to available-for-sale securities	—	20,552	—
Other items of comprehensive (loss)/income	(38 )	(136 )	(179 )
Other comprehensive (loss)/income, net of tax	(82,592 )	47,361	(13,394 )
Comprehensive income	63,814	248,193	109,421

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

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Ship Finance International Limited  
CONSOLIDATED BALANCE SHEETS  
as of December 31, 2016 and 2015  
(in thousands of \$)

	2016	2015
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	62,382	70,175
Available-for-sale securities	118,489	199,594
Trade accounts receivable	3,549	2,057
Due from related parties	17,519	45,659
Other receivables	11,370	10,441
Inventories	5,083	5,056
Prepaid expenses and accrued income	3,608	5,790
Investment in direct financing and sales-type leases, current portion	32,220	37,145
Assets held for sale	24,097	—
Financial instruments (short-term): at fair value	110	—
Total current assets	278,427	375,917
Vessels and equipment, net	1,737,169	1,641,317
Newbuildings	33,447	40,149
Investment in direct financing and sales-type leases, long-term portion	523,815	474,298
Investment in associated companies	130	84,615
Loans to related parties - associated companies, long-term	330,087	387,712
Receivables from related parties - others, long-term	9,268	—
Other long-term assets	18,992	27,746
Financial instruments (long-term): at fair value	6,042	800
Total assets	2,937,377	3,032,554
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Short-term debt and current portion of long-term debt	174,900	208,031
Trade accounts payable	1,229	835
Due to related parties	850	416
Accrued expenses	13,800	12,646
Financial instruments (short-term): at fair value	39,309	—
Other current liabilities	8,882	17,037
Total current liabilities	238,970	238,965
Long-term liabilities		
Long-term debt	1,377,974	1,426,174
Financial instruments (long-term): at fair value	61,456	113,642
Other long-term liabilities	124,882	11,963
Total liabilities	1,803,282	1,790,744
Commitments and contingent liabilities		
Stockholders' equity		
Share capital (\$0.01 par value; 150,000,000 shares authorized; 101,504,575 shares issued and outstanding at December 31, 2016). (\$1.00 par value; 125,000,000 shares authorized; 93,468,000 shares issued and outstanding at December 31, 2015).	1,015	93,468
Additional paid-in capital	282,502	285,859
Contributed surplus	680,703	588,133
Accumulated other comprehensive loss	(84,779 )	(1,037 )

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Accumulated other comprehensive loss – associated companies	(976 )	(2,126 )
Retained earnings	255,630	277,513
Total stockholders' equity	1,134,095	1,241,810
Total liabilities and stockholders' equity	2,937,377	3,032,554

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, 2016, 2015 and 2014  
(in thousands of \$)

	2016	2015	2014
Operating activities			
Net income	146,406	200,832	122,815
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	94,293	78,080	67,393
Vessel impairment charge	5,314	42,410	11,800
Available-for-sale securities impairment charge	—	20,552	—
Amortization of deferred charges	10,972	11,613	11,271
Amortization of seller's credit	(1,324 )	(1,904 )	(1,903 )
Equity in earnings of associated companies	(27,765 )	(33,605 )	(33,497 )
Loss/(gain) on sale of assets and termination of charters	167	(7,364 )	(23,931 )
Gain on sale of investment in associated company	—	—	(6,055 )
Gain on redemption of Horizon loan notes and warrants	—	(44,552 )	—
Gain on redemption of Frontline loan notes	—	(28,904 )	—
Adjustment of derivatives to fair value recognized in net income	(4,399 )	13,278	7,699
Loss/(gain) on repurchase of bonds	8,802	(1,007 )	21
Interest receivable in form of notes	(633 )	(2,182 )	(3,197 )
Other, net	365	(1,134 )	(458 )
Changes in operating assets and liabilities			
Trade accounts receivable	(1,492 )	1,196	5,109
Due from related parties	8,433	14,105	(20,634 )
Other receivables	(856 )	(840 )	(9,418 )
Inventories	(27 )	(2,529 )	(320 )
Prepaid expenses and accrued income	2,181	(715 )	(1,104 )
Trade accounts payable	394	(1,572 )	(1,095 )
Accrued expenses	1,046	(5,302 )	4,358
Other current liabilities	(11,804 )	7,945	3,547
Net cash provided by operating activities	230,073	258,401	132,401
Investing activities			
Repayments from investments in direct financing and sales-type leases	30,410	35,946	43,120
Additions to newbuildings	(188,142)	(223,109)	(202,333)
Purchase of vessels	—	(273,552)	(192,864)
Proceeds from sale of vessels and termination of charters	29,102	42,275	199,429
Proceeds from sale of investment in associated company	—	111,095	—
Proceeds from redemption of Horizon loan notes and warrants	—	71,681	—
Proceeds from redemption of Frontline loan notes	—	112,687	—
Net amounts received from/(paid to) associated companies	193,517	(62,083 )	88,585
Proceeds from repayment of investment loan (included in other receivables)	—	—	50,000
Other investments and long-term assets, net	(25,488 )	(20,722 )	(7,877 )
Net cash provided by/(used in) investing activities	39,399	(205,782)	(21,940 )
Financing activities			
Proceeds from shares issued, net of issuance costs	323	675	927
Payments in lieu of issuing shares for exercised share options	—	—	(1,196 )
Repurchase of bonds	(296,800)	(23,787 )	(75,262 )
Proceeds from issuance of short-term and long-term debt	522,000	595,305	733,632



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Repayments of short-term and long-term debt	(329,303)	(435,706)	(616,783)
Debt fees paid	(5,099 )	(7,155 )	(7,460 )
Repayments of lease obligation liability	(97 )	—	—
Cash dividends paid	(168,289)	(162,594)	(152,142)
Net cash used in financing activities	(277,265)	(33,262 )	(118,284)
Net (decrease)/increase in cash and cash equivalents	(7,793 )	19,357	(7,823 )
Cash and cash equivalents at start of the year	70,175	50,818	58,641
Cash and cash equivalents at end of the year	62,382	70,175	50,818
Supplemental disclosure of cash flow information:			
Interest paid, net of capitalized interest	65,184	68,215	82,524

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, 2016, 2015 and 2014

(in thousands of \$, except number of shares)

	2016	2015	2014
Number of shares outstanding			
At beginning of year	93,468,000	93,404,000	93,260,000
Shares issued	8,036,575	64,000	144,000
At end of year	101,504,575	93,468,000	93,404,000
Share capital			
At beginning of year	93,468	93,404	93,260
Shares issued	117	64	144
Transfer arising from reduction in par value of issued shares	(92,570)	—	—
At end of year	1,015	93,468	93,404
Additional paid-in capital			
At beginning of year	285,859	285,248	285,632
Payments in lieu of issuing shares	—	—	(1,196)
Amortization of stock-based compensation	403	—	29
Shares issued	206	611	783
Equity component of convertible bond issuance due 2021	4,551	—	—
Adjustment to equity component of convertible bond issuance due 2018 arising from reacquisition of bonds	(8,517)	—	—
At end of year	282,502	285,859	285,248
Contributed surplus			
At beginning of year	588,133	586,089	581,569
Transfer arising from reduction in par value of issued shares	92,570	—	—
Amortization of deferred equity contributions	—	2,044	4,520
At end of year	680,703	588,133	586,089
Accumulated other comprehensive loss			
At beginning of year	(1,037)	(48,240)	(34,851)
Gain on hedging financial instruments reclassified into earnings	—	(1,348)	(4,504)
Fair value adjustments to hedging financial instruments	9,702	27,154	(351)
Loss on available-for-sale securities reclassified into earnings	—	20,552	—
Fair value adjustments to available-for-sale securities	(93,406)	981	(8,355)
Other comprehensive loss	(38)	(136)	(179)
At end of year (for breakdown see below)	(84,779)	(1,037)	(48,240)
Accumulated other comprehensive loss – associated companies			
At beginning of year	(2,126)	(2,284)	(2,279)
Fair value adjustment to hedging financial instruments	1,150	158	(5)
At end of year (consists entirely of fair value adjustments to hedging financial instruments)	(976)	(2,126)	(2,284)
Retained earnings			
At beginning of year	277,513	239,275	268,602
Net income	146,406	200,832	122,815
Dividends declared	(168,289)	(162,594)	(152,142)
At end of year	255,630	277,513	239,275
Total stockholders' equity	1,134,095	1,241,810	1,153,492



	2016	2015	2014
Accumulated other comprehensive loss			
Fair value adjustments to hedging financial instruments	(5,457 )	(15,159)	(40,965)
Fair value adjustments to available-for-sale securities	(78,960)	14,446	(7,087 )
Other items	(362 )	(324 )	(188 )
Accumulated other comprehensive loss	(84,779)	(1,037 )	(48,240)

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

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## 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, 2016, the Company owned 11 very large crude oil carriers ("VLCCs"), four Suezmax crude oil carriers, eight Capesize dry bulk carriers, five Supramax dry bulk carriers, seven Handysize dry bulk carriers, two Kamsarmax dry bulk carriers, 20 container vessels, two car carriers, two jack-up drilling rigs, two ultra-deepwater drilling units, five offshore support vessels and two chemical tankers. The two ultra-deepwater drilling units and one of the jack-up drilling rigs referred to above are owned by wholly-owned subsidiaries of the Company that are accounted for using the equity method (see Note 16: Investment in associated companies). At December 31, 2016, the Company had also contracted to acquire two product tankers scheduled for delivery in 2017. In addition, the Company has entered into agreements to charter-in two 19,200 twenty-foot equivalent units ("TEU") newbuilding container vessels on a long-term bareboat basis, one of which was delivered from the shipyard in December 2016, with the other delivered in March 2017. At December 31, 2016, one of the VLCCs was being classified as a "held for sale" asset.

Since its 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, 2016, 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

Revenues and expenses are recognized on the accrual basis.

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 and freight billings, where contracts exist, the charter and voyage rates are predetermined, service is provided and the collection of the revenue is reasonably assured.

Each charter agreement is evaluated and classified as an operating or a capital lease. Rental receipts from operating leases are recognized in income as it is earned ratably on a straight line basis over the duration of the period of each charter as adjusted for off-hire days.

Rental payments from capital leases, which are 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.

Voyage revenues are recognized ratably over the estimated length of each voyage, and accordingly are allocated between reporting periods based on the relative transit time in each period. Voyage expenses are recognized as incurred. Probable losses on voyages are provided for in full at the time such losses can be estimated.

Vessel operating expenses are expensed as incurred. Under a time charter, specified voyage costs such as fuel and port charges are paid by the charterer and other non-specified voyage expenses, such as commissions, are paid by the Company. Vessel operating costs include crews, voyage costs not applicable to the charterer, maintenance and insurance and are paid by the Company. Under a bareboat charter, the charterer assumes responsibility for all voyage and vessel operating costs and risks of operation. If payment is received in advance from charterers, it is recorded as deferred charter revenue and recognized as revenue over the period to which it relates.

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Amounts receivable from profit sharing arrangements with Frontline Shipping Limited ("Frontline Shipping") and also previously Frontline Shipping II Limited ("Frontline Shipping II"), which are related parties, are accrued based on amounts earned at the reporting date. Such profit share income has two elements:

- 50% profit sharing: From January 1, 2012, up to and including June 30, 2015, the charter agreements with Frontline Shipping and Frontline Shipping II included provisions whereby they were to pay the Company profit sharing of 25% of their earnings on a time-charter equivalent basis from their use of the Company's fleet above average threshold charter rates each fiscal year. In December 2011, the Company received a \$106 million compensation payment from Frontline Ltd. ("Frontline"), of which \$50 million represented a non-refundable advance relating to this 25% profit sharing agreement. The amendments to the charter agreements made on June 5, 2015, increased the profit sharing percentage to 50% for earnings above new threshold levels from July 1, 2015, onwards. The Company did not recognize any income under the 25% profit sharing agreement, as the cumulative share of earnings did not attain the starting level of \$50 million over the three and a half years of the agreement's duration. The new 50% profit sharing agreement is not subject to any such constraints.

- Cash sweep: The charter agreements effective from January 1, 2012, were essentially the continuation of previous agreements amended to temporarily reduce the time-charter rates by \$6,500 per day for the four year period commencing January 1, 2012. The agreements additionally provided that during the four year period Frontline Shipping and Frontline Shipping II would pay the Company 100% of any earnings on a time-charter equivalent basis above the temporarily reduced time charter rates, subject to a maximum of \$6,500 per day per vessel. This arrangement was terminated with effect from July 1, 2015 (see Note 23: Related party transactions).

As detailed in Note 23: Related party transactions, the Company also has, or has had, profit sharing arrangements with related parties Golden Ocean Group Limited ("Golden Ocean"), Deep Sea Supply Plc ("Deep Sea") and United Freight Carriers ("UFC"). Amounts receivable under these arrangements are accrued on the basis of amounts earned at the reporting date.

All contingent elements of rental income, such as profit share, cash sweep 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.

#### Available-for-sale securities

Available-for-sale securities held by the Company consist of share investments and interest-earning listed and unlisted corporate bonds. Any premium paid on their acquisition is amortized over the life of the bond. Available-for-sale securities are recorded at fair value, with unrealized gains and losses recorded as a separate component of other comprehensive income. 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.

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, 2016 and 2015, no provision was made for doubtful receivables.

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#### Inventories

Inventories are comprised principally of fuel and lubricating oils and are stated at the lower of cost and market 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.

#### 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 Capital Leases

Leases (charters) of our vessels where we are the lessor are classified as either capital leases or operating leases, based on an assessment of the terms of the lease. For charters classified as capital 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 capital leases that are 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 capital leases that are 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 capital 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 capital 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 capital 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.

#### Other Long-Term Investments

Other long-term investments are measured at fair value using the best available value indicators, and are included in "Other long-term assets" in the Consolidated Balance Sheets. The Company currently has one long-term investment, consisting of shares in a container vessel owner/operator which are not publicly traded, and the best estimate available for the valuation of this investment is the cost basis. When using this basis of valuation, the Company carries out regular reviews for possible impairment adjustments. Following such a review, an impairment adjustment of \$2.9 million was made to the carrying value of this asset in 2012, reducing its carrying value to \$nil (December 31, 2015: \$nil; December 31, 2014: \$nil).

#### Deemed Equity Contributions

The Company has accounted for the acquisition of vessels from Frontline at Frontline's historical carrying value. The difference between the historical carrying value and the net investment in each lease was recorded as a deferred deemed equity contribution. These deferred deemed equity contributions were presented as a reduction in the net investment in direct financing leases in the balance sheet, due to the related party nature of both the transfer of the vessels and the subsequent direct financing leases. The deferred deemed equity contributions were amortized as credits to contributed surplus over the life of the lease arrangements, as lease payments were applied to the principal balance of each lease receivable. Amendments were made to the charter agreements on June 5, 2015, reducing daily

lease payments from July 1, 2015, onwards. In the course of re-stating the amended leases, it was concluded that amortization of the deferred deemed equity contributions is no longer appropriate and these items are now incorporated into the revised lease schedules.

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#### 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. The Company carried out a review of the carrying value of its vessels, drilling rigs and long-term investments in the year ended December 31, 2016, and concluded that the carrying value of one container vessel was impaired and a charge was taken against this vessel. In the year ended December 31, 2015, reviews of the carrying value of long-lived assets indicated that two container vessels and two off-shore supply vessels were impaired, and charges were taken against those assets. In the year ended December 31, 2014, reviews of the carrying value of long-lived assets indicated that the carrying value of five container vessels were impaired, and charges were taken against those assets, which were sold in 2015.

#### 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.

#### 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.





## Derivatives

### 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.

## 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.

## 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

During the period, the Company adopted ASU 2015-03 "Interest - Imputation of Interest, (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs", which requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts and premiums. This ASU is effective for fiscal years beginning after December 15, 2015, and is effective retrospectively. As a result, at December 31, 2016, \$27.1 million (December 31, 2015: \$32.3 million) of debt issuance costs have been reclassified from Non-Current Assets to Non-Current Liabilities as a direct deduction from long-term debt (see Note 19 - Long-Term Debt).

### 3. RECENTLY ISSUED ACCOUNTING STANDARDS

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09 "Revenue from Contracts with Customers" which will replace almost all existing revenue recognition guidance in U.S. GAAP and is intended to improve and converge with international standards the financial reporting requirements for revenue from contracts with customers. The core principle of ASU 2014-09 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. ASU 2014-09 was effective for reporting periods and interim periods beginning on or after December 15, 2016. In August 2015, the FASB issued ASU 2015-14 "Deferral of the Effective Date" to delay the implementation of ASU 2014-09 by one year, in response to feedback from preparers, practitioners and users of financial statements. Accordingly, ASU 2014-09 is now effective for reporting periods and interim periods beginning on or after December 15, 2017. The Company is in the process of considering the impact of the standard on its consolidated financial statements and expects to complete the assessment during fiscal year 2017. For vessels operating on voyage charters, we expect to continue recognizing revenue over time. The time period over which revenue will be recognized is still being determined and, depending on the final conclusion, each period's voyage results could differ materially from the same period's voyage results recognized based on the present revenue recognition guidance. However, the total voyage results recognized over all periods would not change. The adoption of the standard is not expected to have a material impact on other income, primarily income earned from the commercial management of related party and third party vessels and newbuilding supervision fees derived from related parties and third parties.

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 is effective for fiscal years and interim periods beginning after December 15, 2017. Early adoption is only permitted for certain particular amendments within ASU 2016-01, where financial statements have not yet been issued. ASU 2016-01 will require the Company to recognize any changes in the fair value of certain equity investments in net income. These changes are currently recognized in other comprehensive income.

In February 2016, the FASB issued 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 ASU 2014-09 (see above). ASU 2016-02 is effective for fiscal years and interim periods beginning after December 15, 2018. Early adoption is permitted. The Company is currently assessing the impact of ASU 2016-02 on its consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU 2016-09 "Compensation - Stock Compensation" to introduce improvements to employee share-based payment accounting. ASU 2016-09 simplifies several aspects of the accounting for share-based payment award transactions, including the income tax consequences, the classification of awards as either equity or liabilities and the classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years and interim periods beginning after December 15, 2016. 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 March 2016, the FASB issued ASU 2016-07 "Investments - Equity Method and Joint Ventures" to simplify the transition to the equity method of accounting. ASU 2016-07 eliminates the requirement that when an investment qualifies for the use of the equity method as a result of an increase in the level of ownership, the investor must adjust the investment, results of operations and retained earnings retrospectively as if the equity method had been in effect during all previous periods in which the investment had been held. ASU 2016-07 is effective for fiscal years and interim periods beginning after December 15, 2016. 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.

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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, the 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 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 Company is currently assessing the impact of ASU 2016-15 on its statement of consolidated 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 will be effective for the Company beginning January 1, 2018. The impact on the consolidated financial statements of the Company will depend on the facts and circumstances of any specific future transactions.

#### 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.

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## 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.

## 6. EARNINGS PER SHARE

The computation of basic 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		
	2016	2015	2014
Basic:			
Net income available to stockholders	146,406	200,832	122,815
Diluted:			
Net income available to stockholders	146,406	200,832	122,815
Interest and other expenses attributable to convertible bonds	15,310	22,449	22,431
Net income assuming dilution	161,716	223,281	145,246

The components of the denominator for the calculation of basic and diluted EPS are as follows:

(in thousands)	Year ended December 31		
	2016	2015	2014
Basic earnings per share:			
Weighted average number of common shares outstanding	93,497	93,450	93,331
Diluted earnings per share:			
Weighted average number of common shares outstanding	93,497	93,450	93,331
Effect of dilutive share options	—	23	84
Effect of dilutive convertible debt	14,543	25,535	23,332
Weighted average number of common shares outstanding assuming dilution	108,040	119,008	116,747

The weighted average number of common shares outstanding excludes 8,000,000 shares issued as part of a share lending arrangement relating to the issue in October 2016 of 5.75% convertible bonds. These shares are owned by the Company and will be returned on or before maturity of the bonds in 2021.

The 3.75% convertible bonds were fully redeemed in cash in February 2016, without any conversion having taken place. The 5.75% convertible bonds were issued in October 2016. Share options were not dilutive at December 31, 2016.

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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, 2016, are as follows:

(in thousands of \$)

Year ending December 31,	
2017	245,539
2018	230,380
2019	205,314
2020	186,447
2021	138,058
Thereafter	177,428
Total minimum lease revenues	1,183,166

The cost and accumulated depreciation of vessels leased to third parties on operating leases at December 31, 2016 and 2015 were as follows:

(in thousands of \$)	2016	2015
Cost	2,154,994	1,964,852
Accumulated depreciation	417,825	323,535
Vessels and equipment, net	1,737,169	1,641,317

An impairment charge of \$4.8 million was recorded against the carrying value of one container vessel in the year ended December 31, 2016. In the year ended December 31, 2015, an impairment charge of \$29.2 million was recorded against the carrying value of two container vessels.

## 8. (LOSS) / GAIN 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		
	2016	2015	2014
(Loss) / gain on sale of assets	(167)	7,364	(1,384)
Gain on termination of charters	—	—	25,315
Total (loss) / gain on sale of assets and termination of charters	(167)	7,364	23,931

The Company distinguishes between gains on termination of charters, where ownership of the underlying vessel is retained, and gains 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



The offshore support vessel Sea Bear, which was accounted for as a direct financing lease asset, was sold to an unrelated party in February 2016. An impairment charge of \$8.1 million had been recorded against the carrying value of this vessel in the year ended December 31, 2015, and a gain of \$14,000 was recorded on its disposal. Sales proceeds included compensation received for early termination of the charter (see Note 23: Related party transactions).

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The VLCC Front Vanguard, which was also a direct financing lease asset, was sold to an unrelated party in July 2016. Sales proceeds included compensation received for early termination of the charter (see Note 23) and a loss of \$181,000 was recorded on its disposal.

The net loss on sale of these vessels in the year ended December 31, 2016, was \$167,000.

During the year ended December 31, 2015, the Company sold three Suezmax tankers and five container vessels to unrelated parties and realized aggregate net gains of \$7.4 million on their disposal.

During the year ended December 31, 2014, the Company sold three double-hull VLCCs to unrelated parties and realized losses of \$1.4 million on their disposal.

#### Gain on termination of charters

In September 2010, the Company agreed five year time-charters at a net rate of approximately \$14,000 per day per vessel for four 34,000 dwt Handysize dry bulk carriers, which were under construction at the time. The vessels were delivered from the shipyard in the second half of 2011 and the first half of 2012, and duly commenced the agreed time-charters. In July 2012, however, the charterer stopped paying the agreed charter hire and the vessels were returned to the Company. Proceedings were initiated against the charterer to recover unpaid charter hire and the matter was settled in the year ended December 31, 2014. A gain on termination of charters amounting to \$25.3 million was recorded in the year ended December 31, 2014, net of legal and other costs.

#### 9. GAIN ON SALE OF LOAN NOTES AND SHARE WARRANTS - OTHER

In May 2015, the Company sold its holding of loan notes in Horizon Lines, LLC and share warrants in Horizon Lines, Inc. for total net cash proceeds of approximately \$71.7 million. These unlisted second lien interest-bearing loan notes and share warrants had been received as compensation on termination of charters to Horizon Lines, LLC in April 2012. At the time of disposal, the notes had a carrying value of approximately \$25.9 million and the warrants had a carrying value of approximately \$1.2 million, resulting in a total gain of \$44.6 million on disposal.

#### 10. OTHER FINANCIAL ITEMS

Other financial items comprise the following items:

(in thousands of \$)	Year ended December 31		
	2016	2015	2014
Net increase/(decrease) in fair value of non-designated derivatives	3,917	(13,051)	(7,636)
Net cash payments on non-designated derivatives	(4,913)	(6,453)	(7,196)
Net increase/(decrease) in fair value of designated derivatives (ineffective portion)	482	(227)	(63)
Other items	(1,575)	(1,558)	(1,337)
Total other financial items	(2,089)	(21,289)	(16,232)

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 increase/ (decrease) in valuation of non-designated derivatives in the year ended December 31, 2016, includes \$nil (2015: \$(1.3) million; 2014: \$(4.5) million) 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, 2016, include a net gain of \$146,000 arising from foreign currency translation (2015: \$53,000; 2014: \$109,000). Other items also include bank charges and fees relating to loan facilities.

## 11. AVAILABLE-FOR-SALE SECURITIES

Marketable securities held by the Company are debt securities and share investments considered to be available-for-sale securities.

(in thousands of \$)	2016	2015
Amortized cost	197,449	185,148
Accumulated net unrealized (loss)/gain	(78,960 )	14,446
Carrying value	118,489	199,594

The Company's investment in marketable securities consists of investments in shares and secured notes which mature in 2019. Available-for-sale securities are recorded at fair value, with unrealized gains and losses recorded as a separate component of other comprehensive income. The net unrealized loss on available-for-sale securities included in other comprehensive income as at December 31, 2016, was \$79.0 million (2015: net unrealized gain \$14.4 million).

The investments in shares at December 31, 2016, consist of listed shares in Frontline with a carrying value of \$78.2 million (2015: \$164.5 million) (see Note 23: Related party transactions and Note 16: Investment in associated companies) and shares in NorAm Drilling Company AS traded on the Norwegian Over the Counter market ("OTC") with a carrying value of \$1.4 million (2015: \$nil).

The investments in secured notes at December 31, 2016, consists of listed and unlisted corporate bonds with a total carrying value of \$38.9 million (2015: \$35.1 million). The Company recorded no impairment charge in respect of available-for-sale securities in the year ended December 31, 2016. In December 2015, the Company determined that the bonds were other-than-temporarily impaired and recorded an impairment charge of \$20.6 million, reducing their amortized cost to fair value at December 31, 2015.

## 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, 2016 and December 31, 2015. As at December 31, 2016, 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, which include accrued interest on notes held as available-for-sale securities, amounts due from vessel managers and claims receivable, are presented with no allowance for doubtful accounts as of December 31, 2016 and December 31, 2015.

## 13. VESSELS AND EQUIPMENT, NET

(in thousands of \$)	2016	2015
Cost	2,154,994	1,964,852
Accumulated depreciation	417,825	323,535
Vessels and equipment, net	1,737,169	1,641,317

During 2016, the Company took delivery of two newbuilding container vessels at an aggregate cost of \$195.0 million. During 2015, the Company took delivery of eight second-hand dry bulk carriers at an aggregate cost of \$272.0 million and three newbuilding container vessels at an aggregate cost of \$270.7 million.

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An impairment charge of \$4.8 million was recorded against the carrying value of one container vessel in the year ended December 31, 2016. In the year ended December 31, 2015, an impairment charge of \$29.2 million was recorded against the carrying value of two container vessels.

Depreciation expense was \$94.3 million for the year ended December 31, 2016 (2015: \$78.1 million; 2014: \$67.4 million).

#### 14. 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. Interest capitalized in the cost of newbuildings amounted to \$1.2 million in the year ended December 31, 2016 (2015: \$0.4 million; 2014: \$0.3 million).

As at December 31, 2016, the Company had agreements for the delivery of two newbuilding vessels (2015: four newbuilding vessels), being two oil product carriers (2015: two container vessels and two oil product tankers), with accumulated costs of \$33.4 million (2015: \$40.1 million). In the year ended December 31, 2016, two newbuilding container vessels were delivered and no new agreements were entered into for the acquisition of newbuilding vessels.

#### 15. INVESTMENTS IN DIRECT FINANCING LEASES

As at December 31, 2016, 12 (2015: 14) of the Company's VLCCs and Suezmax tankers are 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 four to ten 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 VLCC Front Vanguard, which was accounted for as a direct financing lease at December 31, 2015, was sold in July 2016 (see Note 8: (Loss)/gain on sale of assets). In November 2016, the Company agreed to sell the VLCC Front Century, also accounted for as a direct financing lease at December 31, 2015, to an unrelated third party. The Company agreed to terminate the charter with Frontline Shipping upon delivery of the vessel to the new owner, which occurred in March 2017. In accordance with US GAAP, this asset has been reclassified and is presented on the balance sheet as "Asset held for sale". An impairment loss of \$0.5 million was recorded to write down its carrying value to its fair value less anticipated cost to sell.

Also at December 31, 2016, one of the Company's offshore support vessels is accounted for as a direct financing lease. The vessel is chartered on a long-term bareboat charter to Deep Sea Supply Shipowning II AS, a subsidiary of Deep Sea Supply AS (formerly Deep Sea Supply BTG AS), which was a joint venture owned 50% by Deep Sea and 50% by BTG Pactual Oil & Gas Empreendimentos e Participacoes S.A. ("BTG Pactual"). In September 2016, Deep Sea acquired BTG Pactual's share in the joint venture and Deep Sea joined Deep Sea Supply AS as charter guarantor under the amended charter agreements. The terms of the charter provide the charterer with a call option to acquire the vessel at the expiry of the charter in 2023. At December 31, 2015, a second offshore support vessel was accounted for as a direct financing lease. This vessel was sold in February 2016 and had been chartered on a long-term bareboat charter to DESS Cyprus Limited, a wholly owned subsidiary of Deep Sea. Deep Sea is a related party.

In October 2015, the Company entered into agreements to charter in two newbuilding container vessels on a bareboat basis, each for a period of 15 years from delivery by the shipyard, and to charter out each vessel on a bareboat basis

for the same 15 year period to MSC Mediterranean Shipping Company S.A. ("MSC"), an unrelated party. The first of these vessels, the MSC Anna, was delivered in December 2016 and this vessel is accounted for as a direct financing lease asset.

The above 14 vessels were accounted for as direct financing leases at December 31, 2016 (2015: 16), and all except one (MSC Anna) are leased to related parties.

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The following lists the components of the investments in direct financing leases as at December 31, 2016, and December 31, 2015:

(in thousands of \$)	2016	2015
Total minimum lease payments to be received	862,083	825,460
Less: amounts representing estimated executory costs including profit thereon, included in total minimum lease payments	(287,168)	(362,959)
Net minimum lease payments receivable	574,915	462,501
Estimated residual values of leased property (un-guaranteed)	213,901	195,238
Less: unearned income	(232,781)	(146,296)
Total investment in direct financing leases	556,035	511,443
Current portion	32,220	37,145
Long-term portion	523,815	474,298
	556,035	511,443

The chartered-in vessel MSC Anna is included in the above, with a total carrying value at December 31, 2016, of \$144.9 million (2015: \$nil).

The minimum future gross revenues to be received under the Company's non-cancellable direct financing leases as of December 31, 2016, are as follows:

(in thousands of \$)	
Year ending December 31,	
2017	101,237
2018	101,203
2019	103,609
2020	99,421
2021	88,855
Thereafter	367,758
Total minimum lease revenues	862,083

## 16. 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.

In addition, on June 5, 2015, the Company received 55 million shares in Frontline, equivalent to approximately 27.73% of Frontline's issued share capital at the time (see Note 23: Related party transactions). Frontline, which is listed on the New York Stock Exchange and the Oslo Stock Exchange and reports its operating results on a quarterly basis, was determined to be an associated company following receipt of these shares. On November 30, 2015, Frontline merged with Frontline 2012 Ltd ("Frontline 2012") and increased its issued share capital, thereby reducing the Company's shareholding in Frontline to approximately 7.03%. Accordingly, Frontline was assessed as no longer being an associated company and the Frontline shares are now held as available-for-sale securities (see Note 11: Available-for-sale securities). The Company's share of the net income of Frontline, in the period of the year ended December 31, 2015, during which it was an associated company accounted for using the equity method, was \$2.6 million (2016: \$nil; 2014: \$nil). The Company also received a dividend of \$2.8 million from Frontline in December 2015, which was recorded against the carrying value of this investment.





At December 31, 2016, 2015 and 2014, the Company had the following participation in investments that are recorded using the equity method:

	2016	2015	2014
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 West Polaris Limited	— %	— %	— %
Bluelot Shipping Company Limited	— %	— %	— %
SFL Corte Real Limited	— %	— %	— %

The determination that Ship Finance is not the primary beneficiary of SFL Deepwater Ltd. ("SFL Deepwater"), SFL Hercules Ltd. ("SFL Hercules"), and SFL Linus Ltd. ("SFL Linus") is due to these subsidiaries each owning assets on which the underlying leases include both fixed price call options and fixed price put options or purchase obligations.

Although the Company has had no equity-accounted interest in SFL West Polaris Limited ("SFL West Polaris"), Bluelot Shipping Company Limited ("Bluelot") and SFL Corte Real Limited ("Corte Real") since December 31, 2014, the Company had equity-accounted earnings from these companies during the year ended December 31, 2014, as shown below.

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 Limited ("Seadrill"), a related party. 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. At December 31, 2016, the balance outstanding under the new facility was \$248.4 million (2015: \$221.1 million), and the available amount under the revolving part of the facility was \$nil (2015: \$50.0 million). The Company guaranteed \$75.0 million of this debt at December 31, 2016 (2015: \$80.0 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 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 expires in 2023. 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, and at December 31, 2016, the balance outstanding under this facility was \$278.7 million (2015: \$256.3 million). At December 31, 2016, the available amount under the revolving part of the facility was \$nil (2015: \$50.0 million). The Company guaranteed \$75.0 million of this debt at December 31, 2016 (2015: \$80.0 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 expires in 2023. 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 ship yard 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, and at December 31, 2016, the balance outstanding under this facility was \$356.3 million (2015: \$353.8 million). At December 31, 2016, the available amount under the revolving part of the facility was \$nil (2015: \$50.0 million). The Company guaranteed \$90.0 million of this debt at December 31, 2016 (2015: \$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.

SFL West Polaris was a 100% owned subsidiary of Ship Finance, incorporated in 2008 for the purpose of holding an ultra deepwater drillship and leasing that vessel to Seadrill Polaris Ltd. ("Seadrill Polaris"), fully guaranteed by its parent company Seadrill. The vessel was chartered on a bareboat basis and the terms of the charter provided the charterer with various call options to acquire the vessel at certain dates throughout the charter. In addition, SFL West Polaris had a put option to sell the vessel to Seadrill Polaris at a fixed price at the end of the charter, which expired in 2023. Because the main asset of SFL West Polaris was the subject of a lease which included both fixed price call options and a fixed price put option, it was determined that this subsidiary of Ship Finance was a variable interest entity in which Ship Finance was not the primary beneficiary. In December 2014, the parent company of the charterer advised the Company of its intention to exercise a purchase option, and the transaction was effected on December 30, 2014 as a sale of SFL West Polaris. The Company recorded a gain of \$6.1 million on the sale, which was recorded as "Gain on sale of investment in associated company".

Bluelot and Corte Real were 100% owned subsidiaries of Ship Finance, each incorporated in 2010 for the purpose of leasing in a 13,800 TEU container vessel on a bareboat charter basis, respectively the CMA CGM Magellan and the CMA CGM Corte Real, and leasing the vessel out on a time-charter basis to CMA CGM. The determination that Ship Finance was not the primary beneficiary of Bluelot and Corte Real was due to these subsidiaries, which did not own vessels, each having been incorporated specifically to participate in a three-party lease agreement, which could be effectively terminated by one of the other parties. In November and December 2013, CMA CGM exercised its options to acquire the two vessel-owning entities, and the charter agreements were terminated in January and March 2014, respectively. The business activities of Bluelot and Corte Real were discontinued upon the re-delivery of their vessels, since when they have been fully consolidated.

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Summarized balance sheet information of the Company's equity method investees is as follows:

	As of December 31, 2016			
(in thousands of \$)	TOTAL	SFL Deepwater	SFL Hercules	SFL Linus
Current assets	122,675	33,763	38,351	50,561
Non-current assets	1,094,442	335,229	326,562	432,651
Total assets	1,217,117	368,992	364,913	483,212
Current liabilities	107,026	25,512	29,280	52,234
Non-current liabilities (1)	1,109,961	343,426	335,603	430,932
Total liabilities	1,216,987	368,938	364,883	483,166
Total shareholders' equity (2)	130	54	30	46

  

	As of December 31, 2015			
(in thousands of \$)	TOTAL	SFL Deepwater	SFL Hercules	SFL Linus
Current assets	120,251	33,735	38,936	47,580
Non-current assets	1,212,302	366,893	362,419	482,990
Total assets	1,332,553	400,628	401,355	530,570
Current liabilities	128,455	25,221	28,624	74,610
Non-current liabilities (1)	1,119,483	335,881	354,025	429,577
Total liabilities	1,247,938	361,102	382,649	504,187
Total shareholders' equity (2)	84,615	39,526	18,706	26,383

SFL Deepwater, SFL Hercules and SFL Linus non-current liabilities at December 31, 2016, include \$119.2 million (2015: \$137.4 million), \$85.9 million (2015: \$125.3 million) and \$125.0 million (2015: \$125.0 million) due to Ship (1) Finance, respectively (see Note 23: Related party transactions). In addition, SFL Linus current liabilities at December 31, 2016, include a further \$0.7 million (2015: \$23.2 million) due to Ship Finance (see Note 23: Related party transactions).

In the year ended December 31, 2016, SFL Deepwater, SFL Hercules and SFL Linus paid dividends of \$46.3 (2) million (2015: \$nil; 2014: \$nil), \$25.1 million (2015: \$nil; 2014: \$nil) and \$42.1 million (2015: \$nil; 2014: \$nil), respectively.

Summarized statement of operations information of the Company's wholly-owned equity method investees is shown below.

	Year ended December 31, 2016						
(in thousands of \$)	TOTAL	SFL Deepwater	SFL Hercules	SFL Linus	SFL West Polaris	Bluelot	Corte Real
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	—	—	—

  

	Year ended December 31, 2015						
(in thousands of \$)	TOTAL	SFL Deepwater	SFL Hercules	SFL Linus	SFL West Polaris	Bluelot	Corte Real
Operating revenues	82,731	22,424	23,315	36,992	—	—	—
Net operating revenues	82,725	22,422	23,313	36,990	—	—	—

Net income (3)	31,001	7,561	7,306	16,134	—	—	—
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(in thousands of \$)	Year ended December 31, 2014						
	TOTAL	SFL Deepwater	SFL Hercules	SFL Linus	SFL West Polaris	Bluelot	Corte Real
Operating revenues	108,632	24,917	24,565	33,236	22,251	1,171	2,492
Net operating revenues	105,567	24,905	24,544	33,221	22,234	232	431
Net income (3)	33,497	8,023	7,755	12,413	4,643	232	431

The net income of the above associated companies in the year ended December 31, 2016, includes interest payable to Ship Finance amounting to \$6.5 million (2015: \$6.5 million; 2014: \$6.5 million), \$6.5 million (2015: \$6.5 million; 2014: \$6.5 million), \$5.6 million (2015: \$5.6 million; 2014: \$4.9 million) and \$nil (2015: \$nil; 2014: \$6.5 million), respectively (see Note 23: 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 at December 31, 2016, Ship Finance and Seadrill were in compliance with all of the covenants under these long-term debt facilities. With Seadrill's potential comprehensive restructuring, there is a risk that the Company, and Seadrill, may not be in compliance with the applicable loan covenants in the future and we would not be able to make further borrowings under such facilities. A chapter 11 filing by Seadrill or the Seadrill Charterers could trigger an event of default under such facilities.

#### 17. ACCRUED EXPENSES

(in thousands of \$)	2016	2015
Vessel operating expenses	4,022	3,676
Administrative expenses	1,414	1,206
Interest expense	8,364	7,764
	13,800	12,646

#### 18. OTHER CURRENT LIABILITIES

(in thousands of \$)	2016	2015
Deferred and prepaid charter revenue	4,326	5,549
Obligations under capital leases - current portion	3,649	—
Employee taxes	151	152
Other items	756	11,336
	8,882	17,037

Other items at December 31, 2015, include \$10.9 million installments payable on newbuildings (2016: \$nil).

## 19. SHORT-TERM AND LONG-TERM DEBT

(in thousands of \$)	2016	2015
Long-term debt:		
3.75% senior unsecured convertible bonds due 2016	—	117,500
Norwegian kroner 600 million senior unsecured floating rate bonds due 2017	65,445	63,681
3.25% senior unsecured convertible bonds due 2018	184,202	350,000
Norwegian kroner 900 million senior unsecured floating rate bonds due 2019	87,801	85,434
5.75% senior unsecured convertible bonds due 2021	225,000	—
U.S. dollar denominated floating rate debt due through 2023	1,017,558	1,049,861
Total debt principal	1,580,006	1,666,476
Less: unamortized debt issuance costs	(27,132 )	(32,271 )
Less: current portion of long-term debt	(174,900 )	(208,031 )
	1,377,974	1,426,174

The outstanding debt as of December 31, 2016, is repayable as follows:

(in thousands of \$)	
Year ending December 31,	
2017	174,900
2018	324,847
2019	264,481
2020	172,060
2021	457,412
Thereafter	186,306
Total debt principal	1,580,006

The weighted average interest rate for floating rate debt denominated in U.S. dollars and Norwegian kroner ("NOK") as at December 31, 2016, was 4.20% per annum (2015: 4.22%). These rates take into consideration the effect of related interest rate swaps. At December 31, 2016, the three month US Dollar London Interbank Offered Rate ("LIBOR") was 0.998% (2015: 0.613%) and the three month Norwegian Interbank Offered Rate ("NIBOR") was 1.17% (2015: 1.13%).

## 3.75% senior unsecured convertible bonds due 2016

On February 10, 2011, the Company issued a senior unsecured convertible bond loan totaling \$125.0 million. Interest on the bonds was fixed at 3.75% per annum and was payable in cash semi-annually in arrears. The bonds were convertible into Ship Finance International Limited common shares at any time up to 10 banking days prior to February 10, 2016. The conversion price at the time of issue was \$27.05 per share, representing a premium of approximately 35% to the share price at the time. Subsequently, dividend distributions reduced the conversion price to \$16.61 at December 31, 2015. The Company had the right to call the bonds after March 3, 2014, if the value of the shares underlying each bond exceeded, for a specified period of time, 130% of the principal amount of the bond. In December 2015, the Company purchased bonds with principal amounts totaling \$7.5 million and the net amount outstanding at December 31, 2015, was \$117.5 million. In February 2016, the amount outstanding was fully redeemed in cash without any conversion into shares having taken place.

## NOK600 million senior unsecured bonds due 2017

On October 19, 2012, the Company issued a senior unsecured bond loan totaling NOK600 million in the Norwegian credit market. The bonds bear quarterly interest at NIBOR plus a margin and are redeemable in full on October 19, 2017. The bonds may, in their entirety, be redeemed at the Company's option from April 19, 2017, upon giving



bondholders at least 30 business days notice and paying 100.50% of par value plus accrued interest. Since their issue, at December 31, 2016, the Company has purchased bonds with principal amounts totaling NOK43.0 million (2015: NOK43.0 million), of which NOK8.0 million (2015: NOK8.0 million) were subsequently re-sold. The Company holds bonds purchased as treasury bonds. The net amount outstanding at December 31, 2016, was NOK565 million, equivalent to \$65.4 million (2015: NOK565 million, equivalent to \$63.7 million).

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### 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 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. Since then, dividend distributions have reduced the conversion price to \$14.3886 per share. In October 2016, the Company purchased and canceled bonds with principal amounts totaling \$165.8 million (2015: \$nil) and the net amount outstanding at December 31, 2016, was \$184.2 million (2015: \$350.0 million). A loss of \$8.8 million was recorded on the purchase and cancellation (2015: \$nil; 2014: \$nil).

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 Holding Ltd., the largest shareholder of the Company, for a one-time loan fee of \$1.0 million.

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 \$3.4 million in the year ended December 31, 2016 (2015: \$4.1 million). As a result of the purchase and cancellation of bonds with principal amounts totaling \$165.8 million (2015: \$nil), a total of \$8.5 million (2015: \$nil) was allocated as the reacquisition of the equity component.

### NOK900 million senior unsecured bonds due 2019

On March 19, 2014, the Company issued a senior unsecured bond loan totaling NOK900 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, 2016, the Company has purchased bonds with principal amounts totaling NOK 142.0 million (2015: NOK142.0 million), which are being held as treasury bonds. The net amount outstanding at December 31, 2016, was NOK758.0 million, equivalent to \$87.8 million (2015: NOK758.0 million, equivalent to \$85.4 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 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 58.0285, equivalent to a conversion price of approximately \$17.2329 per share.

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 Holding Ltd., 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 Holding Ltd. and received \$80,000 from Hemen Holding Ltd.

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 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 \$0.2 million in the year ended December 31, 2016 (2015: \$nil).

\$49 million secured term loan and revolving credit facility

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In March 2008, two wholly-owned subsidiaries of the Company entered into a \$49.0 million secured term loan and revolving credit facility with a bank. The proceeds of the facility were used to partly fund the acquisition of two newbuilding chemical tankers, which also serve as security for this facility. The Company has provided a limited corporate guarantee for this facility, which bears interest at LIBOR plus a margin and has a term of ten years. At December 31, 2016, the amount available under the revolving part of the facility was \$20.0 million (2015: \$12.0 million). The net amount outstanding at December 31, 2016, was \$nil (2015: \$8.0 million).

**\$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, 2016, was \$23.4 million (2015: \$26.3 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, 2016, was \$23.4 million (2015: \$26.3 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 has a term of eight years. The net amount outstanding at December 31, 2016, was \$30.2 million (2015: \$34.1 million).

**\$95 million secured term loan and revolving credit facility**

In February 2011, a wholly-owned subsidiary of the Company entered into a \$95 million secured term loan and revolving credit facility with a bank, secured against a jack-up drilling rig. The facility, which was fully prepaid and canceled in July 2016, bore interest at LIBOR plus a margin and had a term of seven years. The net amount outstanding at December 31, 2016, was \$nil (2015: \$22.5 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, 2016, was \$44.9 million (2015: \$50.8 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, 2016, was \$110.1 million (2015: \$122.2 million).

**\$53 million secured term loan facility**

In November 2012, two wholly-owned subsidiaries of the Company entered into a \$53.2 million secured term loan facility with a bank, secured against two car carriers. The facility bears interest at LIBOR plus a margin and has a term of approximately five years. The net amount outstanding at December 31, 2016 was \$35.5 million (2015: \$39.9 million).

\$45 million secured term loan and revolving credit facility

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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, 2016, the available amount under the revolving part of the facility was \$9.0 million (2015: \$9.0 million). The net amount outstanding at December 31, 2016, was \$36.0 million (2015: \$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. 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. The net amount outstanding at December 31, 2016, was \$54.7 million (2015: \$87.8 million). One of the vessels was sold in February 2016 and the facility now relates to the remaining five vessels.

**\$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, 2016, was \$20.0 million (2015: \$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, 2016, was \$109.4 million (2015: \$117.9 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, 2016 was \$112.6 million (2015: \$121.1 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, 2016, was \$31.5 million (2015: \$34.0 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. Four of the tankers were sold and delivered to their new owners prior to December 31, 2016, and the facility was secured against the remaining 13 tankers at December 31, 2016. The facility bears interest at LIBOR plus a margin and has a term of three years. At December 31, 2016, the available amount under the facility was \$175.6 million (2015: \$154.6 million). The net amount outstanding at December 31, 2016, was \$40.0 million (2015: \$73.5 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 acquired 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, 2016 was \$145.6 million (2015: \$159.5 million).

\$210 million secured term loan facility

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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 fund the acquisition of three newbuilding 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, 2016, the net amount outstanding was \$200.2 million (2015: \$70.0 million).

The aggregate book value of assets pledged as security against borrowings at December 31, 2016, was \$2,009 million (2015: \$2,087 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, 2016, the Company is in compliance with all of the covenants under its long-term debt facilities. The \$101.4 million secured term loan facility entered into in August 2014 contains certain financial covenants on Deep Sea. As at December 31, 2016, Deep Sea was in compliance with all covenants under the loan agreement.

## 20. OTHER LONG-TERM LIABILITIES

(in thousands of \$)	2016	2015
Unamortized sellers' credit	6,124	11,960
Obligations under capital leases - long-term portion	118,754	—
Other items	4	3
	124,882	11,963

The Company acquired six offshore support vessels from Deep Sea, which were originally chartered back to subsidiaries of Deep Sea under bareboat charter agreements. As part of the purchase consideration, the Company received seller's credits totaling \$37.0 million which are being recognized as additional bareboat revenues over the period of the charters. In 2013, the charters for five of the vessels were transferred from subsidiaries of Deep Sea to a subsidiary of Deep Sea Supply BTG AS, and the seller's credits for these five vessels were also transferred to the new counterparty. In September 2016, Deep Sea fully acquired Deep Sea Supply BTG AS and the company was renamed Deep Sea Supply AS. The other vessel, for which the charter was not transferred in 2013, was sold in February 2016.

In October 2015, the Company entered into agreements to charter in two newbuilding 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 of these vessels, the MSC Anna, was delivered in December 2016 and this vessel is accounted for as a direct financing lease asset. The Company's future minimum lease obligations under this non-cancellable lease are as follows:

(in thousands of \$)

Year ending December 31,	
2017	12,527
2018	12,527
2019	12,527
2020	12,561
2021	12,527
Thereafter	151,993
Total lease obligations	214,662



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Less: imputed interest payable	(92,259 )
Present value of obligations under capital lease	122,403
Less: current portion	(3,649 )
Obligations under capital lease - long-term portion	118,754

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## 21. SHARE CAPITAL, ADDITIONAL PAID-IN CAPITAL AND CONTRIBUTED SURPLUS

Authorized share capital is as follows:

(in thousands of \$, except share data)	2016	2015
150,000,000 common shares of \$0.01 par value each (2015: 125,000,000 common shares of \$1.00 par value each)	1,500	125,000

Issued and fully paid share capital is as follows:

(in thousands of \$, except share data)	2016	2015
101,504,575 common shares of \$0.01 par value each (2015: 93,468,000 common shares of \$1.00 par value each)	1,015	93,468

The Company's common shares are listed on the New York Stock Exchange.

In November 2006, the Board of Directors approved the Ship Finance International Limited Share Option Scheme (the "Option Scheme"). 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 22: Share option plan). In the year ended December 31, 2016, the Company issued a total of 36,575 new shares of \$1.00 each following the exercise by two officers and three employees of options granted in 2011 (2015: 64,000 new shares issued to satisfy options exercised by two officers and three employees). The weighted average exercise price of the options was \$12.11 per share (2015: \$10.55 per share), resulting in a premium on issue of \$0.2 million (2015: \$0.6 million).

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 November 2016, in relation with the Company's issue of senior unsecured convertible bonds totaling \$225 million (see below), 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.

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. Since then, dividend distributions have reduced the conversion price to \$14.3886 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 \$20.7 million and recorded as "Additional paid-in capital" (see Note 19: Long-term Debt). In October 2016, the Company purchased and canceled bonds with principal amounts totaling \$165.8 million. The equity component of these extinguished bonds was valued at \$8.5 million and this amount has been deducted from "Additional paid-in capital".

In October 2016, the Company issued a senior unsecured convertible bond totaling \$225 million. 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 58.0285, equivalent to a conversion price of approximately \$17.2329 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 \$4.6 million and recorded as "Additional paid-in capital" (see Note 19: Long-term Debt).

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The Company accounted for the acquisition of vessels from Frontline at Frontline's historical carrying value. The difference between the historical carrying values and the net investment in the leases was recorded as a deferred deemed equity contribution, which was presented as a reduction in net investment in direct financing leases in the balance sheet. This accounting treatment arose from the related party nature of both the initial transfer of the vessels and the subsequent leases. The deferred deemed equity contributions were amortized to contributed surplus over the life of the lease arrangements, as lease payments were applied to the principal balance of the lease receivable. In the six months ended June 30, 2015, the Company credited contributed surplus with \$2.0 million of such deemed equity contributions (year ended December 31, 2015: \$2.0 million). On June 5, 2015, the charter agreements with Frontline were amended with effect from July 1, 2015 (see Note 23: Related party transactions), following which the remaining unamortized deferred deemed equity contributions were incorporated into the lease schedules and no further amounts have been credited to contributed surplus in respect of deferred deemed equity contributions.

## 22. SHARE OPTION PLAN

The Option Scheme adopted in November 2006 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 option is exercised, provided the subscription price shall never be reduced below the par value of the share. Options granted under the scheme will vest at a date determined by the board at the date of the grant. The options granted under the plan to date vest over a period of one to three years and have a five year term. There is no maximum number of shares authorized for awards of equity share options, and either authorized unissued shares of Ship Finance or treasury shares held by the Company may be used to satisfy exercised options.

The following summarizes share option transactions related to the Option Scheme in 2016, 2015 and 2014:

	2016		2015		2014	
	Options	Weighted average exercise price \$	Options	Weighted average exercise price \$	Options	Weighted average exercise price \$
Options outstanding at beginning of year	125,000	12.56	189,000	13.17	423,000	9.99
Granted	279,000	14.38	—	—	—	—
Exercised	(125,000)	12.11	(64,000)	10.55	(224,000)	5.41
Forfeited	—	—	—	—	(10,000)	5.56
Options outstanding at end of year	279,000	13.03	125,000	12.56	189,000	13.17
Exercisable at end of year	—	—	125,000	12.56	189,000	13.17

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 assumptions used to calculate the fair values of the new options granted in 2016 were a) risk free interest rate of 1.08%, b) expected share price volatility of 31.3%, c) expected dividend yield of 0% and d) expected life of options 3.5 years. No new options were granted in 2015 and 2014, and all options outstanding at December 31, 2015, were

exercised in 2016. The weighted average fair value of options granted in 2016 is \$3.06 per share as at grant-date (2015: \$nil; 2014: \$nil).

The total intrinsic value of options exercised in 2016 was \$0.3 million on the day of exercise (2015: \$0.3 million; 2014: \$2.9 million). There are no options fully vested but not exercised at December 31, 2016.

As of December 31, 2016, the unrecognized compensation costs relating to non-vested options granted under the Option Scheme was \$0.5 million (2015: \$nil) and their intrinsic value amounted to \$0.5 million. This cost will be recognized over the remaining vesting periods, which average 2.2 years. During the year ended December 31, 2016, the Company recognized an expense of \$0.4 million in compensation cost relating to the stock options (2015: \$nil; 2014: \$nil).

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### 23. 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 New York Stock Exchange in June 2004. A significant proportion of the Company's business continues to be transacted with related parties.

The Company has had transactions with the following related parties, being companies in which our principal shareholders Hemen Holding Ltd. and Farahead Investment Inc. (hereafter jointly referred to as "Hemen") and companies associated with Hemen have, or had, a significant direct or indirect interest:

- Frontline (1)
- Frontline 2012 (1)
- Frontline Shipping and Frontline Shipping II (collectively the Frontline Charterers)
- Seadrill
- NADL
- Golden Ocean (2)
- United Freight Carriers ("UFC" - which is a joint venture approximately 50% owned by Golden Ocean)
- Deep Sea
- Golar Management UK Limited ("Golar") (3)
- Seatankers Management Co. Ltd. ("Seatankers")
- Arcadia Petroleum Limited ("Arcadia")
- NorAm Drilling Company AS ("NorAm Drilling" - formerly Global Rig Company ASA)

(1) On November 30, 2015, Frontline and Frontline 2012 merged, leaving Frontline as the surviving legal entity and Frontline 2012 becoming a wholly-owned subsidiary of Frontline.

(2) In March 2015, Golden Ocean Group Limited merged with Knightsbridge Tankers Limited, leaving Knightsbridge Tankers Limited as the surviving legal entity and changing its name to Golden Ocean Group Limited.

(3) From September 2014, Golar ceased to be a related party to the Company, following disassociation through the sale of shares held by a company associated with Hemen.

The Consolidated Balance Sheets include the following amounts due from and to related parties, excluding direct financing lease balances (see Note 15: Investments in direct financing leases):

(in thousands of \$)	2016	2015
Amounts due from:		
Frontline Charterers	11,906	18,052
Frontline Ltd	3,008	2,816
UFC	—	1,639
Deep Sea	1,945	—
SFL Linus	660	23,152
Total amount due from related parties	17,519	45,659
Loans to related parties - associated companies, long-term		
SFL Deepwater	119,167	137,437
SFL Hercules	85,920	125,275
SFL Linus	125,000	125,000
Total loans to related parties - associated companies, long-term	330,087	387,712
Loans to related parties - others, long-term		
Deep Sea	9,268	—
Total loans to related parties - others, long-term	9,268	—
Amounts due to:		
Frontline Charterers	229	229
Frontline Management	493	143
Seatankers	79	—
Other related parties	49	44
Total amount due to related parties	850	416

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, 2016. As described below in "Related party loans", at December 31, 2016 and 2015, 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

As at December 31, 2016, 12 of the Company's vessels leased to Frontline Shipping (December 31, 2015: 14) and one of its offshore support vessels leased to a subsidiary of Deep Sea (December 31, 2015: two), are recorded as direct financing leases. In addition, at December 31, 2016, four offshore support vessels were leased to a subsidiary of Deep Sea and eight dry bulk carriers were leased to a subsidiary of Golden Ocean under operating leases. Also at December 31, 2016, one vessel leased to Frontline Shipping is recorded as a held for sale asset.

At December 31, 2016, the combined balance of net investments in direct financing leases with Frontline Shipping and Deep Sea was \$411.1 million (2015: \$511.4 million) of which \$28.9 million (2015: \$37.1 million) represents short-term maturities.

At December 31, 2016, the net book value of assets leased under operating leases to Deep Sea and Golden Ocean was \$328.6 million (2015: \$499.6 million).

At December 31, 2016, the carrying value of the held for sale asset leased to Frontline Shipping was \$24.1 million (2015: \$nil). In November 2016, the Company agreed to sell the VLCC Front Century to an unrelated party, and agreement was made with Frontline Shipping for the early termination of the charter upon delivery to the new owner, which occurred in March 2017 (see Note 27: Subsequent Events).

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 the year.

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A summary of leasing revenues earned from the Frontline Charterers, Deep Sea, Golden Ocean and UFC is as follows:

(in millions of \$)	2016	2015	2014
Operating lease income	65.3	42.9	26.4
Direct financing lease interest income	22.9	34.2	45.4
Finance lease service revenue	44.5	46.5	46.5
Direct financing lease repayments	30.3	35.9	43.1
Profit sharing revenues	51.5	59.6	33.8

On December 30, 2011, amendments were made to the charter agreements with Frontline Shipping and Frontline Shipping II, which related to 28 vessels accounted for as direct financing leases. In terms of the amending agreements, the Company received a compensation payment of \$106 million and agreed to a \$6,500 per day reduction in the time charter rate of each vessel for the period January 1, 2012, to December 31, 2015. Thereafter, the charter rates were to revert to the previously agreed daily amounts. The leases were amended to reflect the compensation payment received and the reduction in future minimum lease payments to be received. During 2012, 2013 and 2014, 11 of the vessels were sold.

On June 5, 2015, further amendments were made to the charter agreements relating to the remaining 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, the fair value of which amounted to \$150.2 million, and also an increase in the profit sharing percentage (see below). The charters for three of the vessels were transferred from Frontline Shipping II to Frontline Shipping, which is now the charter counterparty for all of the vessels. As part of the amended agreement, Frontline was released from its guarantee obligations under the charters, and in exchange a cash reserve of \$2 million per vessel has been built up in Frontline Shipping as security for its obligations under the charters.

The Company's holding of Frontline ordinary shares represented approximately 27.73% of the issued share capital of Frontline at the time of receipt in June 2015. On November 30, 2015, Frontline merged with Frontline 2012 and increased its issued share capital, reducing the Company's holding to approximately 7.03%. Accordingly, from June 5, 2015, to November 30, 2015, the Company's shareholding was accounted for as an investment in associated companies (see Note 16: Investment in associated companies). Since December 1, 2015, the Company's holding of Frontline shares has been held under available-for-sale securities (see Note 11: Available-for-sale securities). In February 2016, Frontline enacted a 1-for-5 reverse stock split of its ordinary shares, and the Company's holding in Frontline now consists of 11 million ordinary shares. In the year ended December 31, 2016, the Company received dividend income totaling \$11.6 million on these shares. As disclosed in Note 16: Investment in Associated Companies, the dividend received from Frontline in December 2015 was recorded against the carrying value of this investment.

Prior to December 31, 2011, Frontline Shipping and Frontline Shipping II paid the Company profit sharing of 20% of their earnings on a time-charter equivalent basis from their use of the Company's fleet above average threshold charter rates each fiscal year. The amendments to the charter agreements made on December 30, 2011, increased the profit sharing percentage to 25% for future earnings above those threshold levels. Of the \$106 million compensation payment received, \$50 million represented a non-refundable advance relating to the new 25% profit sharing agreement. The Company earned and recognized profit sharing revenue under the 25% arrangement in the year ended December 31, 2016, of \$nil (2015: \$nil; 2014: \$nil). The amendments to the charter agreements effective from July 1, 2015, increased the profit sharing percentage from 25% to 50% for earnings above the new reduced time-charter rates,

calculated and payable on a quarterly basis. The Company earned and recognized profit sharing revenue under the 50% arrangement of \$50.9 million in the year ended December 31, 2016 (2015: \$37.3 million; 2014: \$nil).

The amendments to the charter agreements effective from January 1, 2012, additionally provided that for the four year period of the temporary reduction in charter rates, Frontline Shipping and Frontline Shipping II would pay the Company 100% of any earnings on a time-charter equivalent basis above the temporarily reduced time charter rates, subject to a maximum of \$6,500 per day per vessel. This arrangement was discontinued from July 1, 2015, when the amendments agreed in June 2015 became effective. In the year ended December 31, 2016, the Company earned and recognized \$nil revenue under this arrangement (2015: \$19.9 million; 2014: \$32.7 million), which is also reported under "Profit sharing revenues".

In the event that vessels on charter to the Frontline Charterers are agreed to be sold, the Company may either pay or receive compensation for the early termination of the lease. 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 September 2015, October 2015 and December 2015, the Suezmax tankers Front Glory, Front Splendour and Mindanao on charter to Frontline Shipping were sold and their leases canceled, with agreed termination fees payable of \$2.2 million, \$1.3 million and \$3.3 million, respectively.

In November 2014, three VLCCs, namely Front Comanche, Front Commerce and Front Opalia, on charter to the Frontline Charterers were sold and their leases canceled, with agreed termination fees receivable of \$49.2 million. Of the termination fees receivable, \$10.5 million was received in cash and \$38.7 million was received in the form of amortizing loan notes from Frontline receivable over the approximately eight remaining years of the canceled leases. The initial face value of the notes received, on which interest at 7.25% was receivable, was \$48.4 million and their initial fair value of \$38.7 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.

In December 2015, Frontline redeemed in full the loan notes received by the Company on the sale of the above three VLCCs in November 2014 and on the sale of two other VLCCs in 2013. The aggregate amount received on redemption was \$113.2 million (2016: \$nil; 2014: \$nil), including accrued interest of \$0.5 million (2016: \$nil; 2014: \$nil). At the time of the redemption, the loan notes had a carrying value of \$83.8 million, resulting in a gain of \$28.9 million on disposal.

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.

In the year ended December 31, 2016, the Company had five other 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 have been 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. In the year ended December 31, 2016, the Company earned no income under this arrangement (2015: \$nil; 2014: \$nil).

In the year ended December 31, 2016, 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, 2016, the Company earned no income under this arrangement (2015: \$nil; 2014: \$nil).

Until their short-term charters ended on the relevant dates during the year, 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 (2015: \$2.5 million; 2014: \$1.1 million).

As at December 31, 2016, the Company was owed a total of \$11.9 million (2015: \$18.1 million) by Frontline Shipping in respect of leasing contracts and profit share.

At December 31, 2016, the Company was owed \$3.0 million (2015: \$2.8 million) by Frontline in respect of various short-term items, including items relating to the operation of vessels in the spot market.

At December 31, 2016, the Company was owed \$nil (2015: \$1.6 million) by UFC in respect of leasing contracts and profit share.

At December 31, 2016, the Company was owed \$1.9 million (2015: \$nil) by Deep Sea and affiliates, including the \$1.4 million carrying value of the short-term portion of the loan notes receivable from Deep Sea (2015: \$nil). The \$9.3 million carrying value of the long-term portion of the loan notes is reported under "Loans to related parties - others, long-term".

At December 31, 2016, the Company was owed \$0.7 million by SFL Linus in addition to the loan due to the Company (2015: \$23.2 million) - see below.

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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. This daily fee has been payable since July 1, 2015, when amendments to the charter agreements became effective, before which the fixed daily fee was \$6,500 per day. 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, 2016, the Company also had 9 container vessels, 14 dry bulk carriers, two Suezmax tankers and two car carriers operating on time charter or in the spot market, for which the supervision of the technical management was sub-contracted to Frontline Management. In the year ended December 31, 2016, total management fees paid to Frontline Management amounted to \$45.9 million (2015: \$48.0 million; 2014: \$48.4 million).

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, 2016, the Company had 9 container vessels and 14 dry bulk carriers operating on time-charters, for which part of the operating management was sub-contracted to Golden Ocean Management. In the year ended December 31, 2016, total management fees paid to Golden Ocean Management amounted to approximately \$21.3 million (2015: \$9.0 million; 2014: \$0.8 million). Management fees are classified as vessel operating expenses in the consolidated statements of operations.

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 Management a management fee of 1.25% of chartering revenues. In 2016, \$0.4 million was paid to Frontline Management pursuant to this arrangement (2015: \$0.4 million; 2014: \$0.3 million).

In 2016, the Company also paid \$0.6 million to Frontline Management (2015: \$0.5 million, 2014: \$0.5 million) for administrative services, including corporate services, and \$0.3 million to Seatankers (2015: \$nil; 2014: \$nil) for the provision of advisory and support services.

The Company pays fees to Frontline Management for the management supervision of some of its newbuildings, which in 2016 amounted to \$nil (2015: \$0.1 million; 2014: \$2.9 million).

In the year ended December 31, 2016, the Company paid \$0.3 million to Seatankers Management Norway AS (2015: \$0.4 million to Frontline Management AS; 2014: \$0.4 million to Frontline Management AS) for the provision of office facilities in Oslo, and \$0.2 million to Frontline Corporate Services Ltd (2015: \$0.1 million to Arcadia; 2014: \$0.1 million to Golar) for the provision of office facilities in London. Golar ceased to be a related party in September 2014.

As at December 31, 2016, the Company owes Frontline Management and Frontline Management AS a combined total of \$0.5 million (2015: \$0.1 million) for various items, including technical supervision fees and office costs. At December 31, 2016, the Company also owes Seatankers \$0.1 million (2015: \$nil) 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 Holding Ltd., 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 Holding Ltd. and received \$80,000 from Hemen Holding Ltd.

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. 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, 2016, the Company received interest income on these loans of \$6.5 million from SFL Deepwater (2015: \$6.5 million; 2014: \$6.5 million), \$6.5 million from SFL Hercules (2015: \$6.5 million; 2014: \$6.5 million) and \$5.6 million from SFL Linus (2015: \$5.6 million, 2014: \$4.9 million) totaling \$18.7 million.

Ship Finance also granted a \$145.0 million fixed interest rate loan to SFL West Polaris, which was repaid when that company was sold on December 30, 2014. The terms of the loan were similar to those in the above continuing loans, and in the year ended December 31, 2016, the Company received interest income on this loan of \$nil (2015: \$nil; 2014: \$6.5 million).

#### Related party purchases and sales of vessels – 2016

No vessels were acquired from or sold to related parties in the year ended December 31, 2016.

#### Related party purchases and sales of vessels – 2015

In the third quarter of 2015, the Company acquired eight Capesize dry bulk carriers from subsidiaries of Golden Ocean for a total acquisition cost of \$272.0 million. The vessels were immediately chartered back to a subsidiary of Golden Ocean on ten year time charters, at rates of \$17,600 per day for the first seven years and \$14,900 per day thereafter. In addition, the Company will receive a 33% profit share of revenues above these rates. Golden Ocean was granted an option to purchase all eight of the vessels at the expiry of the charters. If the purchase option is not exercised, Ship Finance has the option to extend the charters for an additional three years at the rate of \$14,900 per day per vessel.

#### Related party purchases and sales of vessels – 2014

The ultra deepwater drilling unit West Polaris is owned by SFL West Polaris, which was a wholly-owned subsidiary of Ship Finance accounted for using the equity method (see Note 16: Investment in associated companies). In December 2014, Seadrill advised the Company of its intention to exercise a purchase option, and the transaction was effected on December 30, 2014 as the sale of SFL West Polaris. The Company recorded a gain of \$6.1 million on the sale, which was recorded as "Gain on sale of investment in associated company".

#### Other related party investments

In November 2016, the Company acquired approximately 12 million shares in NorAm Drilling for a consideration of approximately \$0.7 million. This investment, on which no dividend was received in the year ended December 31, 2016, is included in "Available-for-sale securities" (see Note 11). The Company also holds within "Available-for-sale securities" 5.7 million \$1 senior secured corporate bonds in NorAm Drilling due 2019, on which interest amounting to \$0.5 million was earned in the year ended December 31, 2016 (2015: \$0.6 million; 2014: \$0.7 million).

## 24. 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 due 2017 and 2019. 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 \$)	2016	2015
Designated derivative instruments -short-term liabilities:		
Interest rate swaps	—	—
Cross currency interest rate swaps	37,101	—
Non-designated derivative instruments -short-term liabilities:		
Interest rate swaps	—	—
Cross currency interest rate swaps	2,208	—
Total derivative instruments - short-term liabilities	39,309	—
Designated derivative instruments -long-term liabilities:		
Interest rate swaps	10,134	11,458
Cross currency interest rate swaps	41,716	87,642
Non-designated derivative instruments -long-term liabilities:		
Interest rate swaps	1,388	2,897
Cross currency interest rate swaps	8,218	11,645
Total derivative instruments - long-term liabilities	61,456	113,642

(in thousands of \$)	2016	2015
Designated derivative instruments -short-term assets:		
Interest rate swaps	110	—
Total derivative instruments - short-term assets	110	—
Designated derivative instruments -long-term assets:		
Interest rate swaps	4,540	487
Non-designated derivative instruments -long-term assets:		
Interest rate swaps	1,502	313
Total derivative instruments - long-term assets	6,042	800

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## 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, 2016, 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	
\$28,680 (reducing to \$24,794)	March 2008	August 2018	4.05% - 4.15%	
\$30,233 (reducing to \$23,394)	April 2011	December 2018	2.13% - 2.80%	
\$44,873 (reducing to \$34,044)	May 2011	January 2019	0.80% - 2.58%	
\$100,000 (remaining at \$100,000)	August 2011	August 2021	2.50% - 2.93%	
\$145,667 (terminating at \$79,733)	May 2012	August 2022	1.76% - 1.85%	
\$105,436 (equivalent to NOK600 million)	October 2012	October 2017	5.92% - 6.23%	*
\$35,467 (reducing to \$32,142)	February 2013	December 2017	0.81% - 0.82%	
\$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	%*
\$108,375 (reducing to \$70,125)	December 2016	December 2021	1.86% - 3.33%	
\$110,500 (reducing to \$70,125)	January 2017	January 2022	1.56% - 3.09%	
\$31,547 (reducing to \$19,413)	September 2015	March 2022	1.67	%
\$200,156 (reducing to \$149,844)	February 2016	February 2021	1.07% - 1.26%	

These swaps relate to the NOK600 million and the NOK900 million unsecured bonds, and the fixed interest rates \*paid are exchanged for NIBOR plus the margin on the bonds. For the remaining swaps the fixed interest rate paid is exchanged for LIBOR, excluding margin on the underlying loans.

Two interest rate swap agreements with a combined notional principal of \$110.5 million have an inception date of January, 2017, and an interest rate swap agreement with a notional principal of \$54.2 million has an inception date of March 2017. The total notional principal amount subject to swap agreements as at December 31, 2016, excluding those with inception dates in the future, was \$1,027.3 million (2015: \$804.8 million).

## Foreign currency risk management

The Company has entered into currency swap transactions, involving the payment of U.S. dollars in exchange for Norwegian kroner, which are designated as hedges against the NOK600 million senior unsecured bonds due 2017 and the NOK900 million senior unsecured bonds due 2019.

Principal Receivable	Principal Payable	Inception date	Maturity date
NOK600 million	US\$105.4 million	October 2012	October 2017
NOK900 million	US\$151.0 million	March 2014	March 2019

Apart from the NOK600 million and NOK900 million senior unsecured bonds due 2017 and 2019, 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, 2016, and 2015, are as follows:

(in thousands of \$)	2016 Carrying value	2016 Fair value	2015 Carrying value	2015 Fair value
Non-derivatives:				
Available-for-sale securities	118,489	118,489	199,594	199,594
Floating rate NOK bonds due 2017	65,445	65,955	63,681	63,719
Floating rate NOK bonds due 2019	87,801	86,026	85,434	79,549
3.75% unsecured convertible bonds due 2016	—	—	117,500	118,021
3.25% unsecured convertible bonds due 2018	184,202	201,206	350,000	378,315
5.75% unsecured convertible bonds due 2021	225,000	224,366	—	—
Derivatives:				
Interest rate/ currency swap contracts – short-term receivables	110	110	—	—
Interest rate/ currency swap contracts – long-term receivables	6,042	6,042	800	800
Interest rate/ currency swap contracts – short-term payables	39,309	39,309	—	—
Interest rate/ currency swap contracts – long-term payables	61,456	61,456	113,642	113,642

The above short-term receivables relating to interest rate/ currency swap contracts at December 31, 2016, all relate to designated hedges. The above long-term receivables relating to interest rate/ currency swap contracts at December 31, 2016, include \$1.5 million which relates to non-designated swap contracts (2015: \$0.3 million), with the balance relating to designated hedges. The above short-term payables relating to interest rate/ currency swap contracts at December 31, 2016, include \$2.2 million which relates to non-designated swap contracts (2015: \$nil), with the balance relating to designated hedges. The above long-term payables relating to interest rate/ currency swap contracts at December 31, 2016, include \$9.6 million which relates to non-designated swap contracts (2015: \$14.5 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.

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The above fair values of financial assets and liabilities as at December 31, 2016, are measured as follows:

	Total fair value as at December 31, 2016	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)
(in thousands of \$)				
Assets:				
Available-for-sale securities	118,489	118,489		
Interest rate/ currency swap contracts – short-term receivables	110		110	
Interest rate/ currency swap contracts - long-term receivables	6,042		6,042	
Total assets	124,641	118,489	6,152	—
Liabilities:				
Floating rate NOK bonds due 2017	65,955	65,955		
Floating rate NOK bonds due 2019	86,026	86,026		
3.25% unsecured convertible bonds due 2018	201,206	201,206		
5.75% unsecured convertible bonds due 2021	224,366	224,366		
Interest rate/ currency swap contracts – short-term payables	39,309		39,309	
Interest rate/ currency swap contracts – long-term payables	61,456		61,456	
Total liabilities	678,318	577,553	100,765	—

The above fair values of financial assets and liabilities as at December 31, 2015, were measured as follows:

	Total fair value as at December 31, 2015	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)
(in thousands of \$)				
Assets:				
Available-for-sale securities	199,594	199,594		—
Interest rate/ currency swap contracts – long-term receivables	800		800	
Total assets	200,394	199,594	800	—
Liabilities:				
Floating rate NOK bonds due 2017	63,719	63,719		
Floating rate NOK bonds due 2019	79,549	79,549		
3.75% unsecured convertible bonds due 2016	118,021	118,021		
3.25% unsecured convertible bonds due 2018	378,315	378,315		
Interest rate/ currency swap contracts – long-term payables	113,642		113,642	

Total liabilities	753,246	639,604	113,642	—
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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.

Available-for-sale securities consist of (i) listed Frontline shares (ii) NorAm shares traded on the Norwegian OTC and (iii) secured listed and unlisted corporate bonds. The fair value of the Frontline and NorAm shares and the listed and unlisted corporate bonds consists of their aggregate market value as at the balance sheet date.

The estimated fair values for the floating rate NOK bonds due 2017 and 2019, and the 3.75%, 3.25% and 5.75% 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 a well-established independent valuation technique applied to contracted cash flows and LIBOR/NIBOR interest rates as at the balance sheet date.

#### 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.

Since the Company was spun-off from Frontline in 2004, Frontline has accounted for a significant proportion of our operating revenues. In the year ended December 31, 2016, Frontline accounted for 28% of our operating revenues (2015: 33%, 2014: 37%). There is thus a concentration of revenue risk with Frontline.

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, 2016, income from our associated companies accounted for 31.7% of our net income (2015: 24.7%, 2014: 46.7%). There is thus a concentration of risk with Seadrill. Seadrill continues to be engaged in ongoing negotiations with its banks, potential new money investors and advisers to an ad hoc committee of bondholders regarding the terms of a comprehensive restructuring, which may include the infusion of new capital. Seadrill has also indicated that it expects the implementation of a comprehensive restructuring plan will likely involve schemes of arrangement or chapter 11 bankruptcy proceedings. If a comprehensive restructuring agreement is not reached, the Company's income generated from associated companies could be reduced or eliminated and could also result in a default under the respective loan facilities provided by the banks in these associated companies resulting in them calling on guarantees made by the

Company. As discussed in Note 25, the Company, at December 31, 2016, guaranteed a total of \$240.0 million of the bank debt in these companies and had loans granted by the Company to these associated companies totalling \$330.7 million. The loans granted by the Company are considered not impaired at December 31, 2016, due to the fair value of ultra deepwater drilling rigs owned by SFL Deepwater and SFL Hercules exceeding the book values at December 31, 2016 and due to current employment under a sub-charter and generally high utilization rates for the type of harsh environment jack-up rig in SFL Linus.

## 25. COMMITMENTS AND CONTINGENT LIABILITIES

## Assets Pledged

	2016
Book value of consolidated assets pledged under ship mortgages (see Note 19)	\$2,009 million

## Other Contractual Commitments

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 16. As at December 31, 2016, their combined bank borrowings amounted to \$883.4 million and the Company guaranteed \$240.0 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 secured loans granted by the Company to SFL Deepwater, SFL Hercules and SFL Linus, in favor of the lenders under the respective credit facilities (2016: \$330.7 million). These loans 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.

At December 31, 2016, the Company had commitments under contracts to acquire newbuilding vessels totaling \$76.1 million (2015: \$261.9 million). In addition, one subsidiary had contractual commitments relating to the chartering-in of one 19,200 TEU container vessel on a 15 year bareboat charter amounting to \$203.0 million at December 31, 2016 (2015: commitments of \$406.1 million relating to two chartered-in 19,200 TEU container vessels), of which \$15.0 million represents the remaining balance from the initial payment, due on delivery of the vessel (2015: \$30.0 million). There are no other contractual commitments at December 31, 2016.

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.

## 26. CONSOLIDATED VARIABLE INTEREST ENTITIES

The Company's consolidated financial statements include 25 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 April 2018 to July 2025. 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, 2016, the vessel of one of these entities is accounted for as a direct financing lease with a carrying value of \$20.2 million, unearned lease income of \$0.8 million and estimated residual value of \$4.0 million. The outstanding loan balances in this entity is \$6.0 million, of which the short-term portion is \$nil.

The other 24 fully consolidated variable interest entities own vessels which are accounted for as operating lease assets, with a total net book value at December 31, 2016, of \$564.9 million. The outstanding loan balances in these entities total \$250.3 million, of which the short-term portion is \$13.9 million.

## 27. SUBSEQUENT EVENTS

In February 2017, the Board of Ship Finance declared a dividend of \$0.45 per share which was paid in cash on March 30, 2017.

In February 2017, Deep Sea announced the plan to merge with Solstad Offshore ASA and Farstad Shipping ASA. The new listed entity will be called Solstad Farstad ASA, and the transaction is expected to be finalized in the second quarter of 2017. Subject to completion of the merger, a wholly owned subsidiary of Solstad Farstad ASA will be the charter guarantor under our agreements going forward.

In February 2017, Seadrill provided an update on the ongoing restructuring of their company in their fourth quarter earnings release. According to Seadrill, the negotiation of a potential financial restructuring with its secured lending banks, unsecured bondholders, and potential new money investors is continuing. In the event a consensual restructuring agreement is not concluded within certain deadlines, or an agreement to an extension of the deadlines is not reached, Seadrill are also preparing various contingency plans, including potential schemes of arrangement or chapter 11 proceedings. In April 2017, Seadrill announced that they continue to be engaged in ongoing negotiations with their banks, potential new money investors and the advisers to an ad hoc committee of bondholders regarding the terms of a comprehensive restructuring, which may include the infusion of new capital. While no definitive terms have been reached, based on stakeholder and new money investor feedback, as well as Seadrill's existing leverage, Seadrill currently believes that a comprehensive restructuring plan will require a substantial impairment or conversion of its bonds as well as impairment, losses or substantial dilution for other stakeholders. Seadrill also announced that it expects the implementation of a comprehensive restructuring plan will likely involve schemes of arrangement or chapter 11 proceedings.

In March 2017, the Company delivered the 1998-built VLCC Front Century to an unrelated third party. The sale of the vessel was agreed in November 2016, in combination with a termination of the charter to Frontline upon delivery of the vessel to the new owner. The net sale price for the vessel was approximately \$23.8 million, including compensation receivable from Frontline for the early termination of the charter.

In March 2017, SFL Europa was released following its detention in the port of Chittagong, Bangladesh, in November 2016 due to unpaid expenses incurred by the previous charterer, Hanjin Shipping. The vessel is being marketed for a new charter.



In March 2017, we took delivery of the MSC Viviana, a 19,200 TEU container vessel chartered-in on a 15-year bareboat lease. Upon delivery, the vessel commenced a 15-year bareboat charter to MSC.

In April 2017, the jack-up drilling rig Soehanah was redelivered to us from the previous charterer, PT Apexindo Pratama Duta TBK (“Apexindo”), following completion of a special periodic survey. The Company received a \$6 million non-amortizing loan note from Apexindo, with a term of approximately six years, which became effective upon the redelivery of the rig to the Company. The rig, which is debt free, is being marketed for new opportunities.

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