May 28th 2016

Island Drilling Company ASA

The Board of Directors' annual report 2015

ISLAND DRILLING

Island Drilling Company ASA

The Board of Directors' annual report 2015

1. The nature of the business

Island Drilling Company ASA (hereinafter referred to as 'Island Drilling' or 'the Company') owns and operates one semi-submersible drilling rig.

The Company was formed in 2006, and in February 2007, ordered its first semi-submersible rig, the 'Island Innovator', based on the GM 4000 design, from Cosco Shipyard, China. The Island Innovator was delivered by the Cosco Shipyard Group on 28 September 2012. The rig started on its charter party for Lundin Norway ASA on 28 September 2013 and completed operations in March 2016. Due to the severe market conditions, the Company has not succeded to find new work for the rig but is marketing the rig for work on the Norwegian Continental Shelf and else were.

The Company's registered office is in Ulsteinvik, Norway.

2. Going concern – project update

During operations for Lundin, the rig performed according to Lundin's expectations and plans throughout the charter period, and Lundin has been satisfied, technically and operationally. The Company's main focus in 2015 has been on continuing to improve operations and increasing available rig time.

A number of measures have been implemented in cooperation with the rig manager, Odfjell Drilling AS (ODAS), to optimise procedures and operations, and to improve technical solutions. Operations have shown a positive development, with planned projects being completed.

'Island Innovator' came off its charter party for Lundin Norway ASA in March 2016, and no new charter party has been secured for the rig. A restructuring of the Company's balance sheet is therefore deemed necessary to enable the Company to come through the current market challenges, and the Company has initiated discussions with both its main shareholders and its lenders in this respect. While these discussions are ongoing, the Company has decided to halt all payments of interest and amortization to all lenders.

ISLAND DRILLING

Furthermore, the company was in breach of financial covenants under its loan agreements as of 31 December 2015. Due to the significant impairment of the rig taken in Q4/15, both the Working Capital (WC) as well as the Equity (and Value Adjusted Equity (VAE)) were negative at year end (requirements are WC> 0, VAE > 30%).

The impairment of the rig in the amount of USD 370,1 million is based on a "Discounted Cash Flow" model, giving a Net Present Value of the rig of USD 258 million. The main assumptions of the model is the rig being idle until H2/19, a day rate commencing H2/19 of USD 300 thousand, increasing by USD 25 thousand / day per half year reaching USD 375 thousand / day in 2021 and remaining at that level throughout the period (2016 – 2036), a discount factor of 10% p.a. and a cost increase at 1,50% p.a.

As of 31.12.15 the Company's cash reserves was USD 21,8 Mill. and operation also in Q1/16 was cash positive. Thus the Company was insufficient (balance sheet test), but not illiquid (cash flow test) and thus the condition for continued operations was still valid.

However, given the financial difficulties the Board of Directors have decided to appoint Clackson's Platou Securities AS as the Company's financial advisors, and initiated discussions with its main shareholders, lenders (banks, financial institutions and bondholders) and other stakeholders involved in the financing of the rig.

The "Going Concern"-assumption is inter alia based on the Company reaching an agreement with its lenders on a sustainable solution for the Company going forward, including postponement of instalments. The possibility of injection of new equity is also explored. Consequently, the annual accounts for 2015 reflect a situation where the Company is not liquidated and no forced sale of the rig is carried through.

While the Company is confident that such sustainable solution will be reached with the relevant stakeholders, there can be no assurance or guarantee that such final solution will be reached.

During the discussions with the relevant stakeholders, the Company will continue to operate normally in all other respect. The liquidity of the Company remains stable for the period to come in anticipation of a sustainable solution.

3. Working environment and personnel

The Company had two employees as of 31 December 2015. The Company's competence and resource requirements have been met through a management agreement with ODAS, an experienced offshore drilling company that had full responsibility for the rig in operational mode and is continuing to manage the rig during lay-up. In addition, Island Drilling has hired consultants to cover HSE/QA and certain technical and financial functions.

No lost-time incidents resulting in major material damage or personal injuries were reported during the year.

Island Drilling has made continuous endeavours to improve the working environment on board the rig, while at the same time contributing to improve the general welfare of the crew, including sponsoring the crew welfare club.

The working environment is regarded as good, and continuous efforts are made to improve it even further.

4. Social Responsibility

The Company ensures that it has a high ethical standard when carrying out the company's business activities, whether this is towards customers, suppliers, employees, authorities, capital markets, owners or the society in general.

The company follows the International Labour Organization's (ILO) convention for the working and living conditions of seafarers which ensures that the employees have comprehensive rights and protection at work. The company's drilling rig is certified in accordance with the working and living conditions in the MLC ("Maritime Labour Convention"). For office staff, the working conditions are in accordance with the Norwegian Working Environment Act.

The Company requires that its employees, agents and representatives complies with applicable laws when it comes to gifts and possible other benefits, and such matters must be reported to an immediate superior. The company requires that all its trading meets all applicable ethical standards. The company respects the traditions and cultures in the countries in which the drilling rig will operate and pledges to comply with the laws in the areas where the business activities are carried out.

5. Equal opportunities

The Company aims to be a workplace where everyone has equal opportunities irrespective of gender, ethnicity or religious orientation.

The Board of Directors consists of five members, three men and two women.

The Company satisfies the requirement of the Norwegian Public Limited Liability Companies Act Section 6-11a that both sexes are represented.

6. Environmental reporting

The Company's business as of 31 December 2015 is not regulated by licence or subject to public orders. The company's activities do not pollute the external environment over and above what is customary for operations of this kind.

The Company has guidelines, principles, policies and standards for how to integrate considerations relating to human rights, labour rights and social issues, the environment and anti-corruption in its business strategies and in day-to-day operations, as well as in relation to stakeholders. The Company has no employees besides administrative personnel. All offshore personnel are employed by the rig manager ODAS.

7. Future developments

The drilling unit is based on the GM 4000 design and is tailored for Norwegian harsh environment operations.

The unit is the first purpose-built drilling and well intervention unit, and it is currently prepared for a full range of services such as Conventional Drilling, Coil Tubing and Through Tubing Rotary Drilling (TTRD) down to water depths of 750 metres. Drilling in water depths of 1200 m can be achieved with minor modifications, while a water depth of 3000 m can be achieved in intervention mode.

As described above, the rig is currently without work, and is temporarily laid up. The market for drilling rigs in general is very depressed, and there are no signs or expectations of an immediate improvement.

Thus the Company's future is dependent upon both the outcome of the current negotiations with the relevant stakeholders, and a general improvement in the market.

8. Market update

The negative trend observed in the rig market throughout 2014 was strengthened further during 2015 – with rigs being committed at very low day rates. This fact was becoming increasingly evident for Island Drilling first during the "Det Norske" tender (the Company re-submitted the commercial offer 3 times), and later in relation to the Lundin tender (where the Company re-submitted the commercial tender 3 times in Q4 2015 alone).

On February 22nd, 2016 Island Drilling received confirmation from Lundin through a "Letter of regret" that the Company did not succeed in the tender, and that the assignment was given to one of Island Drilling's competitors. Lundin awarded the new contract to a fully winterized rig at a day rate lower than Island Drilling's final bid.

The last well under the Lundin contract was completed mid-March, 2016. Thus the "Island Innovator" is out of work following completion of well #12 under the fixed Lundin drilling contract.

To date, the number of rigs being laid-up and/or scrapped has not been sufficient to stabilize the utilization and thus the market rates. This has a significant negative impact on the day rates reported in the market for new fixtures.

As a consequence of the failure to secure additional work for 2016 the rig was temporarily laid up at Hanøytangen following completion of the contract with Lundin, awaiting award of a new contract.

9. Performance, cash flow, investments, financing and liquidity

The Board of Directors is of the opinion that the annual accounts give a true and fair picture of Island Drilling's assets and liabilities, financial position and result. As described above, a significant event's has taken place after 31 December 2015 through the rig being laid up. This has been taken into consideration in the annual accounts, and is of importance in assessing the Company's accounts and financial position.

The Company had a turnover of TUSD 170 961 in 2015. Due to the general decline in the market value of drilling rigs, Island Drilling has recognised an impairment charge on the rig in the amount of TUSD 370 103 in 2015. Depreciation amounted to TUSD 32 492, and the operating profit was negative in the amount of minus TUSD 297 284. Net financial items amounted to minus TUSD 45 245, resulting in a loss for the year before tax of TUSD 342 529.

The Company has no expenditures relating to Research and Development.

ISLAND DRILLING

The total cash flow from operational activities in the Company was TUSD 48 969. The total cash flow from investments in 2015 was minus TUSD 5 590, while the cash flow from financing activities amounted to minus TUSD 50 453. The net cash flow in the period was thus minus TUSD 7 074.

The Company's cash position was TUSD 21 751 as of 31 December 2015.

The Company's total fixed assets amounted to TUSD 258 010 at year end. Long-term liabilities amounted to USD 0, as due to the breach of financial covenants all debt are classified as short term, including the long-term senior loan facility and the USD 140 000 000 bond that was issued in April 2013.

The total capital at year end was TUSD 316 579. The equity capital was minus USD 125 660 as of 31 December 2015.

10. Financial risk

10.1 Market risk

The Company is generally exposed to market risk. As no long-term contract has been entered into for Island Innovator, the market risk is significant.

10.2 Currency risk

The Company is to some extent exposed to changes in the foreign exchange markets. The charter contract with Lundin was in USD and a significant part of the long-term debt is in USD. However, a significant part of the Company's operating expenses are payable in NOK. The USD versus NOK exposure is reduced by using hedging instruments, i.e. a significant portion of the fixed future USD income has been sold against NOK to cover future operating expenses payable in NOK. As the contract with Lundin is now terminated, the Company is no longer in a position to sell USD forward.

As of 31.12.15 the Company had entered into currency swap agreements with DNB Markets as counterparty. Total amount sold on forward as of this date was 51,9 MUSD with maturity until September 2016. The market value on these forward contracts was negative with 7,2 MUSD as of 31.12.15 and is recognized in the profit and loss statement as a finance expense as these forward contracts does not meet the requirements for hedging according to IFRS.

10.3 Interest risk

The Company is exposed to changes in the interest rate level, since the pre- and post-delivery loans, as well as the bond issued in April 2013, are at floating interest rates. However, the Company may fix the interest rates for a longer term.

10.4 Credit risk

The risk relating to counterparties not having the means to fulfil their obligations is seen as low, since the Company's unsettled claims are in the Company's favour. To reduce the risk in relation to large suppliers' delivery obligations, the company has obtained performance guarantees from the relevant suppliers' banks. The Company has not entered into set-off agreements or similar financial instruments to minimise the credit risk.

10.5 Liquidity risk

The present long-term external financing was secured in April 2013.

The company has sufficient liquidity to cover operating expenses going forward. However, as described under "Going concern" above, a restructuring of the Company's balance sheet is deemed necessary to enable the Company to come through the current market challenges, and the Company has initiated discussions with relevant stakeholders (lenders and main shareholders) in this respect. Without operating revenues the Company is not in a position to service the debt in full going forward.

While these discussions are ongoing, the Company has decided to halt all payments of interest and amortization to all lenders.

11. Loss for the year and allocations

The Board proposes the following coverage of the loss for the year of USD 342 529 000 Transferred from the share premium: USD - 79 118 000

Transferred to uncovered loss: USD -263 411 000

Total allocated: USD - 342 529 000

Ulsteinvik, 26 May 2016

Sign.	*Sign.*	*Sign.*
Øivind Lund Chairman of the Board	Maria Loen Board Member	Jan Krokeide Board Member
Sign.	*Sign.*	*Sign.*
Dionne Chouest Austin Board Member	Morten Ulstein Board Member	Roger Simmenes Chief Executive Officer

ISLAND DRILLING