



***NORTHERN OFFSHORE LTD***

**Interim Management Report and Consolidated Financial  
Statements  
For the Six Months Ended June 30, 2010**



**Northern Offshore, Ltd.  
Oslo Børs: NOF**

## Contents

1.	Directors' Report	
a.	Introduction .....	3
b.	Highlights .....	3
c.	Overview of the Fleet .....	4
d.	Market Outlook .....	4
e.	Risk Update .....	6
f.	Liquidity and Financing .....	6
g.	Financial Review .....	8
h.	Major Related Party Transactions .....	9
i.	Responsibility Statement .....	10
2.	Consolidated Financial Statements	
a.	Consolidated Balance Sheets .....	12
b.	Consolidated Statements of Income .....	13
c.	Consolidated Statements of Shareholders' Equity .....	14
d.	Consolidated Statements of Cash Flows .....	15
e.	Notes to the Consolidated Financial Statements .....	16

## Interim Management Report for the Six Months Ended June 30, 2010

### **Introduction**

Northern Offshore, Ltd. (referred to as “the Company” and collectively with its subsidiaries as the “Group”) operates offshore oil and gas production and drilling vessels in various markets around the world. The Group’s fleet consists of one floating production facility and five drilling units, (a drillship, a semisubmersible and three jackup drilling rigs). In addition, the Group provides rig management services, and is currently operating in this capacity offshore Azerbaijan in the Caspian Sea. The Company is domiciled in Bermuda and maintains its executive offices in Houston, Texas.

### **Highlights for the First Half of 2010 and subsequent events for the third quarter to date**

- The Group reported second quarter 2010 revenues of US\$48.9 million and a net loss of US\$0.5 million.
- The Group reported for the first half of 2010 net income of US\$22.7 million or US\$0.15 per diluted share on revenues of US\$116.9 million.
- The Company paid off its bank loan of US\$97.5 million.
- The Company entered into a new US\$120 million Secured Revolving Credit Facility on April 23, 2010.
- The Company retired its US\$100 million public bond loan on June 14, 2010.
- The jackup Energy Endeavour completed its drilling contract with Maersk Olie og Gas (“Maersk”) April 5, 2010. The rig was demobilized to Esbjerg, Denmark for upgrades to the fire and gas safety system and accommodations. The repairs were completed at the end of May 2010. Maintenance work continues on the rig with a minimum warm stack crew while the rig is being marketed.
- The jackup Energy Enhancer’s one well contract with Perenco commenced on June 4, 2010 with approximate 40 days duration. The contract has four options of a combined estimated 105 days for well abandonment operations. The first three options of combined estimated 100 days duration have been exercised by the client and will keep the rig employed to late October 2010.
- The drillship Energy Searcher resumed operations July 5, 2010 upon completion of shipyard work in Singapore. Operations resumed on the fourth well in the five-well program provided under the contract with Vietgazprom. The final well is expected to conclude in late 2010.
- The Company paid US\$20 million of the outstanding US\$100 million Revolving Facility Loan in July 2010.
- The Company hired a new Chief Executive Officer.

## **Overview of the Fleet**

### **Energy Driller**

The semisubmersible Energy Driller is currently working in India under a three-year contract with Oil and Natural Gas Corporation “ONGC”. This contract is scheduled to continue until July 2011. The rig continues to meet the client and company expectations for well performance and equipment downtime while drilling wells offshore India.

### **Energy Searcher**

The drillship Energy Searcher completed its third well of a five-well contract with Vietgazprom in April 2010. The rig entered the shipyard in May to undergo repairs to the hull. Operations resumed in July with the fourth well in the five-well program provided under the contract. The final well under the program is expected to conclude in late 2010.

### **Energy Exerter**

The jackup Energy Exerter is warm stacked offshore Malta with minimal crews conducting necessary maintenance and is currently available.

### **Energy Enhancer**

The jackup Energy Enhancer commenced its contract with Perenco UK Limited (“Perenco”) on June 4, 2010 at a reduced rate until June 10, 2010 as the client was not ready to commence drilling operations. On June 11, 2010 the rig was mobilized to the drilling location to commence its one well program with an expected duration of 40 days. Perenco has exercised three of the four options which would extend the contract duration for an estimated additional 100 days.

### **Energy Endeavour**

The jackup Energy Endeavour completed its contract with Maersk on April 5, 2010. The rig was demobilized to Esbjerg, Denmark for upgrades to the fire and gas safety system and crew accommodations which completed May 2010. Maintenance work continues on the rig with a minimal warm stack crew while it awaits its next contract.

### **Northern Producer**

The floating production facility Northern Producer continued with its contract with EnQuest Dons Limited, formerly Petrofac Energy Developments Limited. The unit continues producing on this same location with further field development ongoing.

### **Support Services**

The company continued its support services contract with Caspian Drilling Company Limited which commenced October 1, 2009 and is expected to finish in July 2011.

## **Market Outlook**

While there is evidence of increasing rig demand in certain markets, the Group remains cautiously optimistic about a general market recovery considering world financial conditions and the continued delivery of new drilling rigs. The Group is encouraged that exploration and production spending across a broad array of customers continues to rebound in 2010. Drilling contractors’ moderating dayrates over 2009 have contributed to stronger cash flow expectations by customers and the stabilization of oil prices could

provide for potential improvement in worldwide rig demand. The BP Macondo well incident in the U.S. Gulf of Mexico may have unknown consequences for the global jackup and floater markets and will be monitored closely to maximize utilization.

The Group's strategies for the second half of 2010 are to capture new work for its uncontracted units, while we continue to uphold the integrity of existing contracts.

***World shallow water floater market (3000' and less)***

In early 2010, this category of rigs was working at an 88% utilization rate on a global basis, declining from 94% a year earlier. The Group believes that rates are likely to remain stable through mid 2010 and short-term contracts will represent the primary opportunity.

***Far East / SE Asia / Australia-New Zealand / Indian Ocean shallow water floater market (less than 3000')***

This regional shallow water floater market, where the Energy Searcher and Energy Driller are located, was functioning at an 85% utilization rate in early 2010, which is only slightly less than the utilization rate of 88% a year earlier. There may be one to four floaters in this region experiencing idle time during 2010, which is a continuation of supply and demand conditions from 2009.

***Worldwide jackup markets***

World jackup markets conditions may have bottomed, with the world marketed supply of jackups contracted at about 84% in early 2010 compared to 85% in early 2009. Jackup markets in Mexico, Norway and India are geographic regions with reasonably firm utilization for 2010, with mildly increasing demand in various other regions. However, this market sector is exposed to the threat of new build deliveries, and therefore rates may be flat to slightly declining through mid 2010, particularly for standard jackups.

***Jackup newbuilds***

Jackup newbuilds continued to enter the market in the second quarter of 2010, some without contracts. The delivery of such uncontracted rigs to the world fleet combined with sporadic program deferrals in various regions contribute to a soft dayrate environment in most markets.

***North Sea jackup market***

Of the 36 jackups in the North Sea in early 2010, three were cold-stacked. The utilization rate for the remaining marketed supply of 33 units was 94%, compared to 97% in early 2009. Based on activity planned for the spring through fall 2010 drilling season, there may be slightly improving utilization through the middle of the year, although work continues to be mostly short-term in duration. The North Sea jackup market continues to work at higher utilization levels than most markets of the world.

***Mediterranean jackup market***

Demand in the Mediterranean jackup market in the second quarter has seen a utilization rate of 86% and rates will likely fluctuate in the 80% range into the third quarter of 2010. The Group believes the supply/demand outlook in the Mediterranean will be stable through the third quarter of 2010, with marginal demand increase offset by new rigs entering the market.

## **Risk Update**

The key risks for the Group for the second half of the year are highlighted below:

### ***Credit risk of customers***

Lack of payments and/or timing of payments from customers may significantly and adversely impair the Group's liquidity and ability to meet its financial covenants under its current financing. The Group gives due consideration to the credit quality of its potential clients during contract negotiations to minimize the risk of payment delinquency, but no assurance can be given that the Group will be able to avoid this risk.

### ***Market risks***

The demand for rigs and vessels will always fluctuate depending on global market drivers such as global oil and gas price levels, political climate, economic climate, availability of capital, operators' willingness to invest, levels of exploration and development for oil and gas and increases in the number of rigs available for contract, among other things. Fluctuations in the oil price have historically been shown to have a significant impact on the demand for services such as those the Group provides. New entrants in the market could also have a negative effect on contractual dayrates and terms as well as market value of the Group's fleet.

### ***Fluctuating value of the fleet***

The value of the rigs and vessels owned by the Group may fluctuate with rig market conditions. An extended period of weak market conditions may reduce drilling rig values. If future cash flow estimates indicate that the carrying values of the Group's rigs may not be recoverable, an impairment charge on the Group's financial statements may be required and could result in breaches of its debt covenants.

Additional risks and uncertainties include limitations on the Group's ability to hire and maintain quality senior management. Adequate or timely replacement could have a material adverse effect on the Group's business, results of operations, financial condition or prospects.

## **Liquidity and Financing**

Total debt outstanding at June 30, 2010 was US\$100.0 million, which is all classified as current. The Group's existing debt facility imposes debt service obligations and significant operating and financial restrictions, which may prevent the Group from capitalizing on business opportunities or adversely affect the ability to operate the business.

On April 23, 2010 the Company entered into a US\$120 million Revolving Credit Facility (the "Facility") with The Royal Bank of Scotland (Lead Arranger), Nordea Bank Norge ASA and NIBC Bank N.V. (the "Lenders"). After entering into the Facility, the remaining US\$30 million outstanding balance of the US\$300 million Secured Term Loan ("Bank Loan") was repaid. The utilized portion of the Facility was initially restricted to a maximum of US\$30 million until repayment of the US\$100 million bond issue described as "FRN Northern Offshore, Ltd. Senior Secured Callable Bond Issue 2007/2010",

Registration Number (ISIN) NO 001 037367.3 (the “Bond Loan”), which was repaid at its maturity on June 14, 2010. Simultaneous with the repayment of the Bond Loan and pledging of additional collateral currently restricted by the Bond Loan Agreement, the full US\$120 million balance of the Facility became available.

The Facility is reduced by US\$24 million per quarter at the end of each calendar quarter, commencing September 30, 2010, with the final reduction at maturity on September 30, 2011. Additionally, prepayments are required under certain circumstances as outlined in the Facility Agreement, and the Facility will be cancelled and required to be repaid in full under certain other circumstances, such as Change of Control, sale of all or substantially all assets, non-approved delisting of the Company’s stock, or the termination of certain contracts currently in place. Change of control is defined as the failure of Geveran Trading Co. Ltd. (“Geveran”) to own more than 25% of the issued share capital of the Company during the Standstill Period which is the period from the effective date until all amounts payable by the Company pursuant to the Facility have been paid in full.

The utilized portion of the Facility bears interest at a rate of 3.00% over London Interbank Offered Rate (“LIBOR”) with a non-utilization fee of 1.5% paid quarterly in arrears on the unutilized portion of the Facility.

The Facility contains certain indemnity, reimbursement and break cost provisions, representations and warranties, affirmative and negative covenants.

The Facility is governed by English law. The Facility identifies certain events or circumstances that would effectuate an event of default including, but not limited to, non-payment on the due date, non-compliance with financial covenants, material adverse change, insolvency, insolvency proceedings, breach of other obligations, misrepresentations, and cross defaults.

For the second quarter of 2010, the Company is in compliance with its financial debt covenants under the Facility.

Based on the current business plan and the projected cash flow for the second half of 2010, the Company may not fully satisfy certain financial covenants. The Company’s adjusted leverage may exceed the allowed ratio per the financial covenant for the third quarter 2010. The timing of customer receipts and major capital expenditures during the third quarter of 2010 will materially impact the company’s ability to satisfy this financial covenant. In addition, by the end of the 2010 financial year, the Company expects to exceed the capital expenditure limit of 110% of the budgeted capital expenditures for 2010. This is due to US\$3.0 million of additional life extension and fatigue works costs for the Northern Producer.

The Company has informed the Lenders that the above financial covenants may not be satisfied and will seek to obtain a waiver in the event of non-compliance. If a waiver is not obtained or the default condition is not remediated, the Lenders have certain rights under the Facility including the right by notice to the Company to declare that all or part of the loans outstanding plus accrued interest shall become immediately due and payable.

## **Financial Review**

### **Three months ending June 30, 2010 vs. June 30, 2009**

The Group reported a net loss of US\$0.5 million, or US\$0.00 per diluted share, for the three months ended June 30, 2010. Net income for the second quarter of 2009 was US\$22.8 million or US\$0.15 per diluted share.

Revenues for the second quarter of 2010 were US\$48.9 million, which is significantly lower than the US\$73.4 million reported in the same period in 2009. This is primarily due to the lower utilization of the jackup fleet, offset by increased production on the Northern Producer and a management services contract which did not begin until late 2009.

Total operating expense for the second quarter of 2010 was US\$46.2 million compared to US\$47.7 million for the quarter ended June 30, 2009. Drilling and production expenses and general and administrative expenses for the current-year quarter were consistent with the same period in 2009. Depreciation expense for the second quarter of 2010 was US\$1.5 million lower than the same period in 2009 due to a change in estimate to reflect current salvage values in the calculation of depreciation expense.

Current quarter interest expense decreased US\$1.0 million from the prior-year quarter due to the payoff of the Secured Term Loan ("Bank Loan") principal balance, retirement of the Bond Loan and lower interest rates. Amortization of drilling contract intangibles decreased US\$2.0 million in the current quarter compared to the same period last year due to the completion of contracts which were in place at the time the company acquired the jackup rigs.

Income taxes for the quarter ending June 30, 2010 decreased to US\$0.4 million from US\$2.3 million in the prior-year quarter, due to the net loss for the second quarter of 2010.

### **Three months ending June 30, 2010 vs. March 31, 2010**

The Group reported a net loss of US\$0.5 million, or US\$0.00 per diluted share, for the three months ended June 30, 2010. Net income for the first quarter of 2010 was US\$23.2 million or US\$0.15 per diluted share.

Revenues of US\$48.9 million reported for the second quarter of 2010 were significantly lower than revenues of US\$68.1 million reported in the first quarter 2010. This is due primarily to the Energy Searcher which was in the shipyard for repairs in the second quarter and the Energy Endeavor which completed its contract with Maersk in early April. This was partially offset by an increase in production in the second quarter on the Northern Producer.

Total operating expense for the second quarter of 2010 was US\$46.2 million compared to US\$39.1 million for the quarter ended March 31, 2010. Drilling and production expense for the current quarter was US\$6.5 million higher than the previous quarter due primarily to shipyard work on the Energy Searcher and Energy Endeavor. Depreciation expense and general and administrative expense for the second quarter of 2010 were comparable to the first quarter of 2010.



Interest expense for the current quarter decreased US\$0.7 million from the prior quarter due to the payoff of the Secured Term Loan ("Bank Loan") principal balance, retirement of the Bond Loan and lower interest rates.

Income taxes for the second quarter 2010 decreased to US\$0.4 million from US\$3.1 million in the prior quarter, due to the net loss for the second quarter of 2010.

### **Six months ending June 30, 2010 vs. June 30, 2009**

Net income for the six months ending June 30, 2010 was US\$22.7 million or US\$0.15 per diluted share compared to net income of US\$26.4 million or US\$0.17 per diluted share for the same period ending June 30, 2009.

Revenues for the first half of 2010 were US\$116.9 million compared to US\$129.9 million for the first half of 2009.

Total cash and cash equivalents at June 30, 2010 were US\$32.3 million, excluding US\$6.7 million of current and noncurrent restricted cash. During the second quarter of 2010 restricted cash decreased by US\$9.1 million as the Letters of Credit of US\$2.0 Million for Maersk Drilling, US\$6.0 million for Maersk Olie og Gas AS and US\$1.2 million for the Energy Exerter were released.

The Group's total assets at June 30, 2010 were US\$581.4 million. The Group was in compliance with its financial covenants for the first half of 2010.

Net cash flows provided by operating activities for the first half of 2010 were US\$53.0 million compared to US\$33.6 million for the first half of 2009. Net cash provided by investing activities was US\$2.4 million due to the release of restricted cash, partially offset by capital expenditures. Capital additions for the six months ended June 30, 2010 were US\$9.8 million. Of this amount US\$3.0 million relates to additional shipyard costs on the Northern Producer which will be paid out of future revenue. This is treated as a non-cash transaction for cash flow statement purposes. Net cash used for financing activities was US\$102.2 million.

### **Related Party Transactions**

The Company entered into a Standstill Agreement ("the Agreement") with Geveran effective as of April 23, 2010 ("the Effective Date") The Agreement calls for Geveran to maintain a minimum ownership of more than 25% of the issued share capital of the Company during the Standstill Period defined as the period from the effective date until all amounts payable by the Company pursuant to the Facility have been paid in full. During the Standstill Period, the Company is required to pay a standstill fee to Geveran in order to compensate it for its inability to reduce its ownership of the shares representing the Minimum Ownership as defined by the Facility. The standstill fee is calculated daily based on the outstanding balance of the Facility. The amount paid in the second quarter was not material to the financial statements.

## **Responsibility Statement**

We confirm to the best of our knowledge, that the financial statements for the period January 1 to June 30, 2010 have been prepared in accordance US GAAP and give a true and fair view of the Group's consolidated assets, liabilities, financial position and profit or loss as a whole. We also confirm, to the best of our knowledge, that the interim management report includes a fair review of important events that have occurred during the first six months of the financial year and their impact on the set of consolidated financial statements, a description of the principal risks and uncertainties for the remaining six months of the financial year, and major related parties transactions.

*The Board of Directors  
Northern Offshore, Ltd.  
August 25, 2010  
Hamilton, Bermuda*

Jim LaChance  
*Chairman of the Board*

Stephen Knudtzon  
*Director*

Hal Goldstein  
*Director*

Cecilie Fredriksen  
*Director*

NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

As of June 30, 2010 and December 31, 2009 and for the three-month and the six-month periods ended June 30, 2010 and 2009

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

(Expressed in thousands of United States dollars, except share data)

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
<b>Current assets</b>		
Cash and cash equivalents	32,270	79,162
Restricted cash	232	9,371
Accounts receivable, net	48,965	35,423
Prepaid expenses	7,663	6,097
Deferred financing fees	3,001	561
Deferred mobilization costs	566	601
	<b>92,697</b>	<b>131,215</b>
<b>Noncurrent assets</b>		
Property, plant & equipment, net	480,669	499,594
Restricted cash, net of current portion	6,438	6,438
Deferred mobilization cost, net of current portion	-	382
Deferred financing fees, net of current portion	779	-
Other noncurrent assets	842	-
<b>Total assets</b>	<b>581,425</b>	<b>637,629</b>
<b>Current liabilities</b>		
Accounts payable	34,507	12,917
Accrued expenses	26,285	21,467
Income tax payable	2,805	3,762
Current portion of debt	100,000	197,500
Deferred revenue	727	2,076
	<b>164,324</b>	<b>237,722</b>
<b>Noncurrent liabilities</b>		
Deferred revenue, net of current portion	2,066	2,396
Other long-term liabilities	-	6,022
	<b>2,066</b>	<b>8,418</b>
<b>Total liabilities</b>	<b>166,390</b>	<b>246,140</b>
<b>Shareholders' equity</b>		
Share capital: US\$0.25 par value authorized: 294,000,000 shares; issued: 157,336,413 at June 30, 2010 and 155,320,354 at December 31, 2009	39,333	38,829
Additional paid-in capital	166,137	165,750
Accumulated other comprehensive loss	(6,691)	(6,691)
Retained earnings	216,256	193,601
<b>Total shareholders' equity</b>	<b>415,035</b>	<b>391,489</b>
<b>Total liabilities and shareholders' equity</b>	<b>581,425</b>	<b>637,629</b>

Approved by the Board of Directors of Northern Offshore, Ltd.

*The accompanying notes form an integral part of the unaudited consolidated financial statements*

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)**

(Expressed in thousands of United States dollars, except share and per share data)

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
<b>Revenue</b>	48,855	73,352	116,945	129,905
<b>Operating expenses</b>				
Drilling and production	(29,191)	(28,934)	(51,900)	(57,927)
Depreciation	(14,669)	(16,225)	(28,737)	(31,998)
General and administrative	(2,371)	(2,299)	(4,690)	(4,030)
Bad debt	-	(233)	-	(3,897)
<b>Total operating expenses</b>	<b>(46,231)</b>	<b>(47,691)</b>	<b>(85,327)</b>	<b>(97,852)</b>
<b>Operating income</b>	<b>2,624</b>	<b>25,661</b>	<b>31,618</b>	<b>32,053</b>
<b>Other income/(expenses), net</b>				
Interest income	28	112	65	202
Interest expense	(1,743)	(2,718)	(4,138)	(5,968)
Amortization of deferred financing fees	(678)	(397)	(1,029)	(794)
Amortization of drilling contract intangibles	-	2,018	-	4,036
Other, net	(312)	409	(336)	(355)
<b>Total other income/ (expense), net</b>	<b>(2,705)</b>	<b>(576)</b>	<b>(5,438)</b>	<b>(2,879)</b>
<b>Income/ (loss) before income taxes</b>	<b>(81)</b>	<b>25,085</b>	<b>26,180</b>	<b>29,174</b>
Income taxes	(444)	(2,293)	(3,525)	(2,762)
<b>Net income/ (loss)</b>	<b>(525)</b>	<b>22,792</b>	<b>22,655</b>	<b>26,412</b>
<b>Earnings per share</b>				
Basic	(0.00)	0.15	0.15	0.17
Diluted	(0.00)	0.15	0.15	0.17
<b>Weighted average common shares ('000)</b>				
Basic	154,489	153,108	154,261	153,104
Diluted	154,489	153,265	156,126	153,183

Approved by the Board of Directors of Northern Offshore, Ltd.

*The accompanying notes form an integral part of the unaudited consolidated financial statements*

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (UNAUDITED)**

(Expressed in thousands of United States dollars, except share data)

	<b>Common shares '000</b>	<b>Share capital</b>	<b>Additional paid-in capital</b>	<b>Accumulated other comprehensive loss</b>	<b>Retained earnings</b>	<b>Total</b>
<b>Balance at December 31, 2008</b>	<b>153,124</b>	<b>38,281</b>	<b>164,860</b>	<b>(6,691)</b>	<b>118,542</b>	<b>314,992</b>
Net income	-	-	-	-	75,059	75,059
Issuance of restricted stock	2,196	548	(548)	-	-	-
Stock-based compensation	-	-	1,438	-	-	1,438
<b>Balance at December 31, 2009</b>	<b>155,320</b>	<b>38,829</b>	<b>165,750</b>	<b>(6,691)</b>	<b>193,601</b>	<b>391,489</b>
Net income	-	-	-	-	22,655	22,655
Issuance of restricted stock	2,016	504	(504)	-	-	-
Payments for taxes on vested shares	-	-	(407)	-	-	(407)
Stock-based compensation	-	-	1,298	-	-	1,298
<b>Balance at June 30, 2010</b>	<b>157,336</b>	<b>39,333</b>	<b>166,137</b>	<b>(6,691)</b>	<b>216,256</b>	<b>415,035</b>

Approved by the Board of Directors of Northern Offshore, Ltd.

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**

(Expressed in thousands of United States dollars)

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities</b>		
Net income	22,655	26,412
<i>Adjustments to reconcile net income to net cash provided by operating activities:</i>		
Bad debt expense	-	3,897
Stock-based compensation	1,298	725
Depreciation	28,737	31,998
Amortization of drilling contract intangibles	-	(4,036)
Amortization of deferred financing fees	1,029	794
<i>Changes in operating assets and working capital</i>		
(Increase) decrease in accounts receivable	229	(34,105)
(Increase) decrease in prepaid expenses	(240)	2,570
Increase in accounts payable	7,819	1,264
Increase (decrease) in other accrued liabilities	(4,169)	2,620
Increase (decrease) in deferred revenue	(1,679)	2,902
Decrease in income tax payable	(957)	(1,154)
Other, net	(1,749)	(300)
<b>Net cash provided by operating activities</b>	<b>52,973</b>	<b>33,587</b>
<b>Cash flows from investing activities</b>		
Capital expenditures	(6,796)	(6,883)
Release of restricted cash	9,163	-
Proceeds from the sale of equipment	-	188
<b>Net cash provided by/ (used in) investing activities</b>	<b>2,367</b>	<b>(6,695)</b>
<b>Cash flows from financing activities</b>		
Proceeds from drawdown of revolver	100,000	-
Payoff of bond loan	(100,000)	-
Payoff of bank term loan	(97,500)	(45,000)
Deferred financing fees	(4,325)	-
Payment for taxes on vested shares	(407)	-
<b>Net cash used in financing activities</b>	<b>(102,232)</b>	<b>(45,000)</b>
<b>Net decrease in cash and cash equivalents</b>	<b>(46,892)</b>	<b>(18,108)</b>
Cash and cash equivalents at beginning of period	79,162	58,759
<b>Cash and cash equivalents at end of period</b>	<b>32,270</b>	<b>40,651</b>
<b>Supplemental disclosure of cash flow information</b>		
Cash paid during the period for:		
Income taxes	4,438	3,708
Interest	2,893	6,165

Approved by the Board of Directors of Northern Offshore, Ltd.

*The accompanying notes form an integral part of the unaudited consolidated financial statements*

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

(Expressed in thousands of United States dollars except share and per share data)

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**1. Unaudited interim information**

Northern Offshore, Ltd. (referred to as the “Company” or collectively with its subsidiaries as the “Group”) is a limited liability company registered in Bermuda. The principal activities of the Group consist of providing drilling and production services to the offshore oil and gas industry.

The Group operates offshore oil and gas production and drilling vessels deployed around the world. The Group’s fleet consists of one floating production facility and five drilling units including a drillship, a semisubmersible and three jackup drilling rigs. The Group’s vessels operate in various markets including the North Sea, the Mediterranean Sea, the Indian Ocean, offshore Russia and Southeast Asia.

Northern Offshore, Ltd. is listed on the Oslo Bors where its shares began trading in September 2007.

The unaudited interim consolidated financial statements as of June 30, 2010 and for the three and six-month periods ended June 30, 2010 and 2009, included herein, have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. The year-end consolidated balance sheet data was derived from the audited financial statements as of December 31, 2009. Although these financial statements and related information have been prepared without audit, and do not include all disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles, the Group believes that the note disclosures are adequate to make the information not misleading. The interim financial results may not be indicative of results that could be expected for a full fiscal year. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Annual Report to Shareholders for the year ended December 31, 2009. The unaudited interim financial statements reflect all adjustments considered necessary for a fair statement of financial position and results of operations for the periods presented.

**2. Summary of significant accounting policies**

Principles of accounting

The consolidated financial statements are prepared based on ASC 270 (“Interim Financial Reporting”) in accordance with accounting principles generally accepted in the United States of America (“US GAAP”).

All dollar amounts included in the financial statements and in the notes herein are expressed in United States dollars (“US\$”) unless designated otherwise.



**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

(Expressed in thousands of United States dollars except share and per share data)

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Changes in Estimates

Beginning January 1, 2010, the Group revised its calculation of estimated depreciation to include estimated salvage values. This change did not have a material impact on the interim financial statements.

Recently issued accounting pronouncements

In January 2010, the FASB issued guidance relating to the disclosure of the fair value of assets. This guidance calls for additional information to be given regarding the transfer of items in and out of respective categories. In addition, it requires additional disclosures regarding the purchase, sales, issuances, and settlements of assets that are classified as level three within the FASB fair value hierarchy. This guidance is effective for annual and interim periods beginning on or after December 15, 2010. These additional disclosures are not expected to have a significant impact on our financial disclosures or our financial condition.

**3. Restricted cash**

The balance in restricted cash relates to a performance bond for the semisubmersible Energy Driller and a bid bond for the drillship Energy Searcher. At June 30, 2010 and December 31, 2009, the restricted cash balance was US\$6.7 million and US\$15.8 million, respectively.

**4. Property, plant and equipment**

The June 30, 2010 change in property, plant and equipment includes US\$3.0 million of additional shipyard costs on the Northern Producer, which will be paid out of future revenue. This is treated as a non-cash transaction for the cash flow statement purposes. The details in fixed assets are as follows:

	<u>2010</u>	<u>2009</u>
<b><u>Production and drilling vessels</u></b>		
Cost	791,765	780,580
Accumulated depreciation	(312,229)	(282,237)
Net book value	<u>479,536</u>	<u>498,343</u>
<b><u>Furniture and fixtures</u></b>		
Cost	1,093	1,106
Accumulated depreciation	(504)	(409)
Net book value	<u>589</u>	<u>697</u>
<b><u>Computer system and hardware</u></b>		
Cost	945	902
Accumulated depreciation	(401)	(348)
Net book value	<u>544</u>	<u>554</u>
<b>Total Fixed Assets</b>	<u>480,669</u>	<u>499,594</u>

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

(Expressed in thousands of United States dollars except share and per share data)

**5. Income taxes**

Under current Bermuda law, the Company is not required to pay income taxes in Bermuda. However, certain of the Company's subsidiaries are taxpayers in foreign jurisdictions. All income taxes of the Group are attributable to income earned from operations in foreign jurisdictions.

The change in the effective tax rate from period to period is primarily attributable to changes in the profitability mix of the Group's operations in various foreign jurisdictions. Because the Group's operations continually change among numerous foreign jurisdictions, and methods of taxation in these jurisdictions vary greatly, there is no direct correlation between the income tax provision and income before taxes.

**6. Earnings per share**

A reconciliation of the numerators and denominators of the basic and diluted per share computations for income from continuing operations follows:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2010	2009	2010	2009
Weighted-average shares outstanding — basic	154,489	153,108	154,261	153,104
Effect of potentially dilutive shares:				
Stock options and awards	-	157	1,865	79
Weighted-average shares outstanding — diluted	154,489	153,265	156,126	153,183
Net income (loss) — basic and diluted	(525)	22,792	22,655	26,412
Net income per share:				
Basic	\$ 0.00	\$ 0.15	\$ 0.15	\$ 0.17
Diluted	\$ 0.00	\$ 0.15	\$ 0.15	\$ 0.17

For the three month period ended June 30, 2010, we excluded stock options and awards totaling 1.6 million shares from the computation of net loss per share because their effect would have been antidilutive. No comparative periods included antidilutive options or awards.

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

(Expressed in thousands of United States dollars except share and per share data)

---

**7. Debt**

**US\$300 Million Bank Loan:**

During the second quarter of 2010, the outstanding US\$30 million balance of the Bank Loan was repaid in part by drawing down US\$20 million under the Facility with the remaining US\$10 million paid from the Company's existing cash on hand.

**US\$100 Million Bond Loan:**

The Company also retired the US\$100 million bond issue described as “FRN Northern Offshore, Ltd. Senior Secured Callable Bond Issue 2007/2010”, Registration Number (ISIN) NO 001 037367.3 (the “Bond Loan”) maturing on June 14, 2010 by utilizing US\$20 million of existing cash on hand and drawing down US\$80 million under the Facility.

**US\$120 Million Revolving Credit Facility:**

On April 23, 2010 the Company entered into a US\$120 million Revolving Credit Facility (the “Facility”) with The Royal Bank of Scotland (Lead Arranger), Nordea Bank Norge ASA and NIBC Bank N.V. After entering into the Facility, the remaining US\$30 million outstanding balance of the Bank Loan was repaid. The utilized portion of the Facility was restricted to a maximum of US\$30 million until the Bond Loan was repaid at its maturity on June 14, 2010. Simultaneous with the repayment of the Bond Loan and pledging of additional collateral currently restricted by the Bond Loan Agreement, the full US\$120 million balance of the Facility became available.

The Facility is reduced by US\$24 million per quarter at the end of each calendar quarter, commencing September 30, 2010, with the final reduction at maturity on September 30, 2011. Additionally, prepayments are required under certain circumstances as outlined in the Facility Agreement, and the Facility will be cancelled and required to be repaid in full under certain other circumstances, such as change of control (including the failure of Geveran Trading Limited (“Geveran”) to own at least 25% of the Company's common stock), sale of all or substantially all assets, non-approved delisting of the Company's stock, or the termination of certain contracts currently in place.

The utilized portion of the Facility bears interest at a rate of 3.00% over LIBOR with a non-utilization fee of 1.5% paid quarterly in arrears on the unutilized portion of the Facility.

The Facility contains certain indemnity, reimbursement and break cost provisions, representations and warranties, affirmative and negative covenants including: maintaining a minimum cash and cash equivalents amount of not less than US\$20 million through September 30, 2010 and US\$25 million thereafter until the Facility

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

(Expressed in thousands of United States dollars except share and per share data)

---

matures, minimum fleet value of 2.5x the total commitments under the Facility, minimum net tangible assets of US\$400 million at year end 2010 and maximum total debt to trailing four quarters Earnings before Interest, Tax, Depreciation and Amortization (EBITDA) less capital expenditures for such period as follows for the periods specified: March 31, 2010: 0.90x, June 30, 2010: 0.80x, September 30, 2010: 0.50x, December 31, 2010: 0.35x, March 31, 2011: 0.30x and June 30, 2011: 0.25x.

The Facility is governed by English law. The Facility identifies certain events or circumstances that would effectuate an event of default including, but not limited to, non-payment on the due date, non-compliance with financial covenants, material adverse change, insolvency, insolvency proceedings, breach of other obligations, misrepresentations, and cross defaults.

The obligations of the Company under the Facility are guaranteed by Jet Drilling (S) Pte. Ltd., Jet Holding Ltd., Energy Endeavour Ltd., Energy Exerter Ltd., Energy Enhancer Ltd. and Energy Offshore Ltd., each of which is a direct or indirect wholly owned subsidiary of the Company (collectively, the “Guarantors”). Qualimar Shipping Company Limited and Northern Offshore UK Ltd. joined the Facility as guarantors upon repayment of the Bond Loan. All amounts owing under or in respect of the Facility and the related documents are collateralized by (i) a first-priority vessel mortgage on the vessels “Energy Endeavour”, “Energy Exerter”, “Energy Enhancer”, “Energy Driller”, “Northern Producer” and “Energy Searcher” (collectively, the “Vessels”), (ii) a first-priority assignment of all earnings and insurances in respect of the Vessels, (iii) a first priority pledge of the shares of each of the Guarantors and (iv) a first priority pledge of the Company’s and the Guarantors’ accounts.

The total amount of loans outstanding under the Facility at June 30, 2010 amounted to US\$100 million with US\$20 million available to be drawn.

**8. Industry and geographical segment information**

From inception through June 30, 2010 the Group provided drilling and production services to the offshore oil industry. The Group reports operating segments based on geographic region. This is attributable to each geographic segment being engaged in providing services within a particular economic environment that are subject to risks and returns that are different from those segments operating in other economic environments. The Group has five reportable segments including “Other” which are consistent with the way the business is managed internally.

Certain costs relate to general stewardship activities and are not attributed to a certain geographic location. As such, management does not analyze net income by geographic location.

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

(Expressed in thousands of United States dollars except share and per share data)

Revenue disclosed in the following table is based on the location of each production and drilling vessel at the time the revenue was earned.

<u>Revenue</u>	<b>Three months ended June 30,</b>		<b>Six months ended June 30,</b>	
	<u>2010</u>	<u>2009</u>	<u>2010</u>	<u>2009</u>
North Sea	14,887	32,382	28,727	57,869
Mediterranean	-	8,765	-	11,988
India	19,456	20,878	40,510	39,820
Vietnam	11,397	11,327	41,511	11,327
Other	3,115	-	6,197	8,901
<b>Total revenue</b>	<b>48,855</b>	<b>73,352</b>	<b>116,945</b>	<b>129,905</b>

**9. Financial risk management**

(i) *Currency risk*

The Group's business is exposed to currency risk arising from various currency exposures primarily with respect to the Singapore dollar, Norwegian kroner, Danish kroner and British pound. The Group does not generally use financial instruments to reduce its exposure to foreign currency risk.

(ii) *Interest rate risk*

The Group is exposed to market risks inherent in the operations, primarily related to interest rate risk which arose from the Group's borrowing and financing requirements. The Group does not generally use derivatives to alter the interest characteristics of the debt instruments. The Group had no holdings of derivative or commodity instruments as of June 30, 2010 and December 31, 2009.

(iii) *Liquidity risk*

Pursuant to the Group's Facility, it has covenants which include, among other things, that the Group maintains a minimum cash balance of US\$20.0 million through September 30, 2010, and US\$25.0 million thereafter until the Facility matures. At June 30, 2010 and December 31, 2009, the Group had cash and cash equivalents of US\$32.3 million and US\$79.2 million, respectively, excluding US\$6.7 million and US\$15.8 million, respectively, of cash which was securing bank guarantees.

(iv) *Oil and gas price risk*

The Group's business is exposed to fluctuations in the price of crude oil and natural gas. The Northern Producer's revenues are indexed to the daily Brent Crude Oil price which directly impacts revenues earned. Additionally, fluctuations

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

(Expressed in thousands of United States dollars except share and per share data)

---

in crude oil and natural gas prices have an indirect impact on the demand for the Group's services.

(v) *Concentration of credit risk*

The Group markets its services to the offshore oil and gas industry, and its customer base consists primarily of major integrated and government-owned international oil companies, as well as smaller independent oil and gas producers. Management believes the credit quality of the Group's customers is generally acceptable. The Group provides allowances for potential credit losses when necessary.

One customer accounted for 47% of trade receivables at June 30, 2010 while another customer accounted for 39% of trade receivables at December 31, 2009. Additionally, one customer accounted for 35% of revenue for the six months ended June 30, 2010, while a different customer accounted for 31% of revenue for the six months ended June 30, 2009.

The Group places its cash and cash equivalents with high credit quality financial institutions to limit the Group's risk of counterparty credit risks default.

**10. Fair values of financial instruments**

The Company's financial instruments consist of cash and cash equivalents, trade accounts receivable, accounts payable and the Facility. The carrying amounts of cash and cash equivalents, trade accounts receivable and accounts payable approximate fair value due to the highly liquid nature of these short-term instruments. As the revolving amounts due under the Facility are short term in nature and the related interest rates are linked to market rates the carrying value of the Facility approximates fair value. Fair value represents the amount at which an instrument could be exchanged in a current transaction between willing parties.

**11. Related Party Transactions**

In conjunction with the Revolving Credit Facility finalized in the second quarter, the Company entered into a standstill agreement with Geveran Trading Co. Ltd. (the "Shareholder") requiring the Shareholder to own approximately 25.5% of the issued and outstanding shares of the Company until the full amount of the Facility is repaid. The Company is required to pay a standstill fee to the Shareholder in order to compensate for its inability to sell, trade or pledge the shares representing the minimum ownership during the standstill period. The standstill fee is calculated daily based on the outstanding balance of the Facility. The amount paid in the second quarter was not material to the financial statements.

**NORTHERN OFFSHORE, LTD.  
AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
(Expressed in thousands of United States dollars except share and per share data)

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**12.     Subsequent Events**

The Company has evaluated subsequent events through August 25, 2010, the date at which these financial statements were available to be issued.

The Company paid down US\$20 million of the outstanding loans under the Facility in July 2010.