Constellation Oil Services Holding S.A.

Consolidated Financial Statements
for the Year Ended December 31, 2018
and Independent Auditor's Report

Deloitte Touche Tohmatsu Auditores Independentes

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Shareholders of
Constellation Oil Services Holding S.A.

Disclaimer of opinion

We were engaged to audit the consolidated financial statements of Constellation Oil Services Holding S.A., (the "Company", or together with its subsidiaries, the "Group"), which comprise the consolidated statement of financial position as at December 31, 2018, and the consolidated statements of operations, of comprehensive income, of changes in shareholders' equity and of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

We do not express an audit opinion on the accompanying consolidated financial statements of the Group. Because of the significance and aggregation of the matters described in the "Basis for disclaimer of opinion" section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

Basis for disclaimer of opinion

Material uncertainty related to the Group's ability to continue as a going concern

As disclosed in Notes 1, 14 and 24 to the consolidated financial statements, the Group presents the following conditions as at December 31, 2018, and for the year then ended:

(i) A net working capital deficiency in the amount of US$1,346,593 thousand.

(ii) An uncertainty on whether the Group's loans and financing debt balances shall become immediately due and payable due to non-compliance with certain restrictive financial debt covenants, regardless the information provided in topic (iii) below.

(iii) A joint Judicial Recovery Plan filed by the Company and certain of its subsidiaries at the First Corporate Court of the Judicial District of the State Capital of Rio de Janeiro, pursuant to the terms of the Brazilian Bankruptcy Law (Law No. 11,101/2005), which was approved by the General Creditors Meeting of the Group on June 28, 2019, and ratified by the judge of said court on July 1, 2019.

The operational continuity of the Group will depend substantially on its ability to enter into new medium and long-term charter agreements, as well as in the successful implementation of the measures set forth in the aforementioned joint Judicial Recovery Plan.

Considering this set of conditions and the pervasiveness involved in the context of the consolidated financial statements, which refers to a scenario of significant uncertainties, we were unable, at the date of this report, to conclude that the going concern assumption used by management in the preparation of consolidated financial statements was appropriate or to determine whether any adjustments to the consolidated financial statements and accompanying explanatory notes were due necessary.

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Partnership with Sete Brasil Participações S.A. and its subsidiaries - Investments in associate entities

The Group, through its subsidiary Angra Participações B.V., is a non-controlling shareholder in the associate entities Urca Drilling B.V., Bracuhy Drilling B.V. and Mangaratiba Drilling B.V. (hereinafter together referred to as the "Investees"). The controlling shareholder of the Investees is Sete International One GmbH, a subsidiary of Sete Brasil Participações S.A. ("Sete Brasil"). The Group's fifteen percent equity participation balance in the Investees amounts to zero as at December 31, 2018. As disclosed in Note 12 to the consolidated financial statements, as at December 31, 2018, the Investees present shareholders' equity deficiency and comprehensive loss in the total aggregate amounts of US$1,384,356 thousand and US$49,656 thousand, respectively, for the year then ended. Such Investees balances have not been audited by us or by any other independent auditor.

Due to the funding and liquidity difficulties in meeting its operational and financial commitments, aiming the construction completion of its semi-submersible offshore drilling rigs (including those related to the aforementioned Investees), Sete Brasil has filed a Judicial Recovery proceeding in April 2016, which has been approved by the General Creditors Meeting of Sete Brasil and ratified in court in November 2018.

Until the date of this report, we were unable to obtain sufficient appropriate audit evidence and, therefore, unable to conclude on the Group's financial position on the Investees as at December 31, 2018, the Group's share of results on the Investees for the year then ended or to determine whether any adjustments to Note 12 to the consolidated financial statements were due necessary.

Balances and transactions with Alperton Capital Ltd.

We draw attention to Note 11 to the consolidated financial statements, which discloses that Constellation Overseas Ltd. ("Constellation Overseas"), one of the Company's subsidiaries, has entered into an arbitration process against Alperton Capital Ltd. ("Alperton"), under the parties' Shareholders' Agreements for Amaralina Star Ltd. ("Amaralina") and Laguna Star Ltd. ("Laguna"), both entities being subsidiaries of the Company. The arbitration process was initiated due to the existence of an unresolved matter between the parties.

Therefore, pursuant to the terms and conditions set forth in said Shareholders' Agreement and based on the Group's legal interpretation of its clauses, Constellation Overseas invoked its right to purchase the shares of Amaralina and Laguna owned by Alperton and, as a consequence, on September 2018, Constellation Overseas would become the sole shareholder of Amaralina and Laguna. Until the date of this report, the Group is not able to foresee the outcome of the aforementioned arbitration process and the share transfer injunction claim initiated by Alperton against Constellation Overseas.

As disclosed in Note 11 (a) to the consolidated financial statements, the Group presented, as at December 31, 2017, noncurrent assets and liabilities balances with Alperton related to shareholders' and project financing loan agreements aiming the construction of the Amaralina Star and Laguna Star drillships. As at December 31, 2017 (current-year opening balances), these balances amounted to US$381,125 thousand and US$345,042 thousand, being loans receivables and intercompany loans payable, respectively. The net income of these assets and liabilities related-party transactions recorded in the year ended December 31, 2017, as financial result, amounts to US$7,950 thousand (US$6,363 thousand, as financial result in 2018, until the date Constellation Overseas, under its legal interpretation, became the sole shareholder of Amaralina and Laguna). Until the date of this report, we have not obtained the external confirmation from Alperton, aiming to corroborate and confirm the noncurrent assets and liabilities balances and transactions as at and for the year ended December 31, 2017, as well as the effects of transactions held in 2018.

Accordingly, we were unable, under the circumstances described above, to conclude on any potential effects of this arbitration process and share transfer injunction claim on the Group's consolidated financial statements as at December 31, 2018 and for the year then ended.

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Incomplete disclosure of information required under IAS 36 – Impairment of Assets

As disclosed in Note 13 to the consolidated financial statements, the Group has estimated the recoverable amounts of its offshore drilling rigs and drillships by applying the income approach method of valuation ("value in use"), under a discounted projected net cash flow analysis over the remaining economic useful life of each equipment individually.

As required under International Accounting Standard (IAS) 36.130 (g), if the recoverable amount of a noncurrent asset is determined based on value in use, when an impairment loss is recognized or reversed during the period, the entity shall disclose the discount rate used in the current and previous estimate of value in use. Despite such requirement, the Group is not disclosing the discount rate (pre-tax rate based on WACC) used in the impairment test for its offshore drilling rigs and drillships as at December 31, 2018, and for the year ended.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our responsibility is to conduct an audit of the Group's consolidated financial statements in accordance with International Standards on Auditing ("ISAs") and to issue an auditor's report. However, because of the significance and aggregation of the matters described in the "Basis for disclaimer of opinion" section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these consolidated financial statements.

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (the "IESBA Code"), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code.

Rio de Janeiro, July 10, 2019

DELOITTE TOUCHE TOHMATSU
Auditores Independentes

John Alexander Harold Auton
Engagement Partner

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CONSTELLATION OIL SERVICES HOLDING S.A.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS OF DECEMBER 31, 2018
(Amounts expressed in thousands of U.S. dollars - US$'000)

ASSETS	Note	December 31, 2018	December 31, 2017
CURRENT ASSETS			
Cash and cash equivalents	6	109,406	216,263
Short-term investments	7	26,047	13,500
Restricted cash	8	42,553	39,035
Trade and other receivables	9	32,410	67,144
Inventories	10	39,883	33,251
Receivables from related parties	11	974	1,377
Recoverable taxes	23.a	12,816	9,377
Deferred mobilization costs		2,264	8,532
Derivatives	17	-	106
Other current assets		10,436	17,613
Total current assets		276,789	406,198
NON-CURRENT ASSETS			
Inventories	10	125,866	143,231
Receivables from related parties	11	17	382,151
Recoverable taxes	23.a	3,059	7,684
Deferred tax assets	23.c	12,168	10,999
Deferred mobilization costs		2,368	4,186
Derivatives	17	-	1,938
Other non-current assets		2,368	1,139
Investments	12	198,503	257,923
Property, plant and equipment, net	13	2,442,049	2,371,280
Total non-current assets		2,786,398	3,180,531
TOTAL ASSETS		3,063,187	3,586,729

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

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CONSTELLATION OIL SERVICES HOLDING S.A.

CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS OF DECEMBER 31, 2018
(Amounts expressed in thousands of U.S. dollars - US$'000)

LIABILITIES AND SHAREHOLDERS' EQUITY	Note	December 31, 2018	December 31, 2017
CURRENT LIABILITIES			
Loans and financings	14	1,475,200	655,788
Payroll and related charges		12,284	22,844
Derivatives	17	-	2,817
Trade and other payables		33,150	37,537
Payables to related parties	11	188	1,428
Taxes payables	23.b	2,479	3,986
Provisions	15	1,035	4,391
Deferred revenues		3,423	32,562
Deficit in investments	12	48,503	20,542
Other current liabilities		47,120	46,293
Total current liabilities		1,623,382	828,188
NON-CURRENT LIABILITIES			
Loans and financings	14	-	999,395
Payables to related parties	11	-	345,042
Deferred revenues		3,526	-
Other non-current liabilities		16,776	25,272
Total non-current liabilities		20,302	1,369,709
TOTAL LIABILITIES		1,643,684	2,197,897
SHAREHOLDERS' EQUITY			
Share capital	18.a	63,200	63,200
Share premium	18.a	766,561	766,561
Transaction costs on issuance of shares		(9,721)	(9,721)
Reserves	18.b/d	(100,371)	(10,697)
Retained earnings		699,834	628,826
Equity attributable to controlling interests		1,419,503	1,438,169
Equity attributable to non-controlling interests	18.e	-	(49,337)
TOTAL SHAREHOLDERS’ EQUITY		1,419,503	1,388,832
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY		3,063,187	3,586,729

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

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CONSTELLATION OIL SERVICES HOLDING S.A.

CONSOLIDATED STATEMENT OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2018
(Amounts expressed in thousands of U.S. dollars - US$'000, except per share amounts)

	Note	Year-ended December 31, 2018	2017
NET OPERATING REVENUE	19	507,932	945,790
COST OF SERVICES	20	(380,783)	(532,443)
GROSS PROFIT		127,149	413,347
General and administrative expenses	20	(80,549)	(27,484)
Other income	21	291,677	2,787
Other expenses	21	(162,432)	(1,442,536)
OPERATING PROFIT / (LOSS)		175,845	(1,053,886)
Financial income	22	16,559	15,276
Financial expenses	22	(124,519)	(131,911)
Foreign exchange variation income/ (loss), net	22	77	(608)
FINANCIAL EXPENSES, NET		(107,883)	(117,243)
Share of results of investments	12	7,683	22,333
PROFIT/ (LOSS) BEFORE TAXES		75,645	(1,148,796)
Taxes	23.d	1,175	119
PROFIT/ (LOSS) FOR THE YEAR		76,820	(1,148,677)
Profit/ (loss) attributable to:			
Controlling interests		71,008	(1,049,596)
Non-controlling interests		5,812	(99,081)
Profit/ (loss) per share (in U.S. dollars - US$)			
Basic	18.g	0.38	(5.55)
Diluted	18.g	0.38	(5.55)

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

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CONSTELLATION OIL SERVICES HOLDING S.A.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED DECEMBER 31, 2018
(Amounts expressed in thousands of U.S. dollars - US$'000)

	Note	Year-ended December 31, 2018	2017
PROFIT/ (LOSS) FOR THE YEAR		76,820	(1,148,677)
OTHER COMPREHENSIVE INCOME/ (LOSS)			
Items that may be reclassified subsequently to profit or loss:			
Cash flow hedges fair value adjustments	17/18.e	(1,208)	7,044
Share of investments' other comprehensive income	12/18.e	8,505	4,529
Foreign currency translation adjustments	18.e	(11,040)	(2,207)
TOTAL COMPREHENSIVE INCOME/ (LOSS) FOR THE YEAR		73,077	(1,139,311)
Comprehensive income/ (loss) attributable to:			
Controlling interests		66,889	(1,041,941)
Non-controlling interests		6,188	(97,370)

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

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CONSTELLATION OIL SERVICES HOLDING S.A.

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY FOR THE YEAR-ENDED DECEMBER 31, 2018
(Amounts expressed in thousands of U.S. dollars - US$'000)

					Reserves							Equity attributable to		
	Note	Share capital	Share premium	Transaction costs on issuance of shares	Legal	Cash flow hedges fair value adjustments	Share of investments' other comprehensive income/ (loss)	Acquisition of non-controlling interests in subsidiaries	Foreign currency translation adjustments	Total reserves	Retained earnings	Controlling interests	Non-controlling interests	Total shareholders' equity
BALANCE AS OF DECEMBER 31, 2016		63,200	766,561	(9,721)	5,683	(3,749)	(12,156)	-	(8,130)	(18,352)	1,678,422	2,480,110	48,033	2,528,143
Loss for the year		-	-	-	-	-	-	-	-	-	(1,049,596)	(1,049,596)	(99,081)	(1,148,677)
Other comprehensive income for the year	18.d	-	-	-	-	5,333	4,529	-	(2,207)	7,655	-	7,655	1,711	9,366
Total comprehensive loss for the year		-	-	-	-	5,333	4,529	-	(2,207)	7,655	(1,049,596)	(1,041,941)	(97,370)	(1,139,311)
BALANCE AS OF DECEMBER 31, 2017		63,200	766,561	(9,721)	5,683	1,584	(7,627)	-	(10,337)	(10,697)	628,826	1,438,169	(49,337)	1,388,832
Profit for the year		-	-	-	-	-	-	-	-	-	71,008	71,008	5,812	76,820
Other comprehensive loss for the year	18.d	-	-	-	-	(1,584)	8,505	-	(11,040)	(4,119)	-	(4,119)	376	(3,743)
Acquisition of non-controlling interests	18.c	-	-	-	-	-	-	(85,555)	-	(85,555)	-	(85,555)	43,149	(42,406)
Total comprehensive income for the year		-	-	-	-	(1,584)	8,505	(85,555)	(11,040)	(89,674)	71,008	(18,666)	49,337	30,671
BALANCE AS OF DECEMBER 31, 2018		63,200	766,561	(9,721)	5,683	-	878	(85,555)	(21,377)	(100,371)	699,834	1,419,503	-	1,419,503

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

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CONSTELLATION OIL SERVICES HOLDING S.A.

CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEAR-ENDED DECEMBER 31, 2018
(Amounts expressed in thousands of U.S. dollars - US$'000)

	Note	Year-ended December 31, 2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit/ (loss) for the year		76,820	(1,148,677)
Adjustments to reconcile profit/ (loss) for the year to net cash provided by operating activities:			
Depreciation of property, plant and equipment	13/20	174,402	229,881
Loss/(gain) on sales of property, plant and equipment, net	21	258	(16)
Impairment loss recognized/(reversed) on property, plant and equipment	13/21	(219,437)	1,400,470
Impairment loss recognized on investments	12	98,860	-
Share of results of investments	12	(7,683)	(22,333)
Recognition of deferred mobilization costs		8,795	10,999
Recognition of deferred revenues, net of taxes levied		(35,831)	(66,592)
Financial expenses on loans and financings	14.a/22	117,795	119,749
Financial income from related parties, net	11/22	(5,878)	(6,530)
Fair value loss on derivatives	17/22	513	5,006
Provision for employee profit sharing plan		-	26
Provision for onerous contract	21	17,279	35,984
Other financial income, net	22	(4,543)	(982)
Recognition/ (reversal) of provisions	21	(21,857)	3,179
Taxes	23.d	(1,175)	(119)
Decrease/(increase) in assets:			
Short-term investments		(15,386)	100,372
Trade and other receivables		32,906	13,746
Inventories		3,388	7,487
Recoverable taxes		1,149	143
Receivables from related parties		283	1,882
Deferred taxes		149	(236)
Deferred mobilization costs		(709)	(6,134)
Other assets		15,088	(108)
Increase/(decrease) in liabilities:			
Payroll and related charges		(7,774)	(8,016)
Trade and other payables		(2,601)	8,171
Payables to related parties		-	(40)
Taxes payables		(1,007)	1,744
Deferred revenues		10,218	2,016
Provisions	15	(3,179)	-
Other liabilities		(4,250)	(3,245)
Cash provided by operating activities		226,593	677,827
Income tax and social contribution paid		(4,163)	(11,132)
Net cash provided by operating activities		222,430	666,695
CASH FLOWS FROM INVESTING ACTIVITIES			
Dividends received	12	-	6,600
Capital decrease in investments	12	4,708	2,575
Acquisition of property, plant and equipment	13	(30,000)	(80,190)
Proceeds from sales of property, plant and equipment	21	27	31
Net cash used in investing activities		(25,265)	(70,984)
CASH FLOWS FROM FINANCING ACTIVITIES			
Payments to related parties		(1,750)	(2,009)
Proceeds from related parties		954	-
Transaction costs paid	14.a	-	(23,524)
Interest paid on loans and financings	14.a	(67,287)	(104,250)
Cash payments on derivatives	17	(2,494)	(12,880)
Restricted cash	8	(3,518)	4,187
Repayment of principal on loans and financings	14.a	(230,491)	(532,481)
Net cash used in financing activities		(304,586)	(670,957)
Decrease in cash and cash equivalents		(107,421)	(75,246)
Cash and cash equivalents at the beginning of the year	6	216,263	293,189
Effects of exchange rate changes on the balance of cash held in foreign currencies		564	(1,680)
Cash and cash equivalents at the end of the year	6	109,406	216,263

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

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1. GENERAL INFORMATION

Constellation Oil Services Holding S.A. (the “Company”, or together with its subsidiaries, the “Group”) was incorporated in Luxembourg on August 30, 2011, as a “*société anonyme*” (i.e., public company limited by shares) and is indirectly controlled by members of the Queiroz Galvão family. The Company has its registered address at 8-10, Avenue de la Gare, L-1610 Luxembourg.

The Company’s objectives are: (i) to hold investments in Luxembourg or foreign countries; (ii) to acquire any securities and rights through participation, contribution, underwriting firm purchase or option, negotiation or in any other way and namely to acquire patents and licenses, and other property, rights and interest in property as deemed necessary, and generally to hold, manage, develop, sell or dispose of the same, in whole or in part, for such consideration as deemed necessary, and in particular for shares or securities of any entity purchasing the same; (iii) to enter into, assist or participate in financial, commercial and other transactions, and to grant to any holding entity, subsidiary, or fellow subsidiary, or any other entity associated in any way with the Company, or the said holding entity, subsidiary or fellow subsidiary, in which the Company has a direct or indirect financial interest, any assistance, loans, advances or guarantees; (iv) to borrow and raise funds in any manner and to secure the repayment of any funds borrowed; and (v) to perform any operation that is directly or indirectly related to its purpose. The Company’s fiscal year is from January 1 to December 31.

The Company holds investments in subsidiaries that own, charter and operate onshore and offshore drilling rigs and drillships for exploration and production companies mainly operating in Brazil. The Group currently charters its onshore and offshore drilling rigs and drillships to a variety of multinational companies, such as Shell Brasil Petróleo Ltda. (“Shell”) and Oil and National Gas Corporation (“ONGC”). As disclosed in Note 12, the Group, through certain of its associate and joint venture entities, also has valid agreements with Petróleo Brasileiro S.A. - Petrobras until 2036.

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a) Fleet of drilling rigs and drillships

Offshore drilling units

Drilling unit	Type	Start of operations	Contract expiration date (current or previous)	Customer (current or previous)
Atlantic Star	Semi-submersible	1997	January 2019	Petrobras
Olinda Star	Semi-submersible	2009	January 2021 (Note 1.b)	ONGC
Gold Star(*)	Semi-submersible	2010	February 2018	Petrobras
Lone Star (*)	Semi-submersible	2011	March 2018	Petrobras
Alpha Star (*)	Semi-submersible	2011	July 2017	Petrobras
Amaralina Star	Drillship	2012	April 2019 (Note 27)	Total
Laguna Star	Drillship	2012	May 2019 (Note 1.d)	Enauta
Brava Star	Drillship	2015	November 2019 (Note 1.c)	Shell

Onshore drilling units

Drilling units	Type	Start of operations	Contract expiration date (current or previous)	Customer (current or previous)
QG-I (*)	Onshore drilling rig	1981	June 2018	Zeus
QG-II (*)	Onshore drilling rig	1981	August 2018	Ouro Preto
QG-III (*)	Onshore drilling rig	1987	April 2016	Petrobras
QG-IV (*)	Onshore drilling rig	1996	June 2015	Petrobras
QG-V (*)	Onshore drilling rig	2011	April 2015	Petrobras
QG-VI (*)	Onshore drilling rig	2008	May 2016	Petrobras
QG-VII (*)	Onshore drilling rig	2008	July 2015	Petrobras
QG-VIII (*)	Onshore drilling rig	2011	November 2019 (Note 27)	Eneva
QG-IX (*)	Onshore drilling rig	2011	June 2014	HRT O&G Exploração e Produção de Petróleo Ltda.

(*) As of December 31, 2018, these drilling units were not hired under charter and service-rendering agreements. The Group is continuously seeking for new customers.

b) Olinda Star offshore drilling rig charter and service-rendering agreements

On April 25, 2017, the Group announced that its offshore drilling rig, the Olinda Star, had been awarded a three-year contract with ONGC, an Indian oil and gas exploration and production state-owned company, for operations within an offshore area in India. Operations commenced on January 12, 2018, supported by a Letter of Award (LOA), and the contract was signed on March 14, 2018.

On December 31, 2017, the Group recognized a provision for onerous contract in the total amount of US$42,231, related to the aforementioned contract.

c) Brava Star drillship charter and service-rendering agreements

On August 1, 2018, the Group announced that its drillship, the Brava Star, had been awarded a contract with Shell, a Brazilian subsidiary of Royal Dutch Shell Plc. The purpose of the agreement is to drill four firm wells plus options for up to an additional period of 810 days at the BC-10, Sul de Gato do Mato and Alto de Cabo Frio Oeste fields (offshore the Brazilian coast). The contract was signed in late July 2018, and operations commenced on March 7, 2019.

On December 31, 2018, the Group recognized a provision for onerous contract in the total amount of US$18,673, related to the aforementioned contract.

d) Laguna Star offshore drilling rig charter and service-rendering agreements

On March 17, 2018, the Laguna Star offshore drilling rig started its 5-year survey and on April 27, 2018, it returned to operate under the charter and service-rendering agreements with Petrobras, which expired on November 2018.

On September 17, 2018, the Group announced that its drillship, the Laguna Star, had been awarded a contract with Enauta Energia S.A. ("Enauta"), formerly named Queiroz Galvão Exploração e Produção S.A., a related party, for a campaign of one firm well up to 90 days, and two additional options for well interventions of 45 days each. The operations will be performed offshore the Brazilian coast, at the Atlanta field. The contract was signed in early September 2018, and operations commenced on February 18, 2019.

On December 31, 2018, the Group recognized a provision for onerous contract in the total amount of US$3,643, related to the aforementioned contract.

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e) Operational and commercial strategies

The Group's capacity to participate in tenders of Petrobras, its main client (Note 24.b), is solely dependent upon the discretionary decision of Petrobras to invite it or not, based on Petrobras' internal criteria such as compliance, operational, commercial, technical and economic background, among others. The Group has taken the necessary actions and measures to comply with Petrobras' requirements, enabling it to continue participating in Petrobras' tenders. Additionally, the Group is currently exploring other commercial opportunities with global oil and gas industry players.

The Group's operations are dependent upon conditions in the oil and gas industry and, specifically, on the exploration and production expenditures of oil and gas companies. The demand for charter and service-rendering agreements for drilling and related services provided by the Group is influenced by, among other factors, oil and gas prices, expectations about future prices, the cost of producing and delivering oil and gas, government regulations and local and international political and economic conditions.

The Group is currently pursuing opportunities to expand and diversify its client portfolio, including new locations. Accordingly, subsidiaries/offices have already been established in important international markets such as Mumbai (India) and Houston (USA), specifically focusing on strategic markets such as India, West Africa and the Gulf of Mexico. As a result of these actions, the Group has participated in some bids and was awarded with a three-year contract with ONGC (Note 1.b).

Additionally, the Group is prepared to take advantage of the opportunities that will arise in the Brazilian market as a result of the changes in Brazil's oil and gas regulation issued by the National Petroleum Agency ("Agência Nacional do Petróleo - ANP"), such as opening of pre-salt oil fields to non-Petrobras operators, new local content rules and Petrobras divestiture plans.

Management believes that the aforementioned strategies, combined with cost containment measures, capital expenditures discipline and its strong operational track record, will position the Group to benefit from the recovery in the oil and gas industry. Certain commercial actions were already successfully implemented, reflecting the obtainment of new charter and service-rendering agreements entered into during the year ended December 31, 2018 (Note 27).

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f) Liquidity and financial restructuring aspects

In addition to the aforementioned ongoing operational and commercial strategies, the Group has taken a series of financial restructuring measures aiming at improving its liquidity position by extending the maturity of its debt through a liability management process. By the end of 2017, the Group began to engage in discussions with its financial creditors regarding the terms of a comprehensive financial restructuring with the objective of achieving a sustainable capital structure. The Group intended to reach this goal by extending debt maturities, reducing fixed amortization, amending financial covenants and raising new capital. The first phase of this liability management process was successfully initiated through the issuance of Senior Secured Notes maturing in November 2024 (the "New Notes"), extending the maturity of Amaralina Star project financing balloon payment from September 28, 2018 to December 8, 2018, and extending the maturity of working capital loans from September 21, 2018 to December 8, 2018 (Note 14). These maturity extensions provided extra time for the Group to continue advancing in the ongoing negotiations with its financial creditors.

After considering the challenges of its economic and financial situation and the maturity schedule of the Group's financial debts, thus recognizing the need to adopt protective measures to its business, the Group concluded that (i) the Company did not meet the insolvency test under Luxembourg law, and (ii) filing a request to commence a Judicial Recovery proceeding in Brazil (the "RJ"), on a partially consensual basis, would be the most appropriate action to be taken. Therefore, on November 29, 2018, the Group executed a Plan Support and Lock-Up Agreement (the "PSA"), under which financial creditors holding approximately 50% of the Group's funded debt agreed to support the approval of a consensual and comprehensive RJ plan (the "RJ Plan"), provided that certain precedent conditions have been met, including an agreement on definitive documentation, approval of the RJ Plan by financial creditors and the Brazilian court and filing of an order enforcing the RJ Plan in a U.S. court. As part of the PSA, the engaged shareholders and certain financial creditors of the Group have committed to provide new capital to the Group.

On December 5, 2018, the Company's Board of Directors authorized the filing of a RJ consistent with the PSA, and on December 6, 2018, the Company and certain of its subsidiaries (hereinafter together referred to as the "RJ Debtors") filed a request for a RJ Plan under the terms of the Brazilian Bankruptcy Law (Law No. 11,101/2005) at the First Corporate Court of the Judicial District of the State Capital of Rio de Janeiro (the "RJ Court"), thus commencing an RJ for the RJ Debtors (the "RJ Proceeding").

In accordance with Brazilian Bankruptcy Law, the RJ Debtors are required to submit to the RJ Court a list of their financial creditors (the "First List of Creditors") for publication. The First List of Creditors was submitted by the RJ Debtors to the RJ Court on December 6, 2018, and was published in the Electronic Court Gazette (*Diário da Justiça Eletrônico*) of the State Capital of Rio de Janeiro on December 18, 2018. In accordance with the PSA, and prior to the closing of the term provided for in the Brazilian Bankruptcy Law, on February 11, 2019, the RJ Debtors presented their RJ Plan to the RJ Court.

After the commencement of the RJ Proceeding, the Group continued to negotiate with certain bondholders representing the majority of the total amount of the New Notes (the "Ad Hoc Group"). On February 12, 2019, the Company's Board of Directors approved the signing of amendments to the PSA, as agreed with the financial creditors, as well as a Backstop Commitment Agreement (the "BCA"). Following successful negotiations, on February 21, 2019, the Group entered into a revised PSA (the "Amended and Restated PSA") with the financial creditors of the project financings of Amaralina Star, Laguna Star and Brava Star drillships, Banco Bradesco S.A. (working capital loans lender) and the Ad Hoc Group. Under the terms of the Amended and Restated PSA, the Group and the Ad Hoc Group entered into the BCA, whereby the Ad Hoc Group members undertook to provide new capital to be invested by the bondholders maturing in November 2024.

The General Creditors Meeting, where the votes of the financial creditors are requested, was scheduled for June 27, 2019. On June 28, 2019, the Group entered into a further revised PSA (the "Second Amended and Restated PSA") and BCA Agreement (the "Amended and Restated BCA"), to make certain amendments to the RJ Plan. Following the submission of an amended RJ Plan (the "Amended and Restated RJ Plan") by the Group to the financial creditors on June 28, 2019, approximately 90% of the financial creditors, in value, approved the Amended and Restated RJ Plan. On July 1, 2019, the judge of the RJ Court approved the Amended and Restated RJ Plan. The RJ Debtors will endeavor to exit the RJ Proceeding by the end of 2019, subject to approval by the RJ Court.

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Once the Amended and Restated RJ Plan is implemented, it will enable the Group to achieve its debt-restructuring goal, which, together with a capital contribution of approximately US$105 million from the shareholders and certain financial creditors, will allow the Group reach a sustainable capital structure.

The RJ Proceeding filing, the submission of the Amended and Restated RJ Plan, the entry into the Second Amended and Restated PSA with a majority of the Group's financial creditors, the entry into the Amended and Restated BCA, as well as the approval by the financial creditors and the ratification of the Amended and Restated RJ Plan submitted in the General Creditors Meeting, correspond to the most significant measures towards the Group's comprehensive financial restructuring.

g) Operational continuity of the Group

The Group's operational continuity will substantially depend on its ability to implement its ongoing operational and commercial strategies and to achieve a comprehensive financial restructuring following the Amended and Restated RJ Plan approval. The Group's management understands that the measures taken until the date of approval of these consolidated financial statements, in addition to the Amended and Restated RJ Plan approval and the successful implementation of the measures set forth in the Amended and Restated RJ Plan will enable the Group to comply with its financial commitments and maintain its operational continuity.

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2. ADOPTION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

2.1. New and amended IFRS Standards that are mandatorily effective for the current year

During the year-ended December 31, 2018, the Group has applied a number of new and revised IFRS issued by the International Accounting Standards Board (IASB) that are mandatorily effective for annual periods beginning on or after January 1, 2018. The following new and revised IFRS had no significant impact on the consolidated financial statements of the Group, except for supplementary disclosures included in the explanatory notes:

Standard or interpretation	Description	Effective date
IFRS 9 (New)	Financial Instruments	January 1, 2018
IFRS 15 (New)	Revenue from Contracts with Customers	January 1, 2018
IFRIC 22 (New)	Foreign Currency Transactions and Advance Considerations	January 1, 2018
IFRS 2 (Amendments)	Classification and Measurement of Share-based Payment Transactions	January 1, 2018
IAS 40 (Amendments)	Transfers of Investment Property	January 1, 2018
IFRS 1 and IAS 28 (Amendments)	Annual Improvements to IFRS Standards 2014 – 2016 Cycle	January 1, 2018

2.2. New and revised IFRS in issue but not yet effective

At the date of authorization of these consolidated financial statements, the Group has not applied the following new and revised IFRS Standards that have been issued but are not yet effective:

New and revised IFRS standards

Standard or interpretation	Description	Effective date
IFRS 16 *Leases*	IFRS 16 specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. However, IFRS 16 has changed and expanded the disclosures required for lessors.	January 1, 2019
IFRS 17 *Insurance Contracts*	The new Standard establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts and supersedes IFRS 4 Insurance Contracts. The Standard outlines a General Model, which is modified for insurance contracts with direct participation features, described as the Variable Fee Approach.	January 1, 2021
Amendments to IFRS 9 *Prepayment Features with Negative Compensation*	Amends the existing requirements in IFRS 9 regarding termination rights in order to allow measurement at amortized cost (or, depending on the business model, at fair value through other comprehensive income) even in the case of negative compensation payments.	January 1, 2019
Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures*	The amendment clarifies that IFRS 9, including its impairment requirements, applies to long-term interests. Furthermore, in applying IFRS 9 to long-term interests, an entity does not take into account adjustments to their carrying amount required by IAS 28.	January 1, 2019
Annual Improvements to IFRS Standards 2015–2017 *Cycle Amendments to IFRS 3 Business Combinations, IFRS 11 Joint Arrangements, IAS 12 Income Taxes and IAS 23 Borrowing Costs*	The *Annual Improvements* include amendments to four Standards: IAS 12 - *Income Taxes* The amendments clarify that an entity should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions that generated the distributable profits. This is the case irrespective of whether different tax rates apply to distributed and undistributed profits. IAS 23 - *Borrowing Costs* The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.	January 1, 2019

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	<u>IFRS 3 - *Business Combinations*</u> The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, the entity applies the requirements for a business combination achieved in stages, including remeasuring its previously held interest (PHI) in the joint operation at fair value. The PHI to be remeasured includes any unrecognized assets, liabilities and goodwill relating to the joint operation. <u>IFRS 11 - *Joint Arrangements*</u> The amendments to IFRS 11 clarify that when a party that participates in, but does not have joint control of, a joint operation that is a business obtains joint control of such a joint operation, the entity does not remeasure its PHI in the joint operation.	
Amendments to IAS 19 *Employee Benefits Plan Amendment, Curtailment or Settlement*	The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognized in the normal manner in other comprehensive income.	January 1, 2019
Amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*	The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognized in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognized in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.	The effective date of the amendments has yet to be set by the IASB
IFRIC 23 *Uncertainty over Income Tax Treatments*	IFRIC 23 sets out how to determine the accounting tax position when there is uncertainty over income tax treatments. The Interpretation requires an entity to: ✓ determine whether uncertain tax positions are assessed separately or as a group; and ✓ assess whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings: ○ If yes, the entity should determine its accounting tax position consistently with the tax treatment used or planned to be used in its income tax filings. ○ If no, the entity should reflect the effect of uncertainty in determining its accounting tax position.	January 1, 2019

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The Group's management is currently conducting an analysis of the impacts, if any, arising from the adoption of new and revised or amended IFRS Standards on its consolidated financial statements, including IFRS 16. Based on the analysis carried out to date, the Group does not expect significant impacts on its consolidated financial statements due to the adoption of these new and revised or amended IFRS Standards.

3. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of the consolidated financial statements are described below. These policies have been applied consistently for all reporting periods.

3.1 Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

3.2 Basis of preparation and consolidation

Preparation

The consolidated financial statements have been prepared on the historical cost basis, except for certain financial instruments that are measured at revalued amounts or fair values at the end of each reporting period, as explained below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods or services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Group considers the characteristics of the asset or liability, and if market participants would consider those characteristics when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such basis, except for measurements that have some similarities to fair value but are not fair value, such as net realizable value in IAS 2 *Inventories* or value in use in IAS 36 *Impairment of Assets*.

Consolidation

The consolidated financial statements incorporate the Company and its subsidiaries (Note 5).

All intra-group transactions, balances, income and expenses are eliminated for consolidation purposes.

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Continuity as a going concern

The Group's consolidated financial statements were prepared on the going concern basis of accounting. Management assessed the Group's ability to continue as a going concern in light of the assumptions and matters disclosed in Note 1.

The significant accounting policies are set out below:

3.3 Functional currency and foreign currencies

The financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the respective entity operates (i.e., the "functional currency"). The Company's functional currency and most part of its subsidiaries is the U.S. dollar, since majority of revenues and costs, debt and capital expenditures are denominated in this currency. The consolidated financial statements are presented in thousands of U.S. dollars, which is the reporting currency of the Group.

Additionally, the Group has determined that the Brazilian real is the functional currency of Serviços de Petróleo Constellation S.A. ("Serviços de Petróleo"), Serviços de Petróleo Constellation Participações S.A. ("Serviços de Petróleo Participações"), Tarsus Serviços de Petróleo Ltda. ("Tarsus") and Manisa Serviços de Petróleo Ltda. ("Manisa"), since these subsidiaries' operations are located in Brazil and the majority of its revenues and costs are denominated in Brazilian reais. Consequently, in preparing these consolidated financial statements, management has translated the financial statements of these subsidiaries into U.S. dollars as follows:

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- ✓ The assets and liabilities for each balance sheet presented are translated at the closing rate on the respective balance sheet date;
- ✓ Income and expenses for each statement of operations are translated at exchange rates at the dates of the transactions; for this purpose, average monthly exchange rates are used as they approximate to the exchange rates in force on the transaction dates; and
- ✓ Shareholders' equity accounts are translated using historical exchange rates.

All resulting exchange differences on currency translation adjustments are recognized as a separate component of other comprehensive income (Note 18.e).

In preparing the consolidated financial statements, transactions in currencies other than the respective entity's functional currency (i.e., foreign currencies) are recognized at the exchange rates prevailing at the transaction dates. At the end of each reporting period, monetary and non-monetary items denominated in foreign currencies are retranslated at the exchange rates prevailing at that date. Currency translation adjustments of monetary items are recognized in profit or loss in the period in which they arise.

3.4 Cash and cash equivalents

Cash and cash equivalents are held to meet short-term cash commitments, and not for investment or any other purposes. The Group considers as cash and cash equivalents (i) cash on hand; (ii) bank deposits; and (iii) short-term investments immediately convertible into a known amount of cash and subject to an insignificant risk of change in value.

Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, for example, three months or less from the investment date.

3.5 Short-term investments

Short-term investments are held to meet the Group's short-term commitments and are often settled for this purpose, and do not have a business model for receiving contractual cash flows. Consists primarily of financial investments measured at fair value through profit or loss. These financial investments have maturities of more than three months or with no fixed time for redemption.

3.6 Trade and other receivables

Trade accounts receivables are initially measured at their fair value, which generally represents the billed amounts, and subsequently at amortized cost and adjusted for allowances for credit losses and impairment, when due necessary. The allowance for doubtful accounts is recognized considering the individual assessment of receivables, the analysis of the economic environment and the history of losses recorded in prior years by maturity range, in an amount considered sufficient by management to cover probable losses on collection. The carrying amounts represent manly their fair values at end of the reporting periods.

3.7 Inventories

Inventories consist of spare parts, materials and supplies held for consumption in the drilling rigs and drillships operations and are stated at the lower of cost incurred and net realizable value. During periods of high drilling rigs and drillships utilization, inventories are entirely classified as current assets. Whenever a drilling rig or drillship is expected to end its charter agreement within a one-year period, all inventory that will not be consumed until the end of such agreement is reclassified to non-current assets. Inventories' costs are determined by using the average cost method of accounting.

3.8 Prepaid expenses

Refers to financial resources applied in prepaid expenses, whose rights of benefits or services will occur in future periods, recorded on the accrual basis of accounting. Prepaid expenses are mainly represented by insurance expenses (Note 25).

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3.9 Legal deposits

There are situations in which management argues the legitimacy of certain liabilities or lawsuits filed against the Group. Therefore, by a court order or by management's own strategy, the amounts in question are deposited in escrow without characterizing the settlement of liabilities, but allowing the Group to continue challenging the lawsuits. In these situations, although the deposits are still assets of the Group, the amounts are only released upon receipt of a final court decision favorable to the Group. When applicable, legal deposits are recorded in non-current assets and are considered as operating activities for the purposes of the statement of cash flows.

3.10 Investments in associates and joint ventures

For investments in associates and joint ventures, the Group applies the equity method of accounting. Under such method, an investment is initially recognized at cost and adjusted thereafter to recognize the Group's share of the profit or loss and other comprehensive income or loss of the investees. When the Group's share of losses of an investee exceeds its interest in that investee (which includes any long-term interests that, in essence, form part of the Group's net investment), the Group discontinues recognizing its share of further losses. Additional losses are recognized only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the investee.

The requirements of IAS 36 - *Impairment of Assets* are applied to determine whether it is necessary to recognize any impairment loss with respect to the Group's investees. When deemed necessary, the entire carrying amount of the investee is tested for impairment in accordance with IAS 36, as a single asset by comparing its recoverable amount (higher of value in use, measured by the discounted cash flows, and fair value less costs to sell) with its carrying amount. Any impairment loss recognized forms part of the carrying amount of the investee. The reversal of an impairment loss is recognized in accordance with IAS 36 to the extent that the recoverable amount of the investee subsequently increases, except when the impairment loss relates to goodwill.

When a Group entity transacts with an investee, profit or loss resulting from such transactions are recognized in the Group's consolidated financial statements only to the extent of interests in the investees that are non-related to the Group.

3.11 Property, plant and equipment ("PP&E")

All PP&E is carried at cost less accumulated depreciation and impairment, when applicable. PP&E consists primarily of onshore and offshore drilling rigs, drillships and its related equipment.

Costs related to equipment under construction are recognized as PP&E cost, in accordance with the actual construction costs. A provision for corresponding unbilled costs from suppliers is recorded as an accrued liability.

Borrowing costs (including interest and fair value adjustments) are capitalized on equipment under construction.

Repair and maintenance costs related to periodic overhauls of the drilling rigs and drillships are capitalized, when the economic benefits associated with the item inflows to the Group and the costs can be reliable measured. These costs are depreciated over the period extending to the next periodic overhaul. Related costs are mainly comprised by shipyard costs and the costs of employees directly involved in the related project. All other repair and maintenance costs are charged to profit or loss in the period in which they are incurred.

The carrying amounts of these assets are based on estimates, assumptions and judgments relating to capitalized costs, useful lives and residual values of the drilling rigs and drillships. These estimates, assumptions and judgments reflect both historical experience and expectations regarding future oil and gas industry conditions and operations. The Group computes depreciation using the straight-line method, considering the respective residual value of the related assets. When significant components of a PP&E item have different useful lives, those components are accounted for as separate PP&E items. Estimated useful lives of PP&E range from 5 (five) to 35 (thirty-five) years. At the end of each year, the Group reviews the estimated useful lives and residual values of PP&E.

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3.12 Impairment of long-lived assets

Assets that are subject to depreciation and amortization are tested for impairment whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purpose of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows (i.e., cash generating units). Non-financial assets that have been impaired are reviewed for possible impairment reversal at each balance sheet date.

Recoverable amounts are substantially determined based on discounted future cash flows calculations and asset price evaluation, both requiring the use of estimates (Note 4.5).

During the years ended December 31, 2018 and 2017, the Group recognized impairment losses and impairment reversals on its long-lived assets (Notes 13 and 21).

3.13 Trade and other payables

Trade and other payables are stated at known or estimated amounts, plus corresponding charges and monetary and/or foreign exchange rate variations incurred, when applicable, and represent obligations to pay for goods or services acquired in the ordinary course of the Group's business activities.

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3.14 Loans and financings

Loans and financings are carried at amortized cost subject to monetary and/or foreign exchange rate variations incurred, when applicable, plus interest incurred through the end of the reporting period.

When applicable, borrowing costs incurred are measured at amortized cost and recognized in liabilities as a reduction of loans and financings and allocated to profit or loss over the agreement term.

Interest paid is presented as a financing activity in the statements of cash flows.

3.15 Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

3.16 Provisions

Provisions are recognized when (i) the Group has a present obligation (legal or constructive) as a result of a past event; (ii) it is probable that the Group will be required to settle the obligation; and (iii) a reliable estimate of the obligation amount can be made. The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, considering the risks and uncertainties surrounding the obligation. Contingent risks assessed as “possible loss” are disclosed in these consolidated financial statements, but not recorded in a specific liability account.

3.17 Current and non-current assets and liabilities

Current and non-current assets and liabilities are stated at their net realizable value and settlement amounts, respectively, and include monetary and/or foreign exchange rate variations incurred, when applicable, plus income earned and expenses incurred, recognized on a pro-rata basis through the balance sheet date.

3.18 Revenue recognition

Charter and service-rendering revenues are recognized when the respective services are rendered based on the contracted day rates and the number of operating days during the period. Some of the charter and service-rendering agreements include uptime bonus payments depending on performance criteria established in the respective agreements. The Group recognizes bonus revenues in the same period that it meets the contractual criteria, renders the related services for which the specific performance criteria is met, and is preapproved by the customer. The Group may also earn revenues for the preparation and mobilization of equipment (drilling units) and personnel.

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Revenue from services rendered is recognized when all of the following conditions are met (performance obligation satisfied over time):

- ✓ The customer simultaneously receives and uses the benefits provided by the Group’s performance as the Group performs.
- ✓ The Group’s performance creates or enhances an asset (for example, work in progress) that the customer controls as the asset is created or enhanced.
- ✓ The Group’s performance does not create an asset with an alternative use for the Group and the Group has an enforceable right to payment for performance completed to date.

Mobilization revenues and costs are deferred and recognized on a straight-line basis over the period that the related charter and drilling services are rendered, which is consistent with the general pace of activity, level of services being provided and day rates being earned over the term of the related agreement.

Revenues are presented net of the related sales taxes levied on the provision of services, after eliminating intercompany sales, when applicable (Note 19).

3.19 Costs and expenses recognition

Costs and expenses are recognized on an accrual basis, based on corresponding revenues earned. Prepaid expenses related to future years are deferred according to their respective terms (Note 25).

3.20 Financial income and expenses

Financial income and expenses are substantially represented by income from cash investments, taxes on financial operations, foreign exchange variation, among others, and are recorded on an accrual basis of accounting (Note 22).

3.21 Current and deferred income tax and social contribution

The provision for income tax and social contribution is based on taxable profit for the year. The taxable profit differs from profit before taxes presented in the statement of operations because it excludes revenues or expenses taxable or deductible in subsequent periods, and excludes non-taxable or non-deductible items. The provision for income tax and social contribution is calculated for each individual entity of the Group, based on the rates prevailing at year-end according to the respective tax regulation in each jurisdiction.

Deferred taxes are recognized for temporary differences and tax loss carryforwards, when applicable. Deferred income tax and social contribution are recognized up to the amounts for which recoverability is considered probable and the assessment of management of the Group's ability to continue as a going concern, as disclosed in Note 1.

3.22 Financial instruments

Financial assets and financial liabilities are recognized in the Group's statement of financial position when the Group becomes a party to the contractual provisions of the financial instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Financial assets

All regular way purchases or sales of financial assets are recognized and derecognized on a trade date basis. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

All recognized financial assets are measured subsequently in their entirety at either amortized cost or fair value, depending on their classification.

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Classification of financial assets

Debt instruments that meet the following conditions are measured subsequently at amortized cost:

- ✓ the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
- ✓ the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Debt instruments that meet the following conditions are measured subsequently at fair value through other comprehensive income (FVTOCI):

- ✓ the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling the financial assets; and
- ✓ the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

By default, all other financial assets are measured subsequently at fair value through profit or loss (FVTPL).

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Derecognition of financial assets

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and recognizes a collateralized borrowing for the proceeds received.

Impairment of financial assets

The Group recognizes a loss allowance for expected credit losses on investments in debt instruments that are measured at amortized cost or at FVTOCI, lease receivables, trade receivables and contract assets. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition of the respective financial instrument. For financial assets, the expected credit loss is estimated as the difference between all contractual cash flows that are due to the Group in accordance with the contract and all the cash flows that the Group expects to receive, discounted at the original effective interest rate.

Financial liabilities and equity

Classification as debt or equity

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recognized at the proceeds received, net of direct issue costs.

Classification of financial liabilities

All financial liabilities are measured subsequently at amortized cost using the effective interest method or at FVTPL.

The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected term of the financial liability, or (where appropriate) a shorter period, to the amortized cost of a financial liability.

A financial liability other than a financial liability held for trading or contingent consideration of an acquirer in a business combination may be designated as at FVTPL upon initial recognition if the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the grouping is provided internally on that basis.

Derecognition of financial liabilities

The Group derecognizes financial liabilities when, and only when, the Group's obligations are discharged, cancelled or have expired. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit or loss.

When the Group exchanges with the existing lender one debt instrument into another one with substantially different terms, such exchange is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

Derivative financial instruments

The Group enters into derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risks, including foreign exchange forward contracts, options and interest rate swaps.

Derivatives are recognized initially at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each reporting date. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

A derivative with a positive fair value is recognized as a financial asset whereas a derivative with a negative fair value is recognized as a financial liability.

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3.23 Cash flow statement

The cash flow statement is prepared using the indirect method, which separates cash flows from operating activities, investing activities and financing activities and reconciles profit/ (loss) for the year to net cash flows to the change in cash and cash equivalents. Investing and financing transactions that do not require the use of cash or cash and cash equivalents have been excluded from the cash flow statement and, when applicable, are disclosed in the consolidated financial statements ("non-cash transactions"). Dividends paid to ordinary shareholders are included in financing activities, while dividends received from subsidiaries are classified as investing activities. Interest paid is also presented as financing activities in the statement of cash flows.

4 CRITICAL ACCOUNTING ESTIMATES

In applying the significant accounting policies described in Note 3, management must use judgement and develop estimates for the carrying amounts of assets and liabilities, which are not easily obtainable from other sources. The estimates and associated assumptions are based on historical experience and other relevant factors. Therefore, future results could differ from those estimates.

The estimates and underlying assumptions are reviewed continuously. The effects of revisions to accounting estimates are recognized prospectively.

Management has concluded that the most significant judgments and estimates considered during the preparation of these consolidated financial statements are the following:

4.1 Measurement of financial instruments

The Group uses valuation techniques that include the use of inputs that are (or not) based on observable market data to estimate the fair values of certain types of financial instruments. Details of the main assumptions used to measure the fair values of financial instruments are disclosed in Note 24.a (fair value hierarchy).

Management believes that the selected valuation techniques and the assumptions used are appropriate to measure the fair values of its financial instruments.

4.2 Provision for impairment of trade and other receivables

The Group recognizes a loss allowance for expected credit losses on trade and other receivables. The amount of expected credit losses is updated at each reporting date to reflect changes in credit risk since initial recognition of the respective financial instrument. The expected credit losses on these financial assets are estimated based on the Group's historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions and an assessment of both the current as well as the forecast direction of conditions at the reporting date, including time value of money where appropriate. As of December 31, 2018 and 2017, no provision for impairment on trade and other receivables was required (Note 9).

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4.3 Inventory current and non-current segregation

The Group classifies inventories that are expected to be consumed within a twelve-month period as current assets. The Group considers that no inventory would be consumed during a period in which a drilling rig or drillship is not hired under a charter agreement in force. Therefore, when a charter agreement is expected to expire within a twelve-month period, the Group reclassifies all inventory to non-current assets. The amount reclassified is based on an estimate derived from the Group's annual budgeting process.

4.4 Useful lives of PP&E

The carrying amounts of PP&E assets are based on estimates, assumptions and judgments related to capitalized costs and useful lives of the drilling rigs, drillships and related equipment. These estimates, assumptions and judgments reflect both historical experience and expectations regarding future oil and gas industry conditions and operations. The Group calculates depreciation using the straight-line method.

As described in Note 3.11, at the end of each year, the Group reviews the estimated useful lives of PP&E.

4.5 Impairment of long-lived assets

The Group evaluates PP&E for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Also the Group evaluates PP&E for impairment reversal if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. The Group substantially uses either discounted future cash flow projections (value in use) or fair value less costs to sell (market approach) techniques in testing an asset for potential impairment or reversal of impairment.

For value in use calculation, the Group's assumptions and estimates underlying this analysis includes the following, by drilling unit (i.e., cash generating units): dayrate, occupation rate, daily operating cost, residual useful life of the drilling rigs and drillships, and estimated proceeds that may be received on disposition.

The underlying assumptions are developed based on the historical data for each drilling unit, which considers rated water depth and other attributes and then assesses its future marketability according to the current and projected market environment at the time of assessment. Other assumptions, such as operating costs, are estimated using historical data adjusted for known developments and future events.

The Group prepares a probable scenario for each drilling unit, which results in a discounted cash flow projection for each drilling unit based on expected operational and macroeconomic assumptions (e.g., inflation indexes, foreign exchange rates, among others) and compare such amount to its carrying amount. Discount rates are based on the Group's internal Weighted Average Cost of Capital ("WACC").

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Management's assumptions are necessarily subjective and are an inherent part of the Group's asset impairment evaluation, and the use of different assumptions could produce results that differ from those disclosed. The Group's methodology generally involves the use of significant unobservable inputs, representative of a Level 3 fair value measurement (Note 24.a), which may include assumptions related to future dayrate revenue, costs and drilling unit utilization, the long-term future performance of the Group's drilling units and future market conditions. Management's assumptions involve uncertainties about future demand for the Group's services, dayrates, expenses and other future events, and management's expectations may not be indicative of future outcomes. Significant unanticipated changes to these assumptions could materially alter the Group's analysis in testing an asset for potential impairment or reversal of impairment.

Other events or circumstances that could affect the Group's assumptions may include, but are not limited to, a further sustained decline in oil and gas prices, cancelations of the Group's charter and service-rendering contracts or contracts of the Group's competitors, contract modifications, costs to comply with new governmental regulations, growth in the global oversupply of oil and geopolitical events, such as lifting sanctions on oil-producing nations. Should actual market conditions in the future vary significantly from market conditions used in the Group's projections, the Group's impairment assessment would likely be different.

During the years ended December 31, 2018 and 2017, impairment losses and/or reversal of impairment, on long-lived assets, as applicable by equipment, were recognized by the Group (Notes 13 and 21).

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4.6 Provisions for claims and other obligations

Claims against the Group, including unasserted claims or assessments are recognized as a liability and/or are disclosed in Notes 3.16, 15 and 16, unless the loss probability is considered to be remote. A provision for claim and other obligation is recorded when the loss is probable and the amount can be reliably estimated. Claims and other similar obligations will be settled when one or more future events occur. Normally, the occurrence of such events is not within the Group's control and, therefore, the assessment of these liabilities is subject to varying degrees of legal uncertainty and interpretation, and requires significant estimates and judgments to be made by management.

Certain conditions may exist as of the date of the consolidated financial statements are issued, which may result in a loss to the Group, but which will only be resolved when one or more future events occur or fail to occur. The Group's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Group or unasserted claims that may result in such proceedings, the Group's legal counsels evaluate the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the liability amount can be estimated, then the estimated liability is accrued in the Group's consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, then the nature of the contingent liability is disclosed.

4.7 Provision for employee profit sharing plan

The profit sharing paid to employees (including key management personnel) is based on the achievement of quality and financial performance metrics, as well as the individual objectives of employees, which are determined annually. This provision is set on a monthly basis and is recalculated at the year-end based on the best estimate of the achieved objectives as set out in the annual budget process.

During the years ended December 31, 2018 and 2017, the Group did not recognize provision for employee profit sharing plan.

4.8 Recoverable taxes and deferred tax assets

The Group recognizes deferred tax assets arising from tax losses and temporary differences between accounting and taxable profits. Deferred tax assets are recognized to the extent that the Group expects to generate sufficient future taxable income based on projections and forecasts made by management. The carrying amount of deferred tax assets is reviewed at the end of each reporting period and, if applicable, reduced to the extent that is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

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5 CONSOLIDATED ENTITIES AND INVESTMENTS

		Ownership interest (%)			
		December 31,			
		2018		2017	
Consolidated entities	Country of incorporation	Direct	Indirect	Direct	Indirect
Alaskan & Atlantic Cooperatief U.A.	Netherlands	-	100.00	-	100.00
Alaskan & Atlantic Rigs B.V.	Netherlands	-	100.00	-	100.00
Alaskan Star Ltd. (“Alaskan”)	British Virgin Islands	-	100.00	-	100.00
Alpha Star Equities Ltd. (“Alpha”) (*)	British Virgin Islands	-	100.00	-	100.00
Amaralina Cooperatief U.A.	Netherlands	-	100.00	-	55.00
Amaralina Star Ltd. (“Amaralina”) (*)	British Virgin Islands	-	100.00	-	55.00
Angra Participações B.V. (“Angra”)	Netherlands	100.00	-	100.00	-
Arazi S.à.r.l. (“Arazi”) (*)	Luxembourg	100.00	-	100.00	-
Becrux B.V.	Netherlands	-	100.00	-	100.00
Bonvie Investments Inc.	British Virgin Islands	-	100.00	-	100.00
Brava Drilling B.V.	Netherlands	-	100.00	-	100.00
Brava Star Ltd. (*)	British Virgin Islands	-	100.00	-	100.00
Centaurus S.à.r.l. (“Centaurus”)	Luxembourg	100.00	-	100.00	-
Constellation Africa Inc.	British Virgin Islands	-	100.00	-	100.00
Constellation Netherlands B.V.	Netherlands	100.00	-	100.00	-
Constellation Overseas Ltd. (“Constellation Overseas”) (*)	British Virgin Islands	-	100.00	-	100.00
Constellation Panamá Corp.	Panamá	-	100.00	-	100.00
Constellation Services Ltd. (“Constellation Services”) (*)	British Virgin Islands	-	100.00	-	100.00
Domenica S.A. (“Dmenica”)	Paraguay	-	100.00	-	100.00
Domenica Argentina S.A.	Argentina	-	100.00	-	100.00
Eiffel Ridge Group C.V.	Netherlands	-	100.00	-	100.00
Gold Star Equities Ltd. (“Gold”) (*)	British Virgin Islands	-	100.00	-	100.00
Hopelake Services Ltd.	British Virgin Islands	-	100.00	-	100.00
Keam Holdings C.V.	Netherlands	-	100.00	-	100.00
Laguna Cooperatief U.A.	Netherlands	-	100.00	-	55.00
Laguna Star Ltd. (“Laguna”) (*)	British Virgin Islands	-	100.00	-	55.00
Lancaster Projects Corp. (“Lancaster”) (*)	British Virgin Islands	-	100.00	-	100.00
London Tower International Drilling C.V.	Netherlands	-	100.00	-	100.00
London Tower Management B.V.	Netherlands	-	100.00	-	100.00
Lone Star Offshore Ltd. (“Lone”) (*)	British Virgin Islands	-	100.00	-	100.00

Consolidated entities	Country of incorporation	Ownership interest (%) December 31, 2018 Direct	2018 Indirect	2017 Direct	2017 Indirect
Manisa Serviços de Petróleo Ltda. (*)	Brazil	-	100.00	-	55.00
Olinda Star Ltd. (“Olinda”)	British Virgin Islands	-	100.00	-	100.00
Palase C.V.	Netherlands	-	100.00	-	55.00
Palase Management B.V.	Netherlands	-	100.00	-	100.00
Podocarpus C.V.	Netherlands	-	100.00	-	55.00
Podocarpus Management B.V.	Netherlands	-	100.00	-	100.00
Positive Investments Management B.V.	Netherlands	100.00	-	100.00	-
Positives Investments C.V.	Netherlands	-	100.00	-	100.00
QGOG Atlantic / Alaskan Rigs Ltd.	British Virgin Islands	-	100.00	-	100.00
QGOG Constellation BVI Ltd.	British Virgin Islands	-	100.00	-	-
QGOG Constellation US LLC.	United States of America	-	100.00	-	100.00
QGOG Constellation UK Ltd.	England	100.00	-	100.00	-
Serviços de Petróleo Constellation Participações S.A. (*)	Brazil	-	100.00	-	100.00
QGOG Perforaciones S.A.C.	Peru	-	100.00	-	100.00
QGOG Star GmbH	Switzerland	100.00	-	100.00	-
Serviços de Petróleo Constellation S.A. (*)	Brazil		100.00		100.00
Queiroz Galvão Óleo e Gás S.A. (“QGOG India”)	India		100.00		-
Snover International Inc. (*)	British Virgin Islands	-	100.00	-	100.00
Star International Drilling Ltd. (“Star”) (*)	Cayman Island	-	100.00	-	100.00
Tarsus Serviços de Petróleo Ltda. (*)	Brazil	-	100.00	-	55.00

(*) – In Judicial Recovery, as disclosed in Note 1.f.

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Investments accounted for by the equity method

Entities	Country of incorporation	Indirect ownership interest (%) December 31, 2018	2017
Associates			
FPSO Capixaba Venture S.A. (“Capixaba”) (1)	Switzerland	20.0	20.0
SBM Espírito do Mar Inc. (“Espírito do Mar”) (1)	Switzerland	20.0	20.0
Urca Drilling B.V.	Netherlands	15.0	15.0
Bracuhy Drilling B.V.	Netherlands	15.0	15.0
Mangaratiba Drilling B.V.	Netherlands	15.0	15.0
Joint Ventures			
Tupi Nordeste Ltd. (2)	Bermuda	20.0	20.0
Tupi Nordeste S.à.r.l. (2)	Luxembourg	20.0	20.0
Guará Norte S.à.r.l (3)	Luxembourg	12.75	12.75
Guará Norte Holding Ltd. (3)	Bermuda	12.75	12.75
Alfa Lula Alto S.à.r.l. (4)	Luxembourg	5.00	5.00
Alfa Lula Alto Holding Ltd. (4)	Bermuda	5.00	5.00
Beta Lula Central S.à.r.l. (5)	Luxembourg	5.00	5.00
Beta Lula Central Holding Ltd. (5)	Bermuda	5.00	5.00

(1) These entities refer to the FPSO Capixaba’s structure (Note 12).
(2) These entities refer to the FPSO Cidade de Paraty’s structure (Note 12).
(3) These entities refer to the FPSO Cidade de Ilhabela’s structure (Note 12).
(4) These entities refer to the FPSO Cidade de Maricá’s structure (Note 12).
(5) These entities refer to the FPSO Cidade de Saquarema’s structure (Note 12).

The Group’s investments in associate and joint venture entities are accounted for by the equity method of accounting in these consolidated financial statements (Note 12).

6 CASH AND CASH EQUIVALENTS

	December 31,	
	2018	2017
Cash and bank deposits	17,556	82,347
Time deposits [a]	91,850	133,916
Total	109,406	216,263

a) Time deposits are comprised as follows:

Financial institution	Currency	Average interest rate (per annum)	December 31, 2018	December 31, 2017
Itaú BBA Nassau	U.S. dollar	0.22%	55,497	59,700
Citibank	U.S. dollar	0.59%	17,286	62,818
Bradesco S.A.	Brazilian real	0.28%	81	5,278
HSBC	U.S. dollar	1.00%	18,701	6,120
Preferred Bank	U.S. dollar	0.10%	250	-
Banco do Brasil	Brazilian real	0.88%	35	-
Total			91,850	133,916

7 SHORT-TERM INVESTMENTS

Short-term investments	Financial institution	Currency	Average interest rate (per annum)	December 31, 2018	December 31, 2017
Time deposits [(i)]	Lafise	U.S. dollar	2.75%	48	47
Repurchase agreements [(iii)]	Bradesco S.A.	Brazilian real	97.10% of CDI[(ii)]	-	13,453
Repurchase agreements [(iii)]	Banco do Brasil	Brazilian real	98.75% of CDI[(ii)]	25,999	-
Total				26,047	13,500

(i) These investments have original maturities of more than three months, or with no fixed time for redemption.

(ii) Brazilian Interbank Deposit Certificate (*Certificado de Depósito Interbancário - CDI*), which average remuneration during the years ended December 31, 2018 and 2017 was 6.50% p.a. and 10.07% p.a., respectively.

(iii) Refers to agreements in which the financial institution commits to repurchase the asset back from the Group in the short-term (i.e., less then twelve months).

8 RESTRICTED CASH

Under certain of the Group's project finance arrangements (Note 14), surplus cash from operations is held in designated reserve accounts, up to a level determined in relation to the future debt servicing requirements of the project finance arrangements.

The following accounts, which deposits have original maturity of less than twelve months, currently refer to (i) the project finance agreements related to the construction of the Amaralina Star and Brava Star drillships (Note 14); and (ii) cash collateral related to Bid/Performance Bonds.

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The amounts in these accounts are comprised by time and bank deposits, as follows:

Financial institution	Financial institution	Average interest rate (per annum)	December 31, 2018	December 31, 2017
Time deposits	Citibank N.A.	0.24%	10,068	9,902
Time deposits	HSBC	1.00%	24,386	24,034
Bank deposits	HSBC	-	5,099	4,999
Bank deposits	Citibank N.A.	-	3,000	100
Total			42,553	39,035

9 TRADE AND OTHER RECEIVABLES

Trade receivables are mainly related to receivables from Petrobras and ONGC for charter and service-rendering agreements relating to the drilling units used in the oil and gas exploration in Brazil and in India. Historically, there have been no defaults on receivables or delays in collections and, consequently, the Group has not recorded a provision for impairment of trade and other receivables for the years presented. The average collection period is of approximately 30 days. Details of financial risk management related to credit risk are disclosed in Note 24.b.

10 INVENTORIES

Inventories consist of spare parts, materials and supplies held for consumption in the drilling rigs and drillships operations. The amounts recognized in the consolidated statement of operations are accounted for as Cost of Services in the sub-account “Materials” (Note 20). As of December 31, 2018, due to an expected period of lower drilling rigs and drillships utilization, the Group reclassified the amount of US$125,866 to noncurrent assets, since such materials are not expected to be consumed within a one-year period (US$143,231 as of December 31, 2017).

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11 RELATED PARTY TRANSACTIONS

Balances and transactions between the Company and its subsidiaries that are part of the Group, have been eliminated for consolidation purposes and are not disclosed in the table below.

The consolidated intercompany balances as of December 31, 2018 and 2017, and transactions for the years ended are as follows:

	December, 31				Year-ended December 31,	
	2018		2017		2018	2017
	Assets	Liabilities	Assets	Liabilities	Income/ (expenses)	Income/ (expenses)
Alperton Capital Ltd. [a]	-	-	381,125	345,042	6,363	7,950
Queiroz Galvão S.A. [b]	-	188	-	1,428	(510)	(1,428)
FPSO Capixaba Venture S.A. [c]	-	-	929	-	25	8
Tupi Nordeste Operações Marítimas Ltda. [d]	216	-	366	-	1,321	1,576
Guará Norte Operações Marítimas Ltda. [d]	162	-	198	-	1,009	1,255
Alfa Lula Alto Operações Marítimas Ltda. [d]	229	-	191	-	986	1,244
Guará Norte Holding Ltd.[e]	83	-	125	-	500	500
Alfa Lula Alto Holding Ltd. [e]	150	-	150	-	600	600
Beta Lula Central Holding Ltd.[e]	50	-	250	-	600	600
Others	101	-	194	-	20	30
Total	991	188	383,528	346,470	10,914	12,335
Current	974	188	1,377	1,428		
Non-current	17	-	382,151	345,042		

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(a) In 2010, the Group and Alperton Capital Ltd. ("Alperton") signed shareholders' and loan agreements in order to construct, charter and operate two drillships for Petrobras, the Amaralina Star and the Laguna Star drillships, through the Group's 55% interest in each of Amaralina Star Ltd. ("Amaralina") and Laguna Star Ltd. ("Laguna"), the remaining 45% of these entities' shares being held by Alperton.

Under these agreements, the Group had committed to finance Alperton's 45% capital expenditures share on these projects.

As of December 31, 2017, the receivables from Alperton referred to the loans receivable bearing interest at 12% p.a., annually compounded, up to the sixth anniversary of the sub-charter agreement with Petrobras. Thereafter, the loans receivable would bear interest at 13% p.a., annually compounded. Repayment of interest and principal was scheduled to occur on a quarterly basis as from one year after the "Date of Acceptance" of the drillships by Petrobras, with the principal being repayable in quarterly installments over the 6-year term of the Petrobras charter agreement, starting from the "Date of Acceptance", provided that Amaralina and Laguna comply with the financing agreement conditions to pay dividends.

As of December 31, 2017, the payable amounts referred to intercompany loans provided by Alperton to Amaralina and Laguna with the same terms and conditions of the Group's receivable amounts from Alperton, except for the maturity date. The receivables from Alperton were due within 6 months from the termination date of the sub-charter agreement with Petrobras and the payables to Alperton were due when Amaralina and Laguna generate enough cash after paying all other obligations and commitments.

The income for the years ended December 31, 2018 and 2017, in the amounts of US$6,363 and US$7,950, respectively, is presented net of expenses. The income for the years ended December 31, 2018 and 2017, in the amounts of US$52,817 and US$41,677, respectively, refer to interest charged on the receivables by Constellation Overseas from Alperton; while the expenses for the years ended December 31, 2018 and 2017, in the amounts of US$46,454 and US$33,727, respectively, refer to interest charged on the payables due by Amaralina and Laguna to Alperton (Note 22 – Financial income from related parties).

The amounts of the loans receivable from Alperton were secured by:

- ✓ A pledge of Alperton's 45% shares in Amaralina and Laguna;
- ✓ An assignment of dividends payable to Alperton by Amaralina and Laguna; and
- ✓ An assignment of amounts payable to Alperton by Amaralina and Laguna.

Any cash available in Amaralina and Laguna for dividends payment would be used to repay the intercompany loans to Alperton. Amaralina and Laguna may not pay any dividends or other payables to Alperton, until the intercompany loans were fully paid. The intercompany loans would be extended in the event that the term of the charter agreements with Petrobras were extended. In this case, the new maturity date would be the end date of the extended agreements.

The Group charged a fee to Alperton for being the guarantor of Amaralina Star and Laguna Star drillships project financings and a fee for being the guarantor for importations under the Special Regime of Temporary Admission (*Regime Aduaneiro Especial de Importação e Exportação de Bens Destinados à Pesquisa e Lavra de Petróleo e Gás* - REPETRO). For the years ended December 31, 2018 and 2017, the net fees charged to Alperton totaled US$6,363 and US$7,950, respectively.

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Non-compliance with the agreements between the Group and Alperton could result in penalties to either parties.

Constellation Overseas request for arbitration against Alperton

On August 7, 2018, Constellation Overseas filed a request for arbitration against Alperton under the parties' Shareholders' Agreements for Amaralina and Laguna. The dispute arises from the existence of a deadlock under the Shareholders' Agreements and involves the determination of the price at which Alperton is obligated to sell its shares in Amaralina and Laguna in such circumstances. In accordance with the Shareholders' Agreements, the request for arbitration was filed with the International Chamber of Commerce ("ICC") under its 2017 Rules of Arbitration.

On September 14, 2018, Alperton submitted its "Answer and Counterclaims" in said arbitration.

On September 21, 2018, further to the existence of an unremedied deadlock and as foreseen in the Shareholder's Agreements, all shares held by Alperton were formally transferred to Constellation Overseas.

On October 18, 2018, Constellation Overseas submitted its "Reply to Counterclaims" in the arbitration.

On February 11, 2019, Alperton submitted an application for an Award of Interim Measures (the "Application") in the arbitration seeking, *inter alia*, an order enjoining Constellation Overseas from pledging or encumbering the shares formerly held by Alperton.

On February 27, 2019, Constellation Overseas submitted its Opposition to Application for Interim Measures. A second round of briefing took place, with Alperton submitting a reply on March 11, 2019 and Constellation Overseas submitted a Rejoinder on March 18, 2019.

On April 8, 2019, the Arbitral Tribunal issued an Interim Order granting the Application in substantial part, subject to Alperton posting a bond of US$33.4 million within 10 days of the interim order (by April 18, 2019).

On April 26, 2019, the Arbitral Tribunal issued an Interim Award, confirming the relief ordered in the Interim Order, and requiring Alperton to post a bond of US$10 million by May 27, 2019.

On May 31, 2019, at Constellation Overseas' request, the Arbitral Tribunal ordered the dissolution of the Interim Award, effective immediately, as a result of Alperton's failure to post a compliant bond.

As of the date of the issuance of these consolidated financial statements, the Group's external legal advisor classifies the chances of a successful outcome in the arbitration as possible.

Additionally, Alperton has commenced ancillary proceedings in the BVI regarding the same dispute. On July 30, 2018, the directors nominated by Alperton to the Amaralina and Laguna boards issued a books and records claim in the BVI High Court (Commercial Division) against Amaralina and Laguna and the five directors nominated by Constellation Overseas to the Amaralina and Laguna boards. No significant progress has been made in this litigation since it was filed.

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On August 16, 2018, two of the directors nominated by Alperton to the Amaralina and Laguna boards issued a breach of fiduciary duties claim in the BVI High Court (Commercial Division) against the directors of Constellation Overseas. No significant progress has been made in this litigation since it was filed.

On September 6, 2018, Alperton and its current and former guarantors under the Shareholders' Agreements issued an application (share transfer injunction claim) against Constellation Overseas and the Amaralina and Laguna in the BVI High Court (Commercial Division). No significant progress has been made in this litigation since it was filed.

As of the date of the issuance of these consolidated financial statements, the Group's external legal advisor classifies the chances of a successful outcome in the BVI proceeding as possible.

Share transfer effects

In connection with the Shareholders' Agreement and the share transfer from Alperton to Constellation Overseas, the assets and liabilities with Alperton were extinct on September 30, 2018. Due to these settlements, the Group recorded a negative amount of US$85,555 as acquisition of non-controlling interests reserve (non-cash investing activity) in the Shareholders' Equity, and a reversion of US$43,149 in the non-controlling interests group in the Shareholders' Equity.

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(b) The payable amount refers to the fee charged by Queiroz Galvão S.A. for being the guarantor for importations under the REPETRO.

(c) Loans bearing interest at LIBOR plus 0.5% p.a., with initial maturity at the end of the charter agreement period between SBM Espírito do Mar B.V. and Petrobras (2022). In December 2018, the outstanding amount was fully repaid by FPSO Capixaba Venture S.A.

(d) As of December 31, 2018 and 2017, the receivable amounts and the income from Tupi Nordeste Operações Marítimas Ltda., Guará Norte Operações Marítimas Ltda. and Alfa Lula Alto Operações Marítimas Ltda. relates to labor costs reimbursement regarding the operation of the FPSO Cidade de Paraty, FPSO Cidade de Ilhabela, and FPSO Cidade de Maricá, respectively.

(e) As of December 31, 2018, and 2017, the receivable amount and the income from Guará Norte Holding Ltd., Alfa Lula Alto Holding Ltd. and Beta Lula Central Holding Ltd. relates to a management fee charged by the Group in respect of the operating services rendered to the FPSO Cidade de Ilhabela, FPSO Cidade de Maricá and FPSO Cidade de Saquarema, respectively.

Key management personnel (i) remuneration for the years ended December 31, 2018 and 2017 is as follows:

	Year ended December 31,	
	2018	2017
Short-term benefits (ii)	4,670	4,264

(i) Key management is defined as the statutory officers and directors of the Group.

(ii) Short-term benefits mainly refers to salaries, social security contributions, annual leave and profit sharing (payable within twelve months from the year-end date). For the years ended December 31, 2018 and 2017, the Group did not record profit sharing contribution.

The compensation paid to key management personnel is evaluated on an annual basis, considering the following main factors: individual performance during prior year, market rates and movements and the individual's anticipated contribution to the Group's growth. Members of key management are also eligible to participate in the Group's retirement benefit plans (Note 26).

12 INVESTMENTS

	December 31, 2018							
	Number of shares (thousands)	Ownership interest (%)	Authorized share capital	Current assets	Non-current assets	Current liabilities	Non-current liabilities	Shareholders' equity (deficiency)
Associates:								
FPSO Capixaba Venture S.A.	100	20.00%	82	8,931	25,210	86,670	113,218	(165,747)
SBM Espírito do Mar Inc.	100	20.00%	88	6,943	240,990	24,661	76,432	146,840
Urca Drilling B.V. [1] (Unaudited)	90	15.00%	€90k	80	22,005	513,061	256,277	(747,253)
Bracuhy Drilling B.V. [1] (Unaudited)	90	15.00%	€90k	74	9,001	207,241	282,768	(480,934)
Mangaratiba Drilling B.V. [1] (Unaudited)	90	15.00%	€90k	6	1	44,472	111,704	(156,169)
Joint Ventures:								
Tupi Nordeste S.à.r.l.	16,020	20.00%	16,020	1,198,397	(37,438)	540,963	-	619,996
Tupi Nordeste Holding Ltd.	12	20.00%	12	10,318	-	71,980	-	(61,662)
Guará Norte S.à.r.l. [2]	50,020	12.75%	50,020	1,621,194	-	819,085	-	802,108
Guará Norte Holding Ltd. [2]	12	12.75%	12	9,047	-	25,119	-	(16,072)
Alfa Lula Alto S.à.r.l. [2]	65,020	5.00%	65,020	1,716,666	-	1,265,681	-	450,985
Alfa Lula Alto Holding Ltd. [2]	5	5.00%	12	11,544	-	29,864	-	(18,320)
Beta Lula Central S.à.r.l. [2]	65,020	5.00%	65,020	1,671,603	-	1,288,052	-	383,551
Beta Lula Central Holding Ltd. [2]	5	5.00%	12	14,121	-	15,248	-	(1,127)

	December 31, 2017							
	Number of shares (thousands)	Ownership interest (%)	Authorized share capital	Current assets	Non-current assets	Current liabilities	Non-current liabilities	Shareholders' equity (deficiency)
Associates:								
FPSO Capixaba Venture S.A.	100	20.00%	82	17,145	71,651	64,242	102,926	(78,372)
SBM Espírito do Mar Inc.	100	20.00%	88	3,429	175,232	24,163	45,286	109,212
Urca Drilling B.V. [1] (Unaudited)	90	15.00%	€90k	124	22,006	503,037	245,176	(726,083)
Bracuhy Drilling B.V. [1] (Unaudited)	90	15.00%	€90k	1,463	9,535	203,779	267,064	(459,845)
Mangaratiba Drilling B.V. [1] (Unaudited)	90	15.00%	€90k	11	1	44,826	104,957	(149,771)
Joint Ventures:								
Tupi Nordeste S.à.r.l.	16,020	20.00%	16,020	131,090	1,073,820	108,991	546,611	549,308
Tupi Nordeste Holding Ltd.	12	20.00%	12	6,645	12,597	18,008	23,091	(21,857)
Guará Norte S.à.r.l. [2]	50,020	12.75%	50,020	1,659,494	-	944,155	-	715,339
Guará Norte Holding Ltd. [2]	12	12.75%	12	31,590	-	34,349	-	(2,759)
Alfa Lula Alto S.à.r.l. [2]	65,020	5.00%	65,020	116,808	1,638,804	124,809	1,256,883	373,920
Alfa Lula Alto Holding Ltd. [2]	5	5.00%	12	14,134	-	17,048	-	(2,914)
Beta Lula Central S.à.r.l. [2]	65,020	5.00%	65,020	79,335	1,626,113	90,001	1,293,963	321,484
Beta Lula Central Holding Ltd. [2]	5	5.00%	12	11,727	244	6,220	868	4,883

The amounts presented in the tables above correspond to the investee's accounting balances before applying the Group's equity participation.

Atendimento Prisma

	Investees' comprehensive income/(loss) for the year ended December 31,					
	2018			2017		
	Net income (loss)	Other comprehensive income (loss)	Total comprehensive income (loss)	Net income (loss)	Other comprehensive income (loss)	Total comprehensive income (loss)
Associates:						
FPSO Capixaba Venture S.A.	(93,604)	6,227	(87,377)	25,971	635	26,606
SBM Espírito do Mar Inc.	37,633	-	37,633	(49,706)	-	(49,706)
Urca Drilling B.V. [1] (Unaudited)	(22,169)	-	(22,169)	(41,667)	-	(41,667)
Bracuhy Drilling B.V. [1] (Unaudited)	(21,089)	-	(21,089)	(26,696)	-	(26,696)
Mangaratiba Drilling B.V. [1] (Unaudited)	(6,398)	-	(6,398)	(6,074)	-	(6,074)
Joint Ventures:						
Tupi Nordeste S.à.r.l.	61,356	11,333	72,689	31,017	12,133	43,150
Tupi Nordeste Holding Ltd.	(46,201)	6,383	(39,818)	22,563	449	23,012
Guará Norte S.à.r.l. [2]	91,145	8,625	99,770	47,738	7,585	55,323
Guará Norte Holding Ltd. [2]	(16,263)	2,966	(13,297)	20,937	219	21,156
Alfa Lula Alto S.à.r.l. [2]	70,968	24,117	95,085	67,457	12,933	80,390
Alfa Lula Alto Holding Ltd. [2]	(12,740)	(2,636)	(15,376)	7,280	(59)	7,221
Beta Lula Central S.à.r.l. [2]	73,573	23,493	97,066	71,423	5,039	76,462
Beta Lula Central Holding Ltd. [2]	(5,829)	(203)	(6,031)	6,022	(120)	5,902

The amounts presented in the tables above correspond to the investee's results and comprehensive income/(loss) before applying the Group's equity participation.

Changes in investments

	December 31, 2017	Capital decrease [3]	Share of results	Share of comprehensive income (loss)	Impairment	December 31, 2018
Associates:						
FPSO Capixaba Venture S.A.	(15,674)	-	(18,721)	1,246	-	(33,149)
SBM Espírito do Mar Inc.	21,842	-	7,527	-	-	29,369
Joint ventures:						
Tupi Nordeste S.à.r.l.	109,862	(400)	12,271	2,266	-	123,999
Tupi Nordeste Holding Ltd.	(4,369)	-	(9,240)	1,277	-	(12,332)
Guará Norte S.à.r.l. [2]	91,206	(1,658)	11,621	1,099	-	102,268
Guará Norte Holding Ltd. [2]	(353)	-	(2,074)	378	-	(2,049)
Alfa Lula Alto S.à.r.l. [2]	18,695	(900)	3,548	1,206	-	22,549
Alfa Lula Alto Holding Ltd. [2]	(147)	-	(637)	(132)	-	(916)
Beta Lula Central S.à.r.l. [2]	16,074	(1,750)	3,679	1,175	-	19,178
Beta Lula Central Holding Ltd. [2]	245	-	(291)	(10)	-	(56)
Sub-Total	237,381	(4,708)	7,683	8,504	-	248,860
Impairment [4]	-	-	-	-	(98,860)	(98,860)
Total	237,381	(4,708)	7,683	8,504	(98,860)	150,000
Total assets (investments)	257,924					198,503
Total liabilities (accumulated deficit in investments)	(20,543)					(48,503)

Atendimento Prisma

	December 31, 2016	Capital decrease	Dividends received	Share of results	Share of comprehensive income (loss)	December 31, 2017
Associates						
FPSO Capixaba Venture S.A.	(20,995)	-	-	5,194	127	(15,674)
SBM Espírito do Mar Inc.	38,383	-	(6,600)	(9,941)	-	21,842
Urca Drilling B.V. (1) (Unaudited)	-	-	-	-	-	-
Bracuhy Drilling B.V. (1) (Unaudited)	-	-	-	-	-	-
Mangaratiba Drilling B.V. (1) (Unaudited)	-	-	-	-	-	-
Joint ventures						
Tupi Nordeste S.à.r.l.	101,232	-	-	6,203	2,427	109,862
Tupi Nordeste Holding Ltd.	(8,972)	-	-	4,513	90	(4,369)
Guará Norte S.à.r.l. (2)	84,152	-	-	6,087	967	91,206
Guará Norte Holding Ltd. (2)	(3,050)	-	-	2,669	28	(353)
Alfa Lula Alto S.à.r.l. (2)	15,525	(850)	-	3,373	647	18,695
Alfa Lula Alto Holding Ltd. (2)	(508)	-	-	364	(3)	(147)
Beta Lula Central S.à.r.l. (2)	13,976	(1,725)	-	3,571	252	16,074
Beta Lula Central Holding Ltd. (2)	(50)	-	-	301	(6)	245
Total	219,693	(2,575)	(6,600)	22,334	4,529	237,381
Total assets (investments)	253,268					257,923
Total liabilities (accumulated deficit in investments)	(33,575)					(20,542)

Atendimento Prisma

(1) During the year-ended December 31, 2016, the Group's 15% equity participation in the associate entities Urca, Bracuhy and Mangaratiba was reduced to zero, following management's understanding of the Group's legal and statutory obligations in respect of such associate entities. Once the investments are reduced to zero, no additional losses will be provided for and no liabilities will be recognized whereas Angra Participações B.V. had not incurred legal or constructive obligations or made payments on behalf of such associates.

(2) The Group jointly controls the entities within the FPSOs Cidade de Ilhabela, Cidade de Maricá and Cidade de Saquarema structures with its partners, since all major financial and operational decisions require the unanimous approval of the Directors and Managers representatives of all the shareholders of these entities. The Group has the right to appoint 1 (one) of 5 (five) Managers in Luxembourg entities and 1 (one) of 4 (four) Directors in Bermuda entities. According to the Shareholders' Agreement, the meetings of the Board of Managers and Board of Directors of Luxembourg and Bermuda entities, respectively, must have a quorum comprised by at least 1 (one) Manager or 1 (one) Director appointed by each shareholder, which means that the Manager or the Director appointed by Arazi and or Lancaster must be present. The Group participates actively in the organization and execution of the operations by seconding personnel to the operating management team in agreed positions.

(3) In January 2018, April 2018 and June 2018, the Group received the amount of US$1,148, US$255, and US$255 from Guara Norte S.à.r.l. In March 2018, June 2018, September 2018 and December 2018, the Group received the amounts of US$300, US$200, US$950 and US$300 from Beta Lula S.à.r.l. In March 2018 and September 2018, the Group received the amounts of US$200 and US$200 from Tupi Nordeste S.à.r.l, and in April 2018 and October 2018 the Group received the amounts of US$750 and US$150 from Alfa Lula Alto S.à.r.l., respectively.

(4) As disclosed in Note 27, on May 28, 2019, the Group confirmed its intention to divest its participation in the FPSO segment, and thus an impairment of US$98,860 was recorded in connection with the market value of those investments.

The main activities of the Group's associates are as follows:

FPSO Capixaba

- ✓ FPSO Capixaba Venture S.A. ("Capixaba")'s core business is to support operations for agreements in the oil and gas industry. Since March 16, 2007, Capixaba is a shareholder of a Brazilian entity, SBM Capixaba Operações Marítimas Ltda., which operates the FPSO Capixaba, currently located offshore the Brazilian coast and chartered to Petrobras until 2022.

- ✓ SBM Espírito do Mar Inc. ("Espírito do Mar") owns the FPSO Capixaba and its main activity is to support charter agreements in the oil and gas industry.

Urca, Bracuhy and Mangaratiba offshore drilling rigs (Partnership with Sete Brasil)

- ✓ Urca Drilling B.V. owns the Urca semi-submersible drilling rig, which is under construction to operate in pre-salt water depths. According to the charter and service-rendering agreements currently in place, upon its construction completion and acceptance by Petrobras, Urca should be chartered to Petrobras until 2031 and Serviços de Petróleo should be its sole operator.

- ✓ Bracuhy Drilling B.V. owns the Bracuhy semi-submersible drilling rig, which is under construction to operate in pre-salt water depths. According to the charter and service-rendering agreements currently in place, upon its construction completion and acceptance by Petrobras, Bracuhy should be chartered to Petrobras until 2033 and Serviços de Petróleo should be its sole operator.

- ✓ Mangaratiba Drilling B.V. owns the Mangaratiba semi-submersible drilling rig, which is under construction to operate in pre-salt water depths. According to the charter and service-rendering agreements currently in place, upon its construction completion and acceptance by Petrobras, Mangaratiba should be chartered to Petrobras until 2034 and Serviços de Petróleo should be its sole operator.

Atendimento Prisma

The Group, through its subsidiary Angra Participações B.V. ("Angra"), is a minority shareholder in the following associate entities with Sete Brasil's subsidiaries: Urca Drilling B.V. ("Urca"), Bracuhy Drilling B.V. ("Bracuhy") and Mangaratiba Drilling B.V. ("Mangaratiba"). The majority shareholder is Sete International One GmbH ("Sete International"), a second tier subsidiary of Sete Brasil.

On December 17, 2015, Angra exercised a put option whereby it has formalized its intention to cease its equity interest in the aforementioned associate entities, by transferring its shares to Sete International in accordance to the Shareholders' Agreement. Such transfer of shares has not occurred to date and on March 23, 2016, Angra called a binding arbitration process in order to settle this issue, which is still in progress. As of December 31, 2018, and on the date of approval of these consolidated financial statements, no new events have occurred that could have changed the progress of said arbitration process.

On April 20, 2016, the Group was informed that Sete Brasil's Extraordinary General Meeting held at that date approved Sete Brasil's petition for judicial recovery, which has been approved by the General Creditors Meeting of Sete Brasil and ratified in court in November 2018.

The audited financial statements of Urca, Bracuhy and Mangaratiba for the years ended December 31, 2018 and 2017 have not been issued to date.

The main activities of the Group's joint ventures are as follows:

FPSO Cidade de Paraty

- ✓ Tupi Nordeste S.à.r.l.'s main activity is to act as a sub-charter party for agreements in the oil and gas industry. The entity charters the FPSO Cidade de Paraty to Petrobras until 2033, which is currently located offshore the Brazilian coast. Operations started in June 2013.

- ✓ Tupi Nordeste Holding Ltd.'s main activity is to support operations for agreements in the oil and gas industry. This entity is a shareholder of a Brazilian entity, Tupi Nordeste Operações Marítimas Ltda., which operates the FPSO Cidade de Paraty to Petrobras until 2033.

FPSO Cidade de Ilhabela

- ✓ Guará Norte S.à.r.l.'s main activity is to act as a sub-charter party for agreements in the oil and gas industry. The entity charters the FPSO Cidade de Ilhabela to Petrobras until 2034, which is currently located offshore the Brazilian coast. Operations started in November 2014.

- ✓ Guará Norte Holding Ltd.'s main activity is to support operations for agreements in the oil and gas industry. This entity is a shareholder of a Brazilian entity, Guará Norte Operações Marítimas Ltda., which operates the FPSO Cidade de Ilhabela to Petrobras until 2034.

Atendimento Prisma

FPSO Cidade de Maricá

- ✓ Alfa Lula Alto S.à.r.l. owns the FPSO Cidade de Maricá, which started its operations on February 7, 2016 after achieving first oil and completing a 72-hour continuous production test (Final Acceptance). On July 12, 2013, the Group entered into a 20-year agreement to charter the FPSO Cidade de Maricá to the Consortium BM-S-11.

- ✓ Alfa Lula Alto Holding Ltd.'s main activity will be to support operations for agreements in the oil and gas industry. This entity is a shareholder of a Brazilian entity, Alfa Lula Alto Operações Marítimas Ltda., which will operate the FPSO Cidade de Maricá to Petrobras until 2036.

FPSO Cidade de Saquarema

- ✓ Beta Lula Central S.à.r.l. owns the FPSO Cidade de Saquarema, which started its operations on July 8, 2016 after achieving first oil and completing a 72-hour continuous production test (Final Acceptance). On July 12, 2013, the Group entered into a 20-year agreement to charter the FPSO Cidade de Saquarema to the Consortium BM-S-11.

- ✓ Beta Lula Central Holding Ltd.'s main activity will be to support operations for agreements in the oil and gas industry. This entity is a shareholder of a Brazilian entity, Beta Lula Central Operações Marítimas Ltda., which will operate the FPSO Cidade de Saquarema to Petrobras until 2036.

Other matters regarding the Group's investments

Partnership with SBM Offshore N.V. - Contingent Liability

The Company, through its subsidiaries, is a non-controlling shareholder in the following associate and joint venture entities with SBM Offshore N.V. ("SBM Offshore") and its subsidiaries: FPSO Capixaba Venture S.A., SBM Espírito do Mar Inc., Tupi Nordeste S.à.r.l., Tupi Nordeste Holding Ltd., Guará Norte S.à.r.l, Guará Norte Holding Ltd., Alfa Lula Alto S.à.r.l., Alfa Lula Alto Holding Ltd., Beta Lula Central S.à.r.l. and Beta Lula Central Holding Ltd.. The majority shareholder is SBM Offshore.

In November 2014, SBM Offshore announced that it had reached an out-of-court settlement agreement with the Dutch Public Prosecutor's Office (*Openbaar Ministerie*) over the inquiry into alleged improper payments to sales agents in Equatorial Guinea, Angola and Brazil in the period from 2007 through 2011, which consisted of a payment by SBM Offshore to the *Openbaar Ministerie* of US$240 million.

In November 2017, SBM Offshore announced that it had signed a Deferred Prosecution Agreement ("DPA") with the United States Department of Justice ("U.S. DoJ"). SBM Offshore also announced that as part of the overall resolution, SBM Offshore USA, Inc. ("SBM USA"), a subsidiary of SBM Offshore, pleaded guilty to a single count of conspiracy to commit a violation of the U.S. Foreign Corrupt Practices Act and SBM Offshore and SBM USA agreed to pay monetary penalties in the total amount of US$238 million.

On July 26, 2018, SBM Offshore announced that SBM Offshore and SBM Holding Inc. S.A. ("SBM Holding") signed a leniency agreement in Brazil with the General Controller's Office (*Ministério da Transparência e Controladoria-Geral da União* – CGU), the Attorney General's Office (*Advocacia Geral da União* - AGU) and Petrobras (the "Leniency Agreement").

The Leniency Agreement provides for:

- ✓ A cash payment by SBM Offshore to Petrobras totalling R$549 million (Brazilian reais) (approximately US$148 million);
- ✓ A reduction of 95% in future performance bonus payments related to FPSOs Cidade de Anchieta and Capixaba lease and operate contracts, representing an agreed nominal value of approximately US$180 million over the period 2016 to 2030;
- ✓ The aggregate of the cash payments to be made (approximately US$189 million) and the net present value of future bonus payments (approximately US$110 million) is in line with the provision maintained by SBM Offshore of US$299 million as at December 31, 2017;
- ✓ Under the terms of the Leniency Agreement, CGU, AGU and Petrobras commit to terminate all of their investigations against SBM Offshore and refrain from initiating new legal proceedings under the Improbity Law, Anti-Corruption Law and Public-Procurement Law in relation to the legacy issues in Brazil.

On September 1, 2018, SBM Offshore announced that signed an additional agreement with the Brazilian Federal Prosecutor's Office (*Ministério Público Federal* – MPF) (the "Agreement"). Such agreement was subject to approval by the Brazilian Fifth Chamber for Coordination and Review and Anti-corruption of the Federal Prosecutor Service ("Fifth Chamber" - *5ª Câmara de Coordenação e Revisão do Ministério Público Federal*).

Atendimento Prisma

On December 18, 2018, SBM Offshore announced that the Fifth Chamber has approved the Agreement. This Agreement comprises a final settlement between SBM Offshore and the MPF with respect to alleged improper sales practices before 2012.

Under the Agreement, the MPF commits to refrain from initiating new legal proceedings against the SBM Offshore under the Improbity Law, Anti-Corruption Law and Public-Procurement Law in relation to the legacy issues in Brazil. The Agreement provides for the payment of an additional fine by SBM Offshore of R$200 million (Brazilian reais). The additional fine is to be paid by SBM Offshore to Petrobras in instalments: an upfront payment of R$60 million (Brazilian reais), with seven R$20 million (Brazilian reais) installments thereafter.

These agreements entered into by SBM Offshore did not have any impact on the Group's consolidated financial statements.

Atendimento Prisma

13 PROPERTY, PLANT AND EQUIPMENT

	Drillships			Offshore drilling rigs					Onshore drilling rigs, equipment and bases [b]		
	Brava Star	Amaralina Star	Laguna Star	Atlantic Star	Alpha Star	Gold Star	Lone Star	Olinda Star		Corporate	Total
Cost											
Balance as of December 31, 2016	695,866	661,323	662,166	351,287	742,274	590,059	710,048	561,178	162,654	27,219	5,164,074
Additions	2,891	31,240	15,055	1,026	1,869	1,476	4,680	17,343	3,966	644	80,190
Disposals	-	-	-	-	-	(271)	-	-	-	(150)	(421)
Currency translation adjustments	-	-	-	-	-	-	-	-	(1,324)	(698)	(2,022)
Balance as of December 31, 2017	698,757	692,563	677,221	352,313	744,143	591,264	714,728	578,521	165,296	27,015	5,241,821
Additions	914	5,714	18,167	197	-	225	225	4,134	-	424	30,000
Disposals	-	-	-	-	-	-	-	(823)	-	(97)	(920)
Transfers	-	-	1,144	-	3,736	-	-	-	(4,880)	-	-
Currency translation adjustments	-	-	-	-	-	-	-	-	(12,223)	(3,146)	(15,369)
Balance as of December 31, 2018	699,671	698,277	696,532	352,510	747,879	591,489	714,953	581,832	148,193	24,196	5,255,532
Accumulated depreciation and Impairment											
Balance as of December 31, 2016	(41,877)	(111,996)	(108,247)	(136,154)	(172,438)	(159,174)	(167,114)	(220,750)	(102,108)	(22,273)	(1,242,131)
Depreciation	(31,988)	(28,018)	(27,596)	(15,348)	(29,074)	(27,923)	(35,977)	(24,658)	(8,175)	(1,124)	(229,881)
Impairment provision [c]	(104,692)	(129,449)	(125,078)	-	(344,431)	(221,575)	(309,237)	(163,113)	(2,895)	-	(1,400,470)
Disposals	-	-	-	-	-	8	-	-	-	135	143
Currency translation adjustments	-	-	-	-	-	-	-	-	1,158	640	1,798
Balance as of December 31, 2017	(178,557)	(269,463)	(260,921)	(151,502)	(545,943)	(408,664)	(512,328)	(408,521)	(112,020)	(22,622)	(2,870,541)
Depreciation	(28,099)	(29,362)	(25,410)	(15,253)	(13,692)	(16,108)	(19,533)	(20,390)	(5,787)	(768)	(174,402)
Impairment (provision)/reversal [c]	(18,436)	2,085	(15,437)	-	25,672	53,443	75,875	103,140	(6,905)	-	219,437
Disposals	-	-	-	-	-	-	-	538	222	97	857
Currency translation adjustments	-	-	-	-	-	-	-	-	8,747	2,419	11,166
Balance as of December 31, 2018	(225,092)	(296,740)	(301,768)	(166,755)	(533,963)	(371,329)	(455,986)	(325,233)	(115,743)	(20,874)	(2,813,483)
Property, plant and equipment, net [a]											
December 31, 2017	520,200	423,100	416,300	200,811	198,200	182,600	202,400	170,000	53,276	4,393	2,371,280
December 31, 2018	474,579	401,537	394,764	185,755	213,916	220,160	258,967	256,599	32,450	3,322	2,442,049
Useful life range (years)	5 – 35	5 – 35	5 - 35	5 – 35	5 – 35	5 – 35	5 – 35	5 - 35	5 – 25	5 - 25	

Atendimento Prisma

(a) The Group's assets that are pledged as security for financing agreements are disclosed in Note 14.

(b) As of December 31, 2018, the amount of US$36,114 (US$45,816 as of December 31, 2017) refers to the onshore drilling rigs.

(c) During the years ended December 31, 2018 and 2017, due to the expiration of certain of its charter and service-rendering agreements the Group evaluated its fleet of drilling units for impairment. During such evaluation, the Group has identified that the impairment loss of some drilling units previously recognized has decreased. Consequently, an impairment reversal was recorded.

<u>*Onshore drilling rigs*</u>

Except for the QG-III and QG-IV units, the Group estimated the fair value of its onshore drilling rigs by applying the market approach, which estimates the amount that would be received for each drilling unit in the principal or most advantageous market for each drilling unit in an orderly transaction between market participants. For the QG-III and QG-IV units, the Group estimated its fair value based on the revaluated historical cost. In calculating the fair value less costs of disposal of these drilling units as of December 31, 2018, the Group recognized a net impairment related to the aggregated result of three onshore drilling rigs in the amount of US$6,905 (US$2,895 as of December 31, 2017).

<u>*Offshore drilling rigs and drillships*</u>

The Group estimated the fair value of each one of its offshore drilling rigs using the income approach method (i.e., value in use), by a discounted projected net cash flow analysis over the remaining economic useful life of each drilling unit, which utilized significant unobservable inputs. As of December 31, 2018, the Group recognized impairment losses related to the Brava Star and Laguna Star drillships, in the total aggregate amount of US$33,873 (US$1,397,575 as of December 31, 2017) and a reversal of impairment related to the Amaralina Star drillship, Alpha Star, Gold Star, Lone Star and Olinda Star offshore drilling rigs in the total aggregate amount of US$260,215. Net effect of US$226,342 as of December 31, 2018.

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14 LOANS AND FINANCINGS

Financial institution	Funding type	Objective	Beginning period	Original maturity [1]	Contractual interest rate (per annum)	Effective interest rate (per annum)	Currency	December 31, 2018	December 31, 2017
Santander, HSBC, Citibank [2]	Senior Notes ("Project Bond")	Refinance Alaskan Star and Atlantic Star rigs, and other corporate purposes	Jul/2011	Jul/2018	5.25%	5.55%	U.S. dollar	-	87,665
HSBC, BAML and Citibank [2]	Senior Unsecured Notes ("Corporate Bond")	Prepay working capital loans	Nov/2012	Nov/2019	6.25%	6.86%	U.S. dollar	98,970	95,587
HSBC, BAML and Citibank [2]	Senior Unsecured Notes ("New Notes")	Refinance Corporate Bond	Jul/2017	Nov/2024	9.00% + 0.50%	10.6%	U.S. dollar	625,411	591,436
							Subtotal - fixed interest rate	724.381	774,688
Bradesco	Loan	Working capital	Sep/2014	Dec/2018	Libor+6.80%	9.16%	U.S. dollar	102,568	101,338
Bradesco	Loan	Working capital	Jan/2015	Dec/2018	Libor+6.50%	8.86%	U.S. dollar	51,242	51,627
							Subtotal - variable interest rate loans	153,810	152,965
BNP, Citi and ING [3] and The Norwegian Ministry of Trade and Industry ("MTI")	Financing	Amaralina Star drillship construction	May/2012	Dec/2018	Libor+2.75%	3.59%	U.S. dollar	129,484	176,791
BNP, Citi and ING [3] and The Norwegian Ministry of Trade and Industry ("MTI")	Financing	Laguna Star drillship construction	May/2012	Dec/2018	Libor+2.75%	3.50%	U.S. dollar	133,716	186,988
BNP, Citi, ING and DNB and Eksportkreditt Norge ("EKN")	Financing	Brava Star drillship construction	May/2015	Sep/2020	Libor+2.00%	3.97%	U.S. dollar	333,809	363,751
							Subtotal - variable interest rate financings	597,009	727,530
							Total	1,475,200	1,655,183
							Current	1,475,200	655,788
							Non-current	-	999,395

(1) As described in Note 1, on December 6, 2018, the RJ Debtors filed for a RJ, which in accordance with the terms of the loans and financings agreements represents an event of default. Accordingly, the amounts owed to the lenders become due and payable, being the payments suspended by the RJ until the approval of the restructuring plan, which established new maturity dates.

(2) Jointly referred to as the "Bookrunners".

(3) Jointly referred to as the "Leader arrangers".

a) Changes in loans and financings

	Year-ended December 31,	
	2018	2017
Balance as of January 1	1,655,183	2,195,689
Principal repayment	(230,491)	(532,481)
Transaction costs paid	-	(23,524)
Interest payment	(67,287)	(104,250)
Total payments	(297,778)	(660,255)
Interest charged through profit and loss	109,125	106,069
Transaction cost charged through profit and loss	8,020	9,856
Debt discounts charged through profit and loss	650	3,824
Financial expenses on loans and financings (Note 22)	117,795	119,749
Balance as of December 31,	1,475,200	1,655,183

Working capital

In January 2015, the Group used the remaining balance of the credit line with Bradesco amounting to US$95 million and signed an additional working capital credit line agreement, with the same financial institution, in the amount of US$75 million, with a 2-year term bearing interest rate at LIBOR plus 4.80% p.a. The Group fully used this additional credit line. Both credit lines were originally due in January 2017.

On January 2, 2017, the Group signed amendments to the working capital credit loan agreements with Bradesco in the amounts of US$150 million and US$75 million, bearing interest rates at LIBOR plus 6.80% p.a. and LIBOR plus 6.50% p.a., respectively, to postpone the maturity dates from January to July 2018.

During 2018 the Group signed a number of amendments to the working capital credit loan agreements with Bradesco to postpone its maturity dates. The latest amendment was signed on November 30, 2018, extending the maturity date to December 8, 2018, but due to the RJ process, the payment was suspended until the approval of the restructuring plan, which established new maturity dates.

Corporate Bond Exchange Offer

On July 27, 2017, the Company issued Senior Secured Notes (the “New Notes”) bearing interest rates at 9.00% p.a. semiannually paid with an additional capitalized interest at 0.50% p.a. to be repaid until 2024 in exchange for an equal aggregate principal amount of its outstanding 6.25% p.a. Senior Notes due in 2019. Due to the RJ process, interest payment was suspended until the approval of the restructuring plan, which established new conditions and maturity dates. The Group paid transaction costs in the aggregate amount of US$23,524 for this transaction occurred in 2017.

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Amaralina Star Facility

On September 28, 2018, the Group announced that Amaralina has entered into an amendment to extend the maturity date of the Amaralina Star Bank Tranche Loans under the Amaralina Star drillship project financing (the "Amaralina Star Facility"). The extended maturity date was October 31, 2018. Other than the extended maturity date, all other material terms of the Amaralina Star Facility were unchanged.

During November 2018, the Group signed a number of amendments to the Amaralina Star Facility to postpone its maturity dates. The latest amendment was signed on November 30, 2018, extending the maturity date to December 8, 2018, but due to the RJ process, the payment was suspended until the approval of the restructuring plan, which established new maturity dates.

Laguna Star Facility

On November 30, 2018, the Group extended the maturity date of the Laguna Star Facility, formerly due on November 30, 2018. The extended maturity date was scheduled to occur on December 8, 2018, but due to the RJ process, the payment is suspended until the approval of the restructuring plan, which will establish new maturity dates.

Senior Secured Notes – Project Bond

On July 30, 2018, the Group fully repaid and discharged QGOG Atlantic/Alaskan Rigs 5.25% Senior Secured Notes in the total outstanding amount of US$58,114.

b) Loans and financings original long term amortization schedule

Year ending December 31,	Gross amount	Transaction costs	Debt discounts	Net amount
2019	611,407	(4,962)	(161)	606,284
2020	307,263	(4,419)	-	302,844
2021	28,565	(3,226)	-	25,339
2022	33,857	(3,226)	-	30,631
2023	37,982	(3,226)	-	34,756
2024	478,119	(2,773)	-	475,346
Total	1,497,193	(21,832)	(161)	1,475,200

Due to the RJ process, the amortizations were suspended until the approval of the restructuring plan, which established new maturity dates and amortization schedule.

As described in Note 1, on December 6, 2018, the RJ Debtors filed for a RJ, which in accordance with the terms of the loans and financings represents an event of default. Accordingly, the amounts owed to the lenders become due and payable, being the payments suspended by the RJ law until the approval of the restructuring plan, which established new maturity dates. Due to this event and as established in IAS 1 – *Presentation of Financial Statements*, the Group reclassified the non-current portion of its loans and financings to current liabilities. This reclassification occurred not as demand payment, but because of the breach as of December 31, 2018, when the Group did not have an unconditional right to defer its settlement for at least twelve months after that date.

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c) Covenants

Financial covenants

The financing agreements contains financial covenants and securities provided to lenders. Noncompliance with such financial covenants could constitute a Restricted Payment Trigger Event, which would lead in the borrower entity of the Group not being allowed to pay dividends, purchase, retire or otherwise distribute capital stock or make certain payments to related parties.

The financial covenants related to the financing agreements ("project financing") of Amaralina Star, Laguna Star, Brava Star and the Project Bond as of December 31, 2017, consist of Debt Service Coverage Ratio, which requires a minimum ratio of Net Operating Cash Flow to Debt Service.

The Debt Service Coverage Ratio is assessed quarterly for dividends distribution intention and semi-annually for compliance with such financial covenants in case. Such covenant is assessed for dividend distribution purposes and as of December 31, 2018. The Group did not distribute dividends.

The indenture governing the Corporate Bond as of December 31, 2018, contains certain financial covenants that limited the Group's ability to incur in additional indebtedness at that date. The financial covenants was measured on the four most recent fiscal quarters for which financial statements was available and consisted of: (i) Unconsolidated Interest Coverage Ratio; and (ii) Consolidated Net Leverage Ratio. These financial covenants were not required to be measured on a regular basis and should be assessed whenever additional indebtedness was envisaged to be incurred by the Group, as required under the indenture. No additional debt was incurred in 2018.

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The New Notes have a restrictive covenant package, including a restriction on dividend payments and additional limitations on the incurrence of indebtedness and liens. On or after January 1, 2022, the indenture governing the New Notes will allow the Company and any of its restricted subsidiaries to incur additional indebtedness if the Company's consolidated net leverage ratio is equal to or less than 3.00 to 1.00. This financial ratio is not required to be measured on a periodic basis and shall only be calculated upon the incurrence of additional indebtedness in accordance with the terms of the indenture. Furthermore, the Company will always be allowed to incur certain permitted indebtedness in accordance with the terms of the indenture.

In connection with the Exchange Offer and Consent Solicitation, on July 25, 2017, the Company executed a Supplemental Indenture for its outstanding 6.25% p.a. Senior Notes due in 2019 to amend and remove certain of its covenants and events of default.

Non-financial covenants

In accordance with the project financing agreements the Group shall deliver to the Administrative Agent a copy of the consolidated financial statements of the Company, Amaralina, Laguna and financial statements of Brava within 180 days after the end of the fiscal year, accompanied by the unqualified independent auditor's reports. As of the issuance date of this consolidated financial statements the Group failed to comply with these non-financial covenants. The Group understands that the existence of this failure does not impair the liens on the collateral and has not had and cannot be reasonably expected to have a material adverse effect on its financial and liquidity position. Additionally, due to the RJ filing all of the Group's debt was accelerated and due in payable. However, the court proceedings and the PSA prevents the lenders from enforcing it. Therefore, after the RJ filing, the Group understands that the possibility of defaults due to non-compliance with covenants is no longer an additional risk.

d) Guarantees

The financings obtained by the Group in order to finance the construction of the drilling rigs, drillships and for other corporate purposes are usually structured as Project Finance/Project Bond; therefore benefiting from a customary security package that includes guarantees such as assignment of the charter receivables, mortgages over the drilling rigs and drillships, pledges over the shares of the drilling rigs and drillships owners, charges over the relevant bank accounts held at the facility agents, including accounts into which the amounts payable under charter agreements are required to be paid, assignment of the relevant insurances along with corporate guarantees during pre-completion period.

In addition, the terms of some of these financing debt instruments restricts the ability of project subsidiaries to pay dividends, incur additional debt, grant additional liens, sell or dispose assets and enter into certain acquisitions, mergers and consolidations, except as already established in such financing debt instruments.

The aforementioned conditions applies to the Project Financing related to Amaralina Star, Laguna Star and Brava Star drillships.

The Corporate Bond issued on November 9, 2012, is guaranteed by the Group on a senior unsecured basis. In addition, the Group has established an interest reserve account in favor of the collateral agent, which is fully funded by cash and/or letters of credit in an amount sufficient to provide for the payment of the next two succeeding interest payments. On June 26, 2015, the Group released the letters of credit related to such interest reserve account, in compliance with the Corporate Bond documentation and considering the Group's consistent deleveraging since the Corporate Bond's issuance.

The New Notes are guaranteed on a senior secured basis by certain subsidiaries of the Company, including but not limited to the guarantor of the Existing Notes, Constellation Overseas, and the entities that own the Unencumbered Rigs. The New Notes will also be guaranteed on a subordinated basis by Star International Drilling Ltd., subject to the terms and conditions of the New Notes.

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The New Notes are secured by certain assets of the Company, including but not limited to, the Company's current unencumbered offshore rigs Olinda Star, Lone Star and Gold Star (the "Unencumbered Drilling Rigs") and the insurance receivables and charter receivables related thereto, subject to the terms and conditions of the New Notes. The New Notes also have a springing collateral package that could consist of additional offshore rigs and drilling vessels as well as their related insurance receivables and charter receivables, subject to the terms and conditions of the New Notes.

15 PROVISIONS

In the normal course of its business activities, the Group engages in agreements with third parties that convey contractual obligations. The Group recognizes provisions for contractual penalties (delay in beginning of operations) that are more likely than not to be payable with respect to certain of its agreements, for which the Group's management does not expect the payable amount to materially differ from the estimated amount.

	Year-ended December 31,	
	2018	2017
Balance as of January 1	4,391	1,230
Olinda Star penalty provision (Note 1.b)		3,179
Olinda Star penalty payment	(3,179)	-
Effect of foreign exchange variations	(177)	(18)
Balance as of December 31	1,035	4,391

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16 PROVISION FOR CONTINGENCIES

a) Contingent assets

The Group has not recognized contingent assets.

b) Contingent liabilities assessed as probable losses

During the normal course of its business activities, the Group is exposed to labor, civil and tax claims. Regarding each claim or exposure, management has assessed the probability that the matter resolution would ultimately result in a financial loss for the Group. As of December 31, 2018, provisions to cover probable losses included in "other non-current liabilities" are mainly related to labor (hardship and retirement) and civil claims.

Changes in loss provision for labor and civil claims are as follows:

	Year-ended December 31,	
	2018	2017
Balance as of January 1	1,223	1,544
Additions	294	652
Reversals	(161)	(961)
Foreign exchange rate variations	(187)	(12)
Balance as of December 31	1,169	1,223

c) Contingent liabilities assessed as possible losses

Based on the Group's in-house legal counsel and external legal advisors' opinions, these claims are not accrued in the consolidated financial statements and consist of labor lawsuits (mainly comprised by compensation due to work related accidents and occupational diseases) in the amount of US$41,041 as of December 31, 2018 (US$31,680 as of December 31, 2017), tax lawsuits in the amount of US$29,747 as of December 31, 2018 (US$32,620 as of December 31, 2017) and civil lawsuits in the amount of US$13 as of December 31, 2018 (US$15 as of December 31, 2017).

The main tax lawsuits assessed as possible losses are as follows:

i. On September 15, 2010, Serviços de Petróleo received a Notice of Violation issued by the tax authorities due to the nonpayment of Services Tax ("*Imposto sobre Serviços de Qualquer Natureza* - ISS") in the city of Rio de Janeiro. Serviços de Petróleo argues, on appeal, that the operations were carried out in other municipalities and the taxes were collected under their tax jurisdictions (ISS due to the site of the service provider). As of December 31, 2018, the estimated amount involved is US$4,959 (US$5,487 as of December 31, 2017).

On January 22, 2015, Serviços de Petróleo received a Notice of Violation issued by the Brazilian Internal Revenue Service (*Receita Federal do Brasil* - RFB) related to Social Integration Program ("*Programa de Integração Social* - PIS") and Social Investment Program ("*Contribuição para o Financiamento da Seguridade Social* - COFINS") collected in the years 2010 and 2011. The RFB initiated a Tax Administrative Process, whereby it requires Serviços de Petróleo to make tax payments, due to the fact that the RFB considered that Serviços de Petróleo made use of improper tax credits aiming to reduce its PIS and COFINS obligations. On February 23, 2015, Serviços de Petróleo argued, on appeal, in order to contest RFB's tax assessment. As of December 31, 2018, the estimated amount involved is US$22,550 (US$25,252 as of December 31, 2017).

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ii. In November 2018, Transocean Offshore Deepwater Drilling Inc. and Transocean Brasil Ltda. (hereinafter together referred to as "Transocean") filed a claim against Serviços de Petróleo and Brava Star Ltd., accusing both entities of infringing Transocean's dual-activity drilling technology patent. On November 19, 2018, all preliminary injunctions requested by Transocean have been rejected by the Third Business Court of Rio de Janeiro and a mediation and conciliation hearing occurred on February 26, 2019, and a new hearing occurred on April 1, 2019, without an agreement between the parties. Transocean appealed solely to carry on an inspection on Brava Star drillship limited to the examination of some pre-determined items related to the dual-activity drilling technology patent and the injunction was granted in this regard. The inspection occurred on January 18, 2019.

As of the date of the issuance of these consolidated financial statements, the Group's management cannot reliably estimate the amount involved, and the external legal advisor classifies the chances of win such claim as possible.

d) Tax, labor and social security matters

The Group enters into transactions and operations that may be interpreted by third parties subjectively and/or contrary to the Group's position. Nevertheless, the Group's actions are supported by its external legal advisors' opinion.

e) Other matters

Petrobras withholding taxes

In July 2014, the Group received letters from Petrobras informing that the RFB issued Notices of Violation against Petrobras regarding the absence of withholding income taxes from charter agreements remittances in 2008 and 2009, related to the Atlantic Star and Alaskan Star offshore drilling rigs. Petrobras indicated that is currently contesting such Notices of Violation, but if the losses on ongoing appeals are confirmed, Petrobras will seek the recoverability of such losses from its contractors, including the Group, and any penalties, interest and fees that would be required to settle the debt with the RFB. Petrobras has informed that the amount involved related to the work performed by the Group amounts to R$152 million (US$67 million translated at historical rates), excluding penalties, interest and fees. The Group has contested Petrobras' allegations in a response letter stating that Petrobras "has no legal or commercial grounds to seek recoverability of such losses from the Group" and that "will not accept any withholding or deduction of the amounts to be received under the charter agreements". Should Petrobras fail on its appeals and, consequently, the Group receives any future charges aiming the reimbursement of Petrobras' losses, the Group will contest such charges.

17 DERIVATIVES

Under the terms of the project financing arrangements (Note 14), the Group was contractually required to manage its risk on variable interest rates by eliminating variable-to-fixed interest rate swaps on its long-term variable rate loans. Accordingly, in order to protect the Group from fluctuations in interest rates, interest rate swaps were used to convert the variable component of interest rates to fixed rates ranging from 1.79% p.a. to 2.90% p.a.. The floating component of interest rate of all derivatives agreements was the US$ LIBOR interest rate.

In the last quarter of 2018, due to the restructuring plan disclosed in Note 1, the Group has finalized its interest rate swaps agreements related to the loans funding the Amaralina Star, Laguna Star and Brava Star drillships.

Information on derivative agreements

Interest rate swaps US$ LIBOR/Pre-fixed rate

				Notional amount		Fair value	
Financial institution	Loans and financings objective	Payable leg interest rate (per annum)	Maturity	Dec. 31, 2018	Dec. 31, 2017	Dec. 31, 2018	Dec. 31, 2017
BNP, Citibank and ING (joint leader arranger)	Amaralina Star construction	2.81%	Sep/2018	-	181,497	-	1,223
BNP, Citibank and ING (joint leader arranger)	Laguna Star construction	2.90%	Nov/2018	-	193,240	-	1,594
BNP, Citi, ING and DNB (mandated leader arranger)	Brava Star construction	1.79%	Sep/2020	-	166,145	-	(1,124)
BNP and ING (mandated leader arranger)	Brava Star construction	1.84%	Sep/2020	-	165,168	-	(920)
			Designated to hedge accounting	-	706,050	-	773
			Total amount	-	706,050	-	773
			Current assets			-	106
			Non-current assets			-	1,938
			Current liabilities			-	2,817

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Changes in fair values are as follows:

	Year-ended December 31,	
	2018	2017
Balance as of January 1,	773	15,691
Fair value adjustments through profit and loss	513	5,006
Fair value adjustments through other comprehensive income/(loss)	1,208	(7,044)
Cash payments on derivatives	(2,494)	(12,880)
Balance as of December 31,	-	773

Hedge accounting

The Group has adopted the hedge accounting as from July 15, 2011, using derivative agreements related to Amaralina Star and Laguna Star drillships construction. The Group has adopted the hedge accounting using the derivative agreement related to Brava Star drillship construction as from June 4, 2015. Accordingly, the effect of the changes in the fair value of the derivative agreements designated to hedge accounting were recorded in "Other Comprehensive Income/(Loss)".

Interest rate swap agreements exchanging variable to fixed interest rates were designated and effective as fair value hedges in respect of interest rates. During the years presented, the hedge was effective in hedging the fair value.

Derivative agreements designated as cash flow hedges

Under interest rate swap agreements, the Group agreed to exchange the differences between fixed and variable rate interest amounts calculated on agreed notional principal amounts. Such agreements enabled the Group to mitigate the risk of cash flow exposures on the issued variable rate debt.

In connection with the project financings (Note 14) for the construction of Amaralina Star, Laguna Star and Brava Star drillships, the Group had a contractual commitment with the same financial institutions to contract derivatives as hedging instruments of the debt in relation to changes in LIBOR. Accordingly, the Group had swap agreements in connection with the rates, spreads, notional, terms and debt cash flows. The swap agreements were contracted in July 2011 and June 2015 and terminated on September 2018 in accordance with the Amaralina Star notional schedule and October 2018 in the case of Laguna Star and Brava Star due to the terms and conditions of the debt restructure negotiations.

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18 SHAREHOLDERS' EQUITY

a) Share capital

As of December 31, 2018 and 2017, the Company's share capital amounts to US$63,200, comprised by 189,227,364 ordinary shares, with no par value, as follows:

	December 31, 2018 and 2017						
	Shares				Rights over the amounts		
	Class A	%	Class B	%	Share capital	Share premium	Total
Lux Oil & Gas International S.à.r.l.	140,293,142	75.10%	-	-	46,857	568,328	615,185
Constellation Holdings S.à.r.l.	16,862,219	9.03%	876,880	36.25%	5,925	71,861	77,786
Constellation Coinvestment S.à.r.l.	14,800,460	7.92%	769,663	31.82%	5,200	63,075	68,275
CIPEF VI QGOG S.à.r.l.	14,564,483	7.80%	757,392	31.31%	5,117	62,069	67,186
CGPE VI, L.P.	288,141	0.15%	14,984	0.62%	101	1,228	1,329
Total shares per class	186,808,445	100.00%	2,418,919	100.00%	63,200	766,561	829,761
Total shares			189,227,364				

On March 13, 2017, the Extraordinary General Meeting of the shareholders of the Company was held, whereby the shareholders resolved: (i) to create 2 (two) classes of shares, one with voting rights ("Class A") and the other with no voting rights ("Class B"); (ii) conversion by the shareholders of their shares into Class A and Class B shares; and (iii) specific amendments to the Company's articles of association.

The Company's ultimate controlling party is the Queiroz Galvão family.

b) Legal reserve

In accordance with Luxembourg Corporate Law, the shareholders of a *société anonyme* must allocate 5% of the Company's annual profit of its stand-alone financial information, after deducting of any losses brought forward from previous years, to the minimum legal reserve. Such allocation must consider the Company's stand-alone statutory financial statements prepared in accordance with Luxembourg Generally Accepted Accounting Principles ("Lux GAAP"), which differs in certain aspects from IFRS/IASB.

The aforementioned requirement will only cease when the legal reserve reaches an amount equivalent to 10% of the Company's issued share capital. Additionally, this reserve may not be distributed in the form of cash dividends, or otherwise, during the Company's existence. The appropriation to legal reserve becomes effective after approval at the general shareholders meeting.

For the year ended December 31, 2018, the Company did not constitute legal reserve due to the fact that it has no statutory profits for the year then ended, based on its stand-alone statutory financial statements prepared in accordance with Lux GAAP.

c) Acquisition of non-controlling interests reserve

As disclosed in Note 11.a, due to the transfer of Amaralina and Laguna shares from Alperton to Constellation Overseas, a negative amount of US$85,555 was recorded as "Acquisition of non-controlling interests reserve", in the Shareholders' Equity.

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d) Shareholders distribution policy

The form of distribution to shareholders, whether as dividends, repayment of share premium or repurchase of own shares is based upon the Company's stand-alone statutory financial statements prepared in accordance with Lux GAAP, which must comply with Luxembourg laws and regulations. Additionally, any distribution of statutory profits to the shareholders will be subject to a Luxembourg withholding tax rate of 15% (17.65% if the dividend tax is not charged to the shareholder), subject to the exceptions provided by the Luxembourg tax law or by double tax treaties concluded by the Grand Duchy of Luxembourg and the country of the shareholders tax residency. The withholding tax must be withheld from the gross distribution and paid to the Luxembourg tax authorities.

Following the Company's articles of association, the share premium account balance presented in the Lux GAAP stand-alone statutory accounts may, for example, be used to provide for the payment of any shares that the Company may redeem from its shareholders, to offset any net realized losses or to make distributions to the shareholders, such list being a non-exhaustive list of the purposes for which the amount of the share premium account may be used.

For the years ended December 31, 2018 and 2017, the Company did not pay dividends.

e) Other Comprehensive Items (OCI)

Cash flow hedging reserve

The cash flow hedging reserve consists of the effective portion of cash flow hedging instruments related to hedged financing transactions (Note 17).

Foreign currency translation adjustments reserve

The currency translation adjustments reserve is used to record exchange adjustments arising from the translation of foreign subsidiaries' financial information.

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Changes in Other Comprehensive Items

Changes in comprehensive loss for the years ended December 31, 2018 and 2017 are as follows:

	Cash flow hedge fair value adjustments attributable to			Share of investments' other comprehensive income/(loss)	Foreign currency translation adjustments	Total
	Controlling interests	Non-controlling interests	Total			
Balance as of December 31, 2016	(3,749)	(2,087)	(5,836)	(12,156)	(8,130)	(26,122)
Fair value adjustments on:						
Derivative agreements	5,333	1,711	7,044	-	-	7,044
Joint ventures' derivative agreements	-	-	-	4,293	-	4,293
Exchange differences:						
On investments arising during the year	-	-	-	236	-	236
Arising during the year	-	-	-	-	(2,207)	(2,207)
Balance as of December 31, 2017	1,584	(376)	1,208	(7,627)	(10,337)	(16,756)
Fair value adjustments on:						
Derivative agreements	(1,584)	376	(1,208)	-	-	(1,208)
Joint ventures' derivative agreements	-	-	-	5,746	-	5,746
Exchange differences:						
On investments arising during the year	-	-	-	2,759	-	2,759
Arising during the year	-	-	-	-	(11,040)	(11,040)
Balance as of December 31, 2018	-	-	-	878	(21,377)	(20,499)

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f) Non-controlling interests

As disclosed in Note 11.a, due to the transfer of Amaralina and Laguna shares from Alperton to Constellation Overseas, the amount of US$43,149 as non-controlling interests was reverted in the Shareholders' Equity.

g) Profit (loss) per share

Basic and diluted profit (loss) per share amounts are calculated by dividing the profit (loss) for the year, all from continuing operations, attributable to ordinary equity holders of the parent by the Company's weighted average number of ordinary shares outstanding during the year.

	Year-ended December 31,	
	2018	2017
Profit/(loss) attributable to controlling interests	71,008	(1,049,596)
Weighted average number of ordinary shares for calculation purposes (thousands of shares) (*)	189,227	189,227
Basic and diluted profit/(loss) per share (in U.S. dollars – US$)	0.38	(5.55)

(*) The Group has no potential dilutive shares. Therefore, diluted profit per share is equal to basic profit per share.

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19 NET OPERATING REVENUE

The Group's operating revenue is mainly derived from charter and service-rendering agreements. As of December 31, 2018 and 2017, Petrobras has accounted for 91% and 99%, respectively, of total revenues.

Net operating revenue is presented after the following items:

	Year-ended December 31,	
	2018	2017
Gross operating revenue	530,614	971,140
Taxes levied on revenue:		
Social Integration Program (PIS) (i)	(1,205)	(3,147)
Social Investment Program (COFINS) (i)	(5,551)	(14,496)
Services Tax (ISS) (i)	(1,501)	(4,038)
Good and Service Tax (GST) (ii)	(10,035)	-
Withholding Income tax (IRRF)	(4,390)	(3,669)
Net operating revenue	507,932	945,790

(i) Taxes levied on revenues are applicable only to the revenues generated by Serviços de Petróleo.

(ii) Refers to indirect tax only applicable in India (Note 23.b).

20 COST OF SERVICES RENDERED AND OPERATING EXPENSES

	Year-ended December 31,					
	2018			2017		
Costs and expenses by nature	Cost of services	General and administrative expenses	Total	Cost of services	General and administrative expenses	Total
Payroll, charges and benefits	(95,307)	(14,639)	(109,946)	(146,065)	(15,263)	(161,328)
Depreciation	(173,888)	(514)	(174,402)	(229,192)	(689)	(229,881)
Materials	(35,645)	-	(35,645)	(56,691)	-	(56,691)
Maintenance	(51,406)	-	(51,406)	(62,467)	-	(62,467)
Insurance	(6,716)	-	(6,716)	(16,359)	-	(16,359)
Other [(1)/(2)]	(17,821)	(65,396)	(83,217)	(21,669)	(11,532)	(33,201)
	(380,783)	(80,549)	(461,332)	(532,443)	(27,484)	(559,927)

(1) Other cost of services: mainly comprised by rig boarding transportation, lodging and meals, data transmission, among others.

(2) Other general and administrative expenses: mainly comprised by transportation, information technology services, external legal advisors fees, independent auditors' fees, advisory services fees, among others.

21 OTHER INCOME (EXPENSES), NET

	Year-ended December 31,	
	2018	2017
Reversal of impairment loss provision (Note 13)	260,215	-
Reversal of provision [(i)]	21,857	-
Reversal of provision for onerous contract	5,037	-
Contractual fee	1,700	1,700
Revenue from sales of PP&E	27	31
Other	2,841	1,056
Other income	291,677	2,787
Provision for impairment loss (Note 13)	(40,778)	(1,400,470)
Impairment loss recognized on investments (Note 12)	(98,860)	-
Provision for onerous contract (Note 1.c/1.d)	(22,316)	(35,984)
Penalties (Note 15)	-	(3,179)
Cost of PP&E sold	(285)	(15)
Other [(ii)]	(193)	(2,888)
Other expenses	(162,432)	(1,442,536)
Total other income/(expenses), net	129,245	(1,439,749)

(i) On December 31, 2018, the Group reversed a legal provision in the amount of US$21,857, due to a change in the assessment of loss likelihood.

(ii) Refer to tax levied on dividends received from SBM Espírito do Mar Inc. during 2017. (Note 12).

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22 FINANCIAL EXPENSES, NET

	Year-ended December 31,	
	2018	2017
Financial income from related parties (Note 11)	6,388	7,958
Interest on short-term investments	2,508	5,751
Other financial income	7,663	1,567
Financial income	16,559	15,276
Financial expenses on loans and financings (Note 14.a)	(117,795)	(119,749)
Derivative expenses (Note 17)	(513)	(5,006)
Financial expenses from related parties (Note 11)	(510)	(1,428)
Other financial expenses	(5,701)	(5,728)
Financial expenses	(124,519)	(131,911)
Foreign exchange variation income/(loss), net	77	(608)
Financial expenses, net	(107,883)	(117,243)

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23 TAXES

Most of the Group's entities are located in jurisdictions that are exempt from corporate income tax except for Serviços de Petróleo and its subsidiary QGOG India. Additionally, certain of the Company's subsidiaries operates in the Netherlands, Switzerland and Luxembourg, but none of these reported taxable income for the years presented.

Serviços de Petróleo and QGOG India, two of the Company's subsidiaries, operates in Brazil and India, respectively, and the related taxes and contributions are as follows:

a) Recoverable taxes

	December 31,	
	2018	2017
Income tax (IRPJ) and social contribution on net income (CSLL) (i)	9,923	8,820
Social Security Contribution (INSS) (ii)	1,361	7,952
Goods and Services Tax - GST(iii)	3,835	-
Other	756	289
Total	15,875	17,061
Current	12,816	9,377
Non-current	3,059	7,684

(i) Mainly refers to withholding taxes on revenues that are compensated with other federal taxes.

(ii) Maintenance revenues generated by Serviços de Petróleo are subjected to Social Security Contribution over Gross Revenue (*Contribuição Previdenciária sobre a Receita Bruta* - CPRB), instead of Serviços de Petróleo being charged of Social Contribution over Payroll (INSS).

(iii) Refers to taxes on supply of goods and services in India. The recoverable GST amounts refer to credits on the acquisition of goods and services.

b) Taxes payables

	December 31,	
	2018	2017
Services Tax (ISS)	426	1,232
Income tax (IRPJ) and social contribution (CSLL)	302	323
Social Integration Program (PIS) and Social Investment Program (COFINS)	-	2,123
State VAT (ICMS)	24	27
Goods and Services Tax - GST(i)	1,727	281
Total	2,479	3,986

(i) GST payables refer to taxes levied on services rendered in India.

c) Deferred tax assets

	December 31,	
	2018	2017
Income tax (IRPJ) and social contribution (CSLL) (*)	12,168	10,999
Total	12,168	10,999

(*) Mainly refers to deferred income arising from tax losses, provisions for contingencies and impairment losses on PP&E, which are derived from Serviços de Petróleo operations aiming future compensation based on reliable taxable profit estimates.

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d) Effect of income tax results

The tax rate used for the years ended December 31, 2018 and 2017 reconciliations below refers to the corporate nominal tax rate of 34% in accordance with Brazilian tax legislation, jurisdiction in which Serviços de Petróleo (Brazilian subsidiary) operates, the corporate nominal tax rate of 20% in accordance with British tax legislation, jurisdiction in which QGOG Constellation UK Ltd. operates and the withholding tax on QGOG India revenues of 4,326% in accordance with India tax legislation, jurisdiction in which QGOG India operates.

The amounts reported as income tax expense in the consolidated statement of operations are reconciled from the nominal rate to the effective rate as follows:

	Year-ended December 31,	
	2018	2017
Profit/ (loss) before taxes	75,646	(1,148,796)
Income tax and social contribution at nominal rate (*)	(3,813)	9,463
Adjustments to derive effective tax rate:		
Non-deductible expenses	1,866	(10,024)
Other	3,122	680
Income tax credit recognized in profit or loss	1,175	119

	Year-ended December 31,	
	2018	2017
Current taxes	(1,918)	(3,381)
Deferred taxes	3,093	3,500

(*) Nominal tax rate applied on profits/ (loss) before taxes related to Serviços de Petróleo and QGOG Constellation UK Ltd. and on revenues related to QGOG India.

24 FINANCIAL INSTRUMENTS

a) General considerations

Details on the Group's financial restructuring plan and capital management are provided in Note 1.

The Group's main financial instruments are as follows:

		December 31,			
		2018		2017	
	Category	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets					
Cash and cash equivalents	FVTPL	109,406	109,406	216,263	216,263
Short-term investments	FVTPL	26,047	26,047	13,500	13,500
Restricted cash	FVTPL	42,553	42,553	39,035	39,035
Trade and other receivables	Amortized cost	32,410	32,410	67,144	67,144
Receivables from related parties	Amortized cost	991	991	383,528	383,528
Derivatives	FVTPL	-	-	2,044	2,044
Financial liabilities					
Loans and financings	Amortized cost	1,475,200	1,040,290	1,655,183	1,448,674
Trade and other payables	Amortized cost	33,150	33,150	37,537	37,537
Payables to related parties	Amortized cost	188	188	346,470	346,470
Derivatives	FVTPL	-	-	2,817	2,817

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The Group has no forward agreements, options, *swaptions* (swaps with non-exercise options), flexible options, derivatives embedded in other products or exotic derivatives. The Group does not conduct derivative transactions for speculative purposes, thus reaffirming its commitment to a policy of conservative cash management.

Except for loans and financings, management also believes that the carrying amounts of the remaining financial instruments do not significantly differ from their fair value as it considers that interest rates on such instruments are not significantly different from market rates. Interest rates that are currently available to the Group for issuance of debt with similar terms and maturities were applied to estimate the fair value of loans and financings.

Additionally, the amounts of trade accounts receivables and payables disclosed in these consolidated financial statements do not significantly differ from their fair value due to the turnover of these accounts being of approximately 30 days. Due to the RJ process, payables related to the period prior to the RJ, in the approximate amount of US$10,478 (suppliers and other liabilities other than loans and financings) could not be paid until the approval of the RJ plan.

Fair value hierarchy

IFRS 7 - *Financial Instruments: Disclosures* defines fair value as the value or price that would be received to sell an asset or paid to transfer a liability in a transaction between participants in an ordinary market on the measurement date. IFRS 7 clarifies that fair value shall be based on assumptions that market participants use when measuring a value or price for an asset or a liability and establishes a hierarchy that prioritizes the information considered to develop those assumptions.

The fair value hierarchy gives greater weight to available market information (i.e., observable data) and less weight to information related to data without transparency (i.e., unobservable data). Additionally, it requires that the entity consider all aspects of nonperformance risk, including the entity's own credit to measure the fair value of a liability.

IFRS 7 also establishes a 3-levels hierarchy to be used in order to measure and disclose the fair value. A categorization tool in the fair value hierarchy is based on the lowest level of "input" significant for its measurement. A description of the 3 hierarchical levels is as follows:

Level 1 - The "inputs" are determined based on prices in an active market for identical assets or liabilities at the measurement date. Additionally, the entity must be able to trade in an active market and the price cannot be adjusted by the entity.

Level 2 - The "inputs" are other than prices as determined by Level 1 that are observable for the asset or liability, directly or indirectly. The "inputs" level include two prices in an active market for similar assets or liabilities, prices in an inactive market for identical assets or liabilities, or "inputs" that are observable or can corroborate the observation of market data by correlation or other means for substantially every part of the asset or liability.

Level 3 - The "inputs" are those unobservable from minor or no market activity. These "inputs" represent management's best estimates as market participants could assign value or price for these assets or liabilities. Generally, the assets and liabilities are measured using Level 3 pricing models, discounted cash flow or similar methods that require significant judgments or estimates, such as the inputs considered in the impairment test.

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The Group measures its short-term investments, restricted cash and derivative financial instruments at fair value through profit or loss. Short-term investments and restricted cash are classified as Level 1, due to the fact that they are measured using market prices for identical instruments. Loans and financings and derivative financial instruments are classified as Level 2, due to the fact that they are measured using similar financial instruments.

Financial instruments fair value measurement

The Group assessed the evaluation of financial assets and liabilities in relation to its market values or its effective recoverable amount, using available information and best practices and methodologies of market valuations for each situation.

Market data information interpretation about methodologies choice requires a higher level of judgment and establishment of reasonable estimate to achieve the fair value. Consequently, the estimate presented may not necessarily indicate the amounts that may be obtained in current market. The use of different hypothesis to fair values calculation can result in significant effect in obtained values.

The method used to assess the derivatives fair value, represented exclusively by interest rate swaps, was obtained by inputs that are observable or can corroborate the observation of market data by correlation or other means for substantially every part of the asset or liability.

For securities that has quoted price in active markets (Project Bond/ Corporate Bond/ New Notes), the fair value is equal to its last quoted price at the balance sheet date obtained from Bloomberg, multiplied by the number of notes in circulation.

For agreements where the current conditions are similar to those in which they originated or that do not have parameters for quotation or contract, fair values are similar to its carrying amounts.

In the evaluation carried out for determining the fair value of assets and liabilities measured at amortized cost method, it was not considered the applicability of this evaluation to trade and other receivables and payables due to its very short-term of maturity.

b) Financial risk management

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The Group is exposed to liquidity, credit and market risks. Management believes that the Group's main market risk refers to its exposure to interest rate risk, as discussed below.

Liquidity risk

Ultimate responsibility for liquidity risk management rests with the Board of Directors, which has built a liquidity risk management framework for managing the Group's short and long-term funding (reclassified to current liabilities) and liquidity management requirements. The Group manages liquidity risk by a combination of maintaining adequate reserves, banking facilities and reserve borrowing facilities (Note 14) and by continuously monitoring forecast and actual cash flows and matching the maturity profiles of financial assets and liabilities.

The Group maintains relationships with specific lenders and constantly monitors its funding needs together with such lenders. The Group manages the majority of its long-term financings (reclassified to current liabilities) on a project-by-project basis. Such financings are arranged as required to support the Group's operations and growth plans.

As of December 31, 2018 and 2017, the Group presents net working capital deficiency in the amounts of US$1,346,593 and US$421,990, respectively, mainly due to the reclassification of part of its inventories to non-current assets (Note 10), working capital loans originally maturing in July 2018, the current portion of its long-term loans and financings (Note 14), reclassified to current liabilities as of December 31, 2018, and lower operating cash flow generation due to the expiration of certain of its charter and service-rendering agreements. As disclosed in Note 1, the Group understands that the successful implementation of the measures set forth in the Amended and Restated RJ Plan, will enable it to comply with its financial commitments and maintain its operational continuity.

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The following table details the Group's liquidity analysis for its non-derivative financial liabilities and related derivative financial instruments, when applicable the table has been drawn up based on the undiscounted contractual cash inflows and outflows for the financial instruments.

When the amount payable is not fixed, the amount disclosed has been determined by reference to the projected interest rates as illustrated by the yield curves at the end of the reporting period:

December 31, 2018

Year	Trade payables	Loans and financings	Derivatives	Payables to related parties	Total
2019	33,150	707,283	-	188	740,621
2020	-	372,125	-	-	372,125
2021	-	80,894	-	-	80,894
2022	-	84,117	-	-	84,117
2023	-	85,388	-	-	85,388
After 2024	-	536,274	-	-	536,274
Total	33,150	1,866,081	-	188	1,899,419

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Due to the RJ proceedings disclosed in Note 1, the amortizations were suspended until the approval of the restructuring plan, which established new maturity dates.

December 31, 2017

Year	Trade payables	Loans and financings	Derivatives	Payables to related parties	Total
2018	37,537	745,462	2,655	6,818	792,472
2019	-	224,139	(1,130)	71,925	294,934
2020	-	358,099	(874)	82,542	439,767
2021	-	80,894	-	92,195	173,089
After 2021	-	705,779	-	226,601	932,380
Total	37,537	2,114,373	651	480,081	2,632,642

Credit risk

Credit risk refers to the risk that counter-party will default on its contractual obligations resulting in financial losses to the Group. Financial instruments that potentially subject the Group to concentrations of credit risk are primarily cash and cash equivalents, short-term investments, restricted cash, trade and other receivables and receivables from related parties. The maximum exposure amounts of such financial instruments are those disclosed in Notes 6, 7, 8, 9 and 11, respectively.

It is the Group's practice to place its cash and cash equivalents and time deposits at financial institutions with high credit ratings or at mutual funds, which invest exclusively in high quality money market instruments. The Group limits the exposure amount to any one financial institution to minimize its credit risk exposure.

For the years ended December 31, 2018 and 2017, Petrobras has accounted for 91% and 99%, respectively, of total revenues (Note 19). Therefore, management considers that the credit risk arising from this concentration is minimal, considering that Petrobras is a government controlled entity with a history of full payment.

Market Risk (interest rate risk)

The Group is exposed to interest rate risk due to the fact that Group entities borrow funds at both fixed and variable interest rates. The Group manages such risk by maintaining an appropriate mix between fixed and variable rate borrowings and by using interest rate swap instruments (until the last quarter of 2018). The Group is exposed to fluctuations in US$ LIBOR interest rates charged on its loans and financings (Note 14). The Group (until the last quarter of 2018) managed the interest rate risk related to the project financing agreements by eliminating variable-to-fixed interest rate swaps (Note 17).

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As a result of the swaps in place at the balance sheet date (December 31, 2017), the Group's exposure to changes in interest rate expense as a result of fluctuations in US$ LIBOR interest rates was in respect of changes in fair values of the respective interest rate swaps. These interest rate swaps were held at fair value in the consolidated statement of financial position (Note 17). The fair value of these instruments was affected by factors including market expectations for future changes to US$ LIBOR. Changes to these expectations affected the value of the Group's swaps, producing effects in the consolidated statement of operations and consolidated statement of comprehensive income unless such changes were capitalized.

Due to the current restructuring debt negotiations, the Group and the creditors agreed to unwind the existing swaps due to the new structure of the debts and new contract terms and conditions to be agreed. The Group will reassess the interest rate risks after the conclusion of the negotiations.

Interest rate sensitivity analysis

The sensitivity analysis below has been determined based on the exposure to interest rates for non-derivative instruments at the end of the reporting period and considers the effects of an increase or decrease of 0.1 percent on outstanding loans and financings and the effects of either an increase or a decrease of 0.1 percent in the interest curve (LIBOR) on the date of the consolidated financial statements. For variable rate liabilities (US$ LIBOR plus spread), the analysis is prepared assuming the liability amount outstanding at the end of the reporting period was outstanding for the entire period. A 0.1 percent increase or decrease in US$ LIBOR is used when reporting interest rate risk internally to key management personnel and represents management's assessment of the reasonably possible change in interest rates.

If the US$ LIBOR had been 0.1 percent higher/lower and all other variables were held constant, the Group's statement of operations would be impacted as follows:

Risk: interest rate variation	December 31, 2018	Scenario I [(i)]	Scenario II [(ii)]
		Increase/ (decrease) in P&L	
Variable interest rate loans (Note 14)	153,810	(154)	154
Variable interest rate financings (Note 14)	597,009	(597)	597
Total	750,819	(751)	751

(i) Increase of 0.1% in interest rate.
(ii) Decrease of 0.1% in interest rate.

c) Capital management

The Group manages its capital structure, which consists of the relation between financial debt and shareholders' equity in accordance with best market practices, as follows:

	December 31,	
	2018	2017
Loans and financings [(a)]	1,475,200	1,655,183
Cash transactions [(b)]	(178,006)	(268,798)
Net debt [(c)]	1,297,194	1,386,385
Shareholders' equity [(d)]	1,419,504	1,388,832
Net debt on shareholders' equity plus net debt [(c)] ÷ [(c) + (d)]	48%	50%

(a) Consider all loans and financings balances.
(b) Includes cash and cash equivalents, short-term investments and restricted cash balances.
(c) Includes all shareholders' equity accounts.

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25 INSURANCE

As of December 31, 2018 and 2017, major assets or interests covered by insurance policies and their respective coverage amounts are summarized below:

	December 31,	
	2018	2017
Civil liability	1,795,500	2,373,000
Operating risks	1,994,534	3,643,573
Operational headquarter and others	30,632	20,826
Total	3,820,666	6,037,399

The Group's practice in relation to its insurance policies is to hire solid insurance companies in the insurance market.

26 PENSION PLAN

The Group, through its subsidiary Serviços de Petróleo, offers a private defined contribution pension plan to all employees, including key management personnel. Under the pension plan, up to 12% of the monthly salary is contributed by the employee and up to 6.5% by Serviços de Petróleo, according to the employee's seniority level. The pension plan is managed by Bradesco Vida e Previdência S.A. When employees choose to leave the plan before the end of payments, the contributions still payable are reduced by the amount already paid by Serviços de Petróleo. Therefore, Serviços de Petróleo's only obligation to the Pension Plan is to make its specified contributions.

For the years ended December 31, 2018 and 2017, contributions payable by Serviços de Petróleo at rates specified by the plan rules amounts to US$86 and US$474, respectively.

27 SUBSEQUENT EVENTS

Amaralina Star offshore drilling rig charter and service-rendering agreements

On February 11, 2019, the Group announced that the Amaralina Star drillship has been awarded a contract with Total E&P do Brasil Ltda. ("Total"), a subsidiary of Total S.A., for one well intervention with an option for an interception well. The contract has an estimated maximum duration of 140 days. The operations will be performed offshore the Brazilian coast, at the Lapa field. The contract was signed in early February 2019, operations commenced on February 28, 2019 and expired on April 25, 2019.

On February 28, 2019, the Group has identified the necessity to recognize a provision for onerous contract in the amount of US$1,134, related to the aforementioned contract.

FPSO Divestiture

On May 28, 2019, following the approval of its business plan, the Group confirmed its intention to divest in the FPSO segment in order to be prepared for future potential investments. Therefore, since that date the investment in the related associates and joint ventures is accounted for as available for sale.

Laguna Star offshore drilling rig charter and service-rendering agreements

On July 4, 2019, the Group announced that the Laguna Star drillship has been awarded a contract with the consortiums of BM-S-11, BM-S-11A and Production Individualization Agreement (*Acordo de Individualização de Produção* - AIP) of Lula, operated by Petrobras. The contract has a duration of 730 days. The operations will be performed in the Santos Basin, located offshore of Brazil, and operations under the contract are expected to commence by the end of October 2019.

QG-VIII onshore drilling rig charter and service-rendering agreements

On July 4, 2019, the Group signed an agreement to render drilling services for Eneva S.A. with the onshore drilling rig QG-VIII. The purpose of the agreement is to drill 3 oil wells in the Azulão Field with an expected duration of 90 days. Operations are expected to start in August 2019.

Atendimento Prisma

28 APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS

The consolidated financial statements were authorized for issue by the Company's Board of Directors on July 10, 2019.

Atendimento Prisma