



***SIEM INDUSTRIES***

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***SIEM INDUSTRIES INC.  
2002 ANNUAL REPORT***

## COMPANY PHILOSOPHY

*Siem Industries Inc. is a diversified industrial holding company which operates through autonomous affiliates. We currently hold interests in four industrial areas including the oil and gas services industry, the ocean transport of refrigerated cargoes, the ocean transport of automobiles and industrial investments. We invest in high yield securities through our acquisition and reorganization fund in those industries in which we have experience.*

*Our objective is to create shareholder value by making acquisitions at reasonable prices and applying entrepreneurial management to these acquisitions.*

*We endeavour to instill within our acquisitions a commitment to focus on long-term growth rather than on short-term results in order that all interested parties may benefit from the use of our capital and management.*

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## TO OUR SHAREHOLDERS:

The nature of the Company's activities, which are focused on acquisitions and reorganizations, is such that we should expect earnings to be volatile. Fiscal 2002 was our second best year ever despite less than acceptable returns from the operations of DSND and STAR Reefers. The Company's net income was **\$50.9 million**, or \$3.00 per share (2001: net loss of \$27.9 million, or \$1.64).

I am satisfied that we have a professional management team throughout the group that is able and motivated to develop our businesses in an efficient way.

The combination of the subsea activities of **DSND** and Halliburton to create Subsea 7 was concluded in May 2002. Subsea 7 operates as an autonomous group directed by its board with equal representation from DSND and Halliburton. Subsea 7 is well-positioned to take a leading role in its sector of the oil and gas service industry. EPIC (engineering, procurement, installation and construction) contracts in the offshore construction field are both complex and demanding. Risk management, involving detailed contract documentation, thorough planning and skilful job execution, is essential to achieving positive results. Strong competition between subsea contractors has made it possible for the clients to lay off large risks onto the contractors without providing sufficient margins to meet the effects of such risks. As a consequence, this industry has suffered huge losses. We believe that a greater appreciation for realistic expectations now exists amongst contractors and that the risk/reward relationship will be healthier in the future.

DSND refinanced its debt at the end of the year and established a solid financial foundation. See DSND's website at "[www.dsnd.com](http://www.dsnd.com)" for additional information.

**STAR Reefers Inc** has established itself as one of the three leading reefer operators in the world. The pool and joint commercial operations with NYK of Japan are successful and contribute to the consolidation of this industry. The market is improving slowly from a low level. STAR has been profitable despite the weak market and its cash flow was sufficient to reduce bank debt from \$158 million to \$129.7 million. Pursuant to its strategy of providing a reliable, first class transportation service for perishable products, STAR sold 6 older vessels and replaced them with 5 newer vessels during the year. See STAR Reefers' website at "[www.star-reefers.com](http://www.star-reefers.com)" for further information.

I took the chair of the board of **Four Seasons Capital AB** in Sweden at the end of February 2002 and my former colleague from Norwegian Cruise Line, Hans Golteus, was appointed managing director. The objective is to develop the seven industrial holdings in the Four Season's portfolio through rationalization and combinations that make each business stronger.

The three car carriers acquired by **Siem Thoen Car Carriers Inc.** in July 2002 have performed well under the term contracts with Volkswagen. The market for car carriers has strengthened since our purchase.

The **Investment Area** of our operations, which includes certain reorganization projects, performed well during the year. Difficult trading conditions for equities were more than compensated by the results achieved from the management of the different financial projects and currency exchange gains. The Siem Acquisition and Reorganisation Fund generated a return of 21.7%. We felt that our currency exchange operations had an acceptable level of risk because of the inherent hedging possibilities available to us by the use of Norwegian kroner to buy U.S. dollar based assets through the purchase of shares in our Norwegian subsidiaries and because of our belief that the kroner was undervalued relative to the dollar. There were no foreign exchange contracts outstanding at year end.

We expect **fiscal 2003** to be a better year for our four industrial operations. Our ownership levels in the four main industrial holdings range between 64 and 88% and two of these subsidiaries are listed on the Oslo Stock Exchange.

Our principle priority is to assist our subsidiaries in their efforts to improve both performance and, particularly, profitability in the future. An evaluation of the present structure of the group will be considered by the Board as a second priority.

I take this opportunity to thank our shareholders for their support of the Company and to commend my colleagues at all levels for their excellent attitude and cooperation during a challenging year.

/s/ Kristian Siem  
Kristian Siem, Chairman

## DESCRIPTION OF BUSINESS

### *INTRODUCTION TO BUSINESS*

Siem Industries Inc. was incorporated in October 1980 under the laws of the Cayman Islands as Bahama Cruise Line, Inc. The name was changed in 1987 to Bermuda Star Line, Inc. prior to its initial public offering and again in 1989 to Norex America, Inc. following the sale of its cruise business. The name was changed to Norex Industries Inc. in July 1996 and to Siem Industries Inc. in May 1998. The “Company” or “Siem Industries”, as used herein, refers to Siem Industries Inc. and its subsidiaries and affiliates unless the context indicates otherwise. The Company operates as a diversified industrial holding company with its main activities in the oil and gas service industry through its holding in DSND Inc. in the shipping industry through its holdings in STAR Reefers Inc. and Siem Thoen Car Carriers Inc. and in the financial investment area through its holdings in Siem Acquisition and Reorganisation Fund, Inc. and Four Seasons Capital AB. Through these latter investments, the Company owns a number of smaller, strategic investments and investments in listed and unlisted senior secured notes and other notes receivables.

Press releases and quarterly financial reports issued by the Company may be obtained from the Company’s website at [www.siemindustries.com](http://www.siemindustries.com).

The currency symbols “\$” (or “USD”), “NOK” and “GBP” refer to United States dollars, Norwegian kroner and British pounds, respectively.

### DESCRIPTION OF MAJOR INVESTMENTS

#### *DSND INC. (“DSND”)*

At December 31, 2002, the Company owned 58,349,653 shares of DSND, or approximately 72.2% of its issued and outstanding shares. The Company now includes DSND’s financial statements in the Company’s consolidated financial statements following its acquisition of a controlling ownership in DSND in late November 2002.

The Company’s investment in DSND originated in 1993. At the time of the investment, DSND Subsea (as DSND was known prior to November 2002), a publicly-traded Norwegian company, functioned as a diversified shipping and offshore investment holding company with a controlling ownership position in several advanced, dynamically-positioned offshore vessels and varied ownership interests in cement carriers, drilling rigs, bulk carriers and a shipping container line. In 1994, DSND Subsea began the process of transforming itself by the sales of its non-core assets and the acquisitions of strategic businesses and assets.

Through the years, DSND Subsea continued to evolve. By 2001, DSND Subsea had become a leader in the international market for subsea construction and operational services for the oil and gas industry and conducted operations in the North Sea, Brazil, Gulf of Mexico and West Africa with a fleet of 40 vessels and ROVs (“remotely-operated vehicles”).

In October 2001, DSND Subsea and Halliburton Subsea, a business unit of Halliburton Company’s Energy Services Group, agreed to combine their respective subsea interests in the upstream oil and gas industry by combining assets, people, ongoing contracts and intellectual property of the two parties. The 50/50 joint venture, Subsea 7 Inc., commenced operations in May 2002 with a combined staff of 3,700 people including 500 engineers and control of 23 modern, high-specification dynamically-positioned vessels, 112 ROV’s and 4 pipeline construction yards. These assets enable Subsea 7 to perform deepwater rigid and reeled and flexible pipelay, deepwater subsea construction, saturation diving and survey activities. Upon commencement of operations, Subsea 7 had an order backlog of \$800 million and immediately established itself as one of the leading global service providers for subsea engineering and construction.

In early October 2002, DSND Inc., a recently established Cayman Islands company whose sole purpose was the acquisition and ownership of shares issued by both DSND Subsea and its subsidiaries, made a voluntary offer to exchange its shares for shares of DSND Subsea on a 1:1 basis. By the end of the month, a total of 55,876,995 shares, or 92.6% of DSND Subsea’s shares, had been tendered, including the 18,756,024 shares owned by the Company. Subsequent to this, DSND Inc. made a mandatory offer to remaining DSND Subsea shareholders to tender their shares either in exchange for DSND Inc. shares on a 1:1 basis or in

exchange for a payment of NOK13.50 cash. In conjunction with the mandatory offer, DSND Inc. undertook the compulsory acquisition of any shares that remained outstanding following the mandatory offer. Upon completion of the mandatory offer and the compulsory acquisition, DSND Inc. had acquired an additional 3,161,097 shares of DSND Subsea through the share exchange and had purchased the remaining outstanding DSND Subsea shares.

In late October 2002, DSND announced a financial restructuring plan to refinance its short-term obligations. The final terms of the plan provided for a private equity placement of NOK370,000,000 at NOK17 per share and a new bond issue in the amount of NOK300,000,000.

At the end of October 2002, the Company purchased 4,693,400 shares of DSND at NOK17.50 and increased its ownership to approximately 40% of DSND. The attainment of a 40% ownership interest triggered a requirement that the Company must either reduce its holding to below 40% of the issued and outstanding shares or submit a mandatory offer to purchase all outstanding shares from the remaining shareholders at the highest price paid by the Company for DSND Subsea shares during the six month period immediately preceding the trigger date. In early November 2002, the Company decided to submit a mandatory offer to purchase shares of DSND at NOK17.50 per share.

In mid-November 2002, the Company acquired a net 16,556,761 additional shares as part of the private placement of equity under the financial restructuring plan. The additional shares increased its ownership to approximately 50% of DSND.

The mandatory offer was completed in late December 2002 and the Company acquired 18,343,468 additional shares to increase its ownership to 72.2% in DSND.

Since the inception of its initial investment in DSND, the Company has provided loans to DSND and has subscribed to and underwritten equity and bond offerings conducted by DSND. At the beginning of 2002, the Company held NOK350,000,000 of DSND's convertible bonds (the "DSND Bonds") and loans outstanding in the amounts of NOK100,000,000 (the "NOK100mm Note") and \$9,300,000 (the "\$9.3mm Note").

The DSND Bonds were scheduled to mature in late July 2002. At a meeting in mid-July 2002, the bondholders agreed that the maturity date would be extended to November 2002, the interest rate would increase from 7% p.a. to 9% p.a. and the conversion feature would be terminated. As consideration for the extension, a fee of 0.2% was paid to all bondholders.

The NOK100mm Note and the \$9,300,000 Note, each loan bearing interest at 12% p.a., were also scheduled to mature in July 2002. In connection with the extension of the maturity date for the DSND Bonds, it was agreed that the maturity dates for each of these loans would be extended to October 2002.

Following the announcement of the financial restructuring plan in October 2002, the Company agreed to extend the maturity dates of the NOK100mm Note and \$9,300,000 Note until the closing of the bond offering. In November 2002, the Company used approximately NOK254,600,000 principal amount of DSND Bonds and related accrued interest and NOK40,000,000 cash to acquire the shares that it had subscribed to in the private placement.

In January 2003, the Company used the principal amounts of the remaining DSND Bonds and the NOK100mm Note and the related accrued interest to offset the purchase price for its NOK219,600,000 subscription for new DSND bonds. The terms provided for interest at 9% p.a., maturity in three years and conversion at the rate of NOK20 per share. The balance of the purchase price was paid using available cash sources. Shortly thereafter, the Company received full payment of the \$9.3mm Note.

DSND's fleet, following the transfer of assets to Subsea 7, includes 13 fully-owned vessels, 2 partially-owned vessels, 2 chartered vessels and 3 managed and operated vessels. The vessels are engaged in core drilling, well maintenance, construction support and cable maintenance. Eleven of the vessels are supply/crew vessels that achieved a utilization rate of 98% in 2002. The Brazilian subsidiary, DSND Consub, has a contract with the Brazilian navy to provide combat management systems onboard 6 of its frigates and a new corvette.

At the end of the first quarter 2003, Subsea 7 had an order book of \$790,000,000. Approximately 88% of this backlog represents work on a cost reimbursable basis and the remainder represents work on a fixed price basis.

For more information on DSND, please visit DSND's website at [www.dsnd.com](http://www.dsnd.com).

#### *STAR REEFERS INC.*

At December 31, 2002, the Company owned 5,612,015 shares of STAR Reefers, or approximately 73.4% of its issued and outstanding shares.

STAR Reefers Inc., a Cayman Islands company, was established in January 2001 under the name of Swan Reefer Inc. in order to acquire shares of Swan Reefer ASA, a publicly-traded Norwegian company ("ASA" and "AS" denote publicly-traded and non-publicly-traded Norwegian companies, respectively; "Swan Reefer AS" will be used hereinafter to reflect the status of the company following its acquisition by Swan Reefer Inc.) (collectively, these entities are referred to as "STAR" unless the context indicates otherwise). STAR is one of the world's leading reefer owners and operators controlling a modern fleet of 39 owned and chartered vessels with a total capacity of 20.8 million cubic feet. The term "reefer" is the trade name for "refrigerated vessels". The operations include the refrigerated transport of perishable commodities such as fruits and vegetables with the shipping activities concentrated during the normal seasonal rush throughout the southern and northern hemisphere harvests.

In recent years, the reefer industry has been plagued with an oversupply of vessels, a substantial number of owners controlling only a few vessels and competition from container shipping lines, all combining to cause historically depressed rates. The low rates exacerbated problems caused by too much debt being taken on to finance the construction of too many new vessels.

In late December 2000, the Company joined a syndicate that proposed to underwrite an equity offering to be made on behalf of Swan Reefer AS in the amount of the \$44,250,000, which included the Company's commitment of \$35,950,000. The proposal was subject to certain conditions becoming satisfied, including the successful completions of a due diligence and a financial restructuring that would result in a debt writedown of approximately \$55,000,000. Shortly thereafter, the subjects were lifted and the underwriters entered into a bridge financing agreement with Swan Reefer AS in the amount of \$44,250,000. The underwriters subsequently contributed their respective interests in the bridge financing agreement as payment for their subscription of shares in the newly-formed Swan Reefer Inc. At the end of January 2001, Swan Reefer AS and Swan Reefer Inc. entered into an agreement whereby the bridge financing agreement was refinanced with a convertible loan agreement in the amount of NOK392,046,150 (the "Convertible Loan"). Terms of the agreement provided for interest at 4% p.a. and conversion into new shares at NOK57.50 during a six year period commencing on the drawdown of the convertible loan.

A voluntary offer was extended to existing Swan Reefer AS shareholders to exchange their shares for new shares in Swan Reefer Inc. Swan Reefer Inc. soon acquired a 90% interest, issued a combined mandatory offer and compulsory acquisition for all shares of Swan Reefer AS not already owned by Swan Reefer Inc. Shortly thereafter, Swan Reefer Inc. was listed on the Oslo Stock Exchange and Swan Reefer AS was delisted. Upon completion of these activities, the Company's ownership in Swan Reefer Inc. was reduced to 70.9%.

During the third quarter of 2001, Swan Reefer Inc. purchased 100% of Albion Reefers Limited with the acquisition effective at the beginning of July 2001. The purchase of Albion Reefers, which traded under the name of STAR Reefers, involved a fleet of six mid-1980's built reefers and 18 reefers on charter and a marketing operation based in London. The purchase price of \$34,800,000 was paid using \$19,000,000 cash, the issuance of 710,500 new shares of Swan Reefer Inc. at \$7.15 per share and the assumption of \$11,400,000 in time charter liabilities. The \$19,000,000 cash payment represents the proceeds of new bank debt. Shortly after the completion of the purchase, Swan Reefer Inc. assumed the STAR Reefers trade name and became STAR Reefers Inc. The issuance of shares reduced the Company's ownership in STAR to 64.3%.

In August 2001, STAR and Nippon Yusen Kaisha ("NYK"), a Japanese company, agreed to establish a shipping pool to be owned 50/50 by the two companies. The new company, NYK STAR Reefers, acts and operates as a joint pool and marketing company responsible for all reefer chartering activities of the fleets

owned and operated by STAR and NYK. Upon commencement of operations in November 2001, NYK STAR Reefers controlled a fleet of 74 reefer vessels with a total capacity of 38 million cubic feet that represents one of the largest operators in the world.

In November 2001, the seller of Albion Reefers Limited exercised its option to put 500,000 shares of STAR to the Company. Following the purchase of these shares, the Company's ownership increased to 73.2%.

In August 2002, STAR declared a \$0.10 per share dividend payable at the shareholder's option in either cash or shares. Approximately \$142,000 was paid to shareholders electing cash and 77,054 shares were distributed to shareholders electing shares. The Company elected the share option and received 69,347 shares, thus increasing its ownership to 73.4%.

In the months following the Company's investment in STAR, STAR began to implement its strategy to move from being a tonnage supplier to the industry to becoming a global reefer operator. STAR has played an active role in the changing reefer marketplace and the consolidation process and NYK STAR Reefers, in its first year of operation, has emerged as one of three major players in the conventional reefer sector. The repositioning of its owned fleet has included the replacement of older vessels with newer vessels. In May 2002, STAR sold 2 mid-1980's built reefers for \$13,000,000. In October 2002, STAR purchased 5 reefers built between 1992-1994 for approximately \$54,000,000. STAR next sold one of its subsidiaries, the owner of 4 vessels, for a gross amount of \$51,900,000 and used the proceeds from the sale to complete a refinancing of its fleet with a new \$129,700,000. To facilitate the closing of the refinancing, the Company provided a \$4,500,000 loan to STAR that matures in July 2003.

Market rates continue to improve slowly, but it should be remembered that the process started from a low level. The past two years have seen the delivery of 2 new vessels and the scrapping of 36 vessels which undoubtedly contributes to some of the improvement in rates. For more information on STAR, please visit STAR's website at [www.star-reefers.com](http://www.star-reefers.com).

#### *SIEM THOEN CAR CARRIERS INC. ("STCC")*

In June 2002, STCC, a Cayman Islands company, was formed by the Company and a third party with ownership interests of approximately 88% and 12%, respectively. STCC's purpose was to acquire 3 car carriers that had been made available for sale by their owner. STCC completed the purchase of the car carrier vessels in July 2002 at a price of approximately \$106,500,000, or \$35,500,000 each. The vessels are sister ships that were delivered in 2000 with a carrying capacity of 4,300 cars and 400 high and heavy units. The vessels are currently under separate charters to the transport division of Volkswagen through mid-2005.

STCC financed the purchase using the proceeds of a \$90,000,000 bank loan. Terms of the facility provide for two tranches, a senior tranche for \$63,000,000 and a junior for \$27,000,000, with interest rates of LIBOR plus 1.375% and LIBOR plus 2.00%, respectively, semiannual payments of principal and interest with balloon payments at maturity in 2007. In addition, the Company agreed to provide a \$15,000,000 guarantee to secure payments in the event that the charters are not renewed at their expirations in 2005 or the charters are not renewed at rates that are not sufficient to satisfy the payment terms. In February 2003, STCC made a prepayment and the lenders agreed to reduce the amount of the guarantee to \$12,000,000 with the reduction to be offset against the scheduled payments in order of maturity.

#### *OTHER INVESTMENTS AND ACTIVITIES*

*Transocean Inc.* – Transocean, a publicly-traded company (NYSE Symbol: RIG), is the world's premier offshore contractor with the largest and most technologically-advanced fleet of offshore drilling units. Transocean is located in every major oil and gas drilling region and specializes in the technically demanding segments of the offshore drilling market with emphasis on deepwater and harsh environment drilling services.

At December 31, 2002, the Company owned 1,423,720 shares of Transocean.

The Company's current investment is a product of the consolidation efforts undertaken during the 1990's in which the Company played an active role. The Company's investment originated as a small equity interest in Wilrig AS, a Norwegian offshore drilling contractor, which operated a modern fleet of

semisubmersible drilling rigs and focused on the specialty markets of deepwater and high pressure/high temperature drilling and subsea completion. Wilrig merged with Transocean ASA. This entity subsequently merged with Sonat Offshore Drilling Inc., a Delaware corporation, and became Transocean Offshore Inc. At the end of 1999, Transocean Offshore merged with Sedco Forex Holdings Limited, a wholly-owned subsidiary of Schlumberger Limited that was spun-off, and became known as Transocean Sedco Forex. In January 2001, Transocean Sedco Forex merged with R&B Falcon and became the present day Transocean.

In May 2002, the Company sold 115,000 shares of Transocean for approximately \$4,300,000 and recognized gains of approximately \$3,600,000. At June 20, 2002, the Company owned 1,423,720 shares of Transocean common stock with a market value of approximately \$32,048,000. For more information on Transocean, please visit Transocean's website at [www.deepwater.com](http://www.deepwater.com).

*Siem Acquisition and Reorganisation Fund, Inc.* ("SARF") – SARF, an investment company incorporated in the Cayman Islands, was established by the Company to provide the Company and third party investors with a vehicle to originate and/or participate in the acquisition, reorganization or restructuring of investment opportunities in particular businesses experiencing distress situations. The Company owned approximately 99% of SARF's outstanding shares at the end of both fiscal 2002 and 2001.

SARF's initial investments focused on debt securities issued by companies operating in industries in which the Company had accumulated wide experience; primarily, the shipping, energy services and financial services industries. The securities were purchased at discounts to face value and, consequently, the effective yields received by the Company were significantly better than the yields at par.

In January 2001, SARF diversified its portfolio when it acquired 1,535,508 shares of STAR Reefers (these shares are reflected in the Company's consolidated shareholdings). This holding was increased to 1,687,760 shares, or 22.30%, in December 2001 when SARF paid for a portion of the shares delivered to the Company upon the exercise of a put option held by the seller of Albion Reefers Limited. Following the declaration of the \$0.10 per share dividend by STAR in August 2002 that was payable in cash or shares, SARF elected the share option and received 21,116 shares to increase its ownership in STAR to 1,708,876 shares, or 22.35%.

SARF performed a periodic review of its investments at the end of fiscal 2001 and decided to record impairments with respect to two of its investments. One of the investments had entered bankruptcy proceedings and a second investment was experiencing liquidity problems. The total impairments recorded was \$9,615,000.

In August 2002, the Company recovered \$1,301,000 on the investment in bankruptcy proceedings with no further recovery expected. A review of the investments the end of 2002 revealed that no further impairments existed.

At December 31, 2002, the value of SARF's portfolio was \$40,313,000, down from \$52,284,000 at the end of 2001. The decrease reflects the sales or liquidations of several investments. The returns for SARF for fiscal 2002 and 2001 were 21.67% and (6.2%), respectively, and the inception-to-date return for SARF at December 31, 2002 was 9.44%.

*FOUR SEASONS CAPITAL AB* – In February 1998, the Company entered into an agreement to acquire a 64% interest in share capital and a 50% voting interest in Four Seasons Capital AB, a Swedish company, with the remaining 36% share capital and 50% voting interest held by the previous managers of Four Seasons. The terms of the agreement provide that the Company will receive the initial proceeds from the sale of Four Seasons' investments to reduce its share capital until such time that each of the parties hold a 50% interest; thereafter, the proceeds from additional sales will be split evenly. Since the acquisition, Four Seasons has continued to hold interests in several industrial companies, including Broström AB ("Broström"), a logistics company for the oil and chemical industries; and an interest in EFG European Furniture Group AB ("EFG"), a developer, manufacturer and marketer of furniture for offices and public areas and one of the largest such companies in Europe. The other companies are engaged in commercial activities based on proprietary and protected advanced technology products.

Broström is one of the premier logistics companies for the oil and chemical industries with a focus on industrial products and chemical tanker shipping and marine and logistics services. The tanker shipping

activities utilize a fleet of more than 60 modern vessels to transport clean oil and chemical products with operations conducted in Northern Europe, the Atlantic including the Caribbean, and Asia including the Middle East. The marine and logistics services business areas include bulk logistics for the distribution and storage of dry and liquid bulk products, travel agency activities involving business travel, group and conference travel and marine travel and ship agency activities involving tramp agency, chartering, liner agency and forwarding. Broström's B shares are quoted on the Stockholm Stock Exchange's O-List. For more information on Broström, please visit Broström's website at [www.brostrom.se](http://www.brostrom.se).

Four Seasons' ownership interest in the various companies ranges from 12% to 40% with only two exceptions that are considered minor.

In February 2002, a new managing director was appointed to oversee the activities of Four Seasons.

*AMER REEFER CO. LIMITED* – In September 2001, the Company together with Vroon B.V., acquired a total of \$67,640,000 face value of bonds issued by Amer Reefer Co. Limited ("ARC"), a holding company for shipowning companies controlling 7 reefer vessels. The purchase price was approximately \$35,067,000, or \$0.52 per dollar of face value (the "ARC Notes"). The Company and Vroon agreed that each partner would receive 50% of the ARC Notes, or \$33,820,000, and register the ARC Notes under their respective names. The ARC Notes, purchased after ARC had entered into Chapter 11 reorganization proceedings, represent 67.64% of the \$100,000,000 bond offering conducted by ARC in 1998. The debtors, together with the largest minority bondholder, filed a plan of reorganization that provides for a recapitalization of the holding company and a payment of \$0.56 per dollar of face value of bonds. The Company and Vroon jointly filed a competing plan of reorganization that equitized the ARC Notes and continued ARC as an ongoing operation. In late July 2002, all holders of bonds and certain parties related to the holders agreed to a settlement whereby the Company and Vroon would receive \$0.67 dollar per dollar of face value of bonds held by them and would be entitled to interest on such amounts based on 3-month LIBOR plus a margin that increased over time. In October 2002, the Company and Vroon received payment in full in respect of the agreed-upon settlement amounts.

*KVAERNER ASA* – From mid-2000 through early-2001, the Company built an investment of approximately \$22,500,000 in the equity of Kvaerner ASA. At the time, Kvaerner, a publicly-traded Anglo-Norwegian company with interests in engineering and construction, shipyards, oil and gas and other manufacturing industries, was struggling to remain competitive in each of the independent activities within this complex group. In May 2001, Kristian Siem, the Company's Chairman, was elected a non-executive director of Kvaerner. Shortly thereafter, the directors realized that Kvaerner had insufficient working capital to address the risk profile of its varied operations and that a refinancing was urgently needed to replace short-term loans with long-term financing to alleviate the pressure on cash flow. At the same time, operational problems began to surface in several of the operating segments.

In October 2001, Yukos Finance B.V., a Russian oil company, made a tender offer to purchase shares of Kvaerner. The Company's Board of Directors, with the exception of Mr. Siem who had recused himself from deliberation of the offer because of his position as a director of both the Company and Kvaerner, reviewed an independent assessment made of the operations of and prospects for Kvaerner and voted to accept the Yukos offer. The divestiture of the Kvaerner shares resulted in a loss of \$18,279,000.

#### DESCRIPTION OF PROPERTY

The Company's registered office is located at c/o Maples and Calder, South Church Street, Grand Cayman, Cayman Islands, British West Indies. The mailing address of the Company's principal executive office is c/o Siem Drilling Ltd., P.O. Box HM429, Hamilton, HM BX, Bermuda, telephone no. +1.441.293.2058 and telefax no. +1.441.293.3231. Siem Drilling Ltd.'s registered office is located at Reid House, Church Street, Hamilton, HM-12, Bermuda where it occupies space and receives certain support services. Siem Offshore AS owns its office facility which is located at Jerpefaret 12, Voksenlia, N-0788 Oslo, Norway, telephone no. +47.22.14.14.77 and telefax no. +47.22.49.45.47.

The Company's principal office will move to George Town, Grand Cayman, Cayman Islands in July 2003. Please visit the Company's website for updated information concerning address and contact details.

## LEGAL PROCEEDINGS

The Company or its subsidiaries or affiliates may become party to various forms of litigation during the conduct of its ordinary business. It is the Company's policy to accrue for amounts related to these legal matters if it is probable that a liability has been incurred and an amount can be reasonably estimated. At December 31, 2002, DSND was involved in several outstanding disputes for which it had established reserves of approximately \$4,000,000 that are deemed adequate. Other than the DSND matters, the Company is not aware of any litigation which, in the opinion of management, is likely to have a material adverse effect on the Company's financial position, results of operations or cashflows.

## CONTROL

The following table sets forth certain information, as of June 20, 2003 with respect to the only persons known to the Company who owned beneficially more than 10% of the Company's common stock, U.S. \$0.25 par value per share (Common Shares), its only outstanding equity securities, and the Common Shares owned by officers and directors of the Company, as a group:

<i>Name of Beneficial Owners or Identity of Group</i>	<i>Shares Beneficially Owned</i>	<i>Percentage of Common Shares</i>
Sero Trust (1)	8,852,688	52.7%
Storebrand Livforsikring AS (2)	2,214,500	13.2%
Officers and Directors as a Group (3)	935,192	5.6%

- (1) *The Sero Trust, whose potential beneficiaries include the mother and certain of the brothers of Mr. Kristian Siem, Chairman and Chief Executive Officer of the Company, is the owner of Elderberry Holdings Limited ("Elderberry").*
- (2) *Storebrand acquired its ownership interest in the early 1990's through private placements.*
- (3) *Mr. Siem personally owns 928,992 Common Shares, or approximately 5.5% of the Common Shares. The Ores Trust is the beneficial owner of 1,327,432 Common Shares, or approximately 7.9% of the Common Shares. Mr. Siem and his wife and children are potential beneficiaries of the Ores Trust. Each of Mr. Siem and the trustee for the Ores Trust hold separate voting and dispositive powers over their respective holdings.*

## NATURE OF TRADING MARKET

The Company's Common Shares were publicly-traded on the American Stock Exchange commencing in 1987 and on the Oslo Stock Exchange commencing in 1997. The Company voluntarily delisted from the American Stock Exchange effective October 1998. The Company was delisted by the Oslo Stock Exchange in November 1999 when it failed to satisfy a requirement for a minimum number of shareholders to be registered on the VPS in Norway. Subsequent to the delisting from the American Stock Exchange, the Company's shares continued to trade in the United States on the NASD OTC Bulletin Board until April 2000. Currently, free quotes for the Company's Common Shares are available from Pink Sheets LLC, a centralized quotation service that collects and publishes market maker quotes for OTC securities, under the symbol "SEMUF" at [www.pinksheets.com](http://www.pinksheets.com). At the end of the day on June 20, 2003, the best bid and ask prices were \$5.00 and \$8.00, respectively, with the latest sale at \$7.00 per share.

As of June 20, 2003, there were 197 holders of record of the Company's Common Shares of which, according to the stock records of the Company, there were 171 holders of record who are citizens or residents of the United States holding an aggregate of approximately 678,518 shares, or 4.0%, and 30 holders of record who are citizens or residents of Norway holding an aggregate of approximately 2,229,665 shares, or 13.3%, of the outstanding Common Shares of the Company.

The Company's policy is to reinvest available funds into the business; consequently, the Company does not pay dividends on a regular basis. In June 2002, the Board of Directors declared that a cash dividend of \$0.05 per Common Share be paid to shareholders of record as of August 2, 2002.

## EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

The Company may not carry on business in the Cayman Islands except in furtherance of its business outside the Cayman Islands and is prohibited from inviting the public of the Cayman Islands to subscribe for any of its common shares.

Neither the Company's Memorandum or Articles of Association nor Cayman Islands law impose any limitations on the right of nonresident or foreign owners to hold or vote their common shares except in the event of insanity of a holder. The laws of the Cayman Islands freely permit the import and export of capital including, but not limited to, the payment of dividends to persons who do not reside in the Cayman Islands.

## TAXATION

The Company is incorporated in the Cayman Islands and is exempt from taxation in that jurisdiction. The Cayman Islands does not impose income taxes or withholding taxes on dividends paid to U.S. shareholders of a Cayman Islands corporation nor does it impose taxes on U.S. shareholders as a result of their ownership or transfer of such shares. The Cayman Islands does not impose estate, gift or inheritance taxes. The Cayman Islands and the United States do not have a reciprocal tax treaty for the avoidance of double taxation.

With respect to direct or indirect holders of Common Shares who are U.S. citizens or residents or U.S. corporations, estates or trusts ("U.S. Shareholders"), the Company does not believe that it meets the criteria for designation as a passive foreign investment company ("PFIC") for 2002. However, it is possible that such designation may have applied in prior years. A PFIC is any corporation not formed in the United States in which either the passive income, such as interest, dividends and gains on the sales of assets which produce passive income, represents 75% or more of its gross income for the taxable year or the average percentage of its assets (by value) that produce or are held for the production of passive income represents 50% or more of its total assets. The Company does not believe that the nature of its activities – an industrial holding company that actively provides financial and management assistance to improve the effectiveness of its operating subsidiaries or affiliates – represents the activities by a non-U.S. corporation that were intended to be targeted by the PFIC rules.

Current U.S. Shareholders are encouraged to consult with their tax advisors prior to transferring, pledging or otherwise disposing of their Common Shares. Tax advisors may recommend that U.S. Shareholders who owned Common Shares prior to 2001 treat the gain on the sale or other disposition of Common Shares and certain distributions with respect to Common Shares as if such amounts were ordinary income earned ratably over the holding period. If such is the recommendation, then the amounts allocated to the current year would be subject to U.S. federal income tax at the U.S. Shareholder's marginal rate; amounts allocated to prior years would be subject to both U.S. federal income tax at the U.S. Shareholder's highest marginal rate during such years and interest charge based on the tax deferral during such years. In addition, a U.S. Shareholder who pledges Common Shares as security for a loan may be treated as having disposed of such shares. Further, the basis of Common Shares held by a U.S. Shareholder at death may not be stepped-up to fair market value as would otherwise be the case.

## SELECTED FINANCIAL DATA

The following selected financial data has been derived from the consolidated financial statements of the Company for the fiscal years ended December 31, 2002, 2001, 2000, 1999 and 1998 and should be read in conjunction with the consolidated financial statements of the Company (including the related notes) and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere herein. The consolidated financial statements of Siem Offshore AS are denominated in Norwegian kroner and converted to U.S. dollars. The currency exchange rates between NOK and U.S. dollars at December 31, 2002, 2001, 2000, 1999 and 1998 were NOK6.9252/\$1.00, NOK8.9451/\$1.00, NOK8.7671/\$1.00, NOK8.0105/\$1.00 and NOK7.6243/\$1.00, respectively, and the currency exchange rate at June 20, 2003 was NOK7.0472/\$1.00.

SELECTED FINANCIAL DATA

(in thousands, except per share amounts)	Years Ended December 31,				
	2002	2001	2000	1999	1998
<b>FINANCIAL PERFORMANCE:</b>					
Income from operations:					
Total revenues (1)	\$ 142,363	\$ 67,227	\$ 106,048	\$ 30,273	\$ 38,136
Total expenses and other	(91,246)	(94,922)	(24,329)	(7,316)	(4,030)
Minority interests	(582)	(342)	—	—	—
Income (loss) before income tax and cumulative effect of accounting changes	50,231	(28,037)	81,719	22,957	34,106
Income tax expense (benefit)	371	(154)	(271)	1,615	39
Net income (loss) before cumulative effect of accounting changes	49,860	(27,883)	81,990	21,342	34,067
Cumulative effect of accounting changes, Net of taxes	1,041	—	—	—	—
Net income (loss)	\$ 50,901	\$ (27,883)	\$ 81,990	\$ 21,342	\$ 34,067
Net income (loss), basic and diluted, per common share:					
Net income (loss) before cumulative effect of accounting changes	\$ 2.94 0.06	\$ (1.69) —	\$ 4.74 —	\$ 1.18 —	\$ 1.75 —
Cumulative effect of accounting changes					
Basic and diluted net income (loss)	\$ 3.00	\$ (1.69)	\$ 4.74	\$ 1.18	\$ 1.75
<b>FINANCIAL POSITION:</b>					
Working capital	\$ 40,535	\$ 145,219	\$ 93,700	\$ 233,043	\$ 35,225
Total assets	697,673	549,618	362,185	368,164	278,934
Long-term debt	300,530	249,563	46,500	53,000	80,163
Shareholders' equity	289,834	259,875	306,561	308,207	189,463
Wtd. avg. no. shares outstanding	16,959	17,001	17,289	18,095	19,493
Ending no. of shares outstanding	16,797	16,997	17,002	17,355	19,067

(1) Includes equity in the income (loss) of unconsolidated affiliates of \$(2,826), \$(9,834), \$(12,697), \$573 and \$10,918 for each of the years ended December 31, 2002, 2001, 2000, 1999 and 1998, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

DSND and Halliburton Subsea completed the transfer assets and personnel into the new joint venture and Subsea 7 commenced operations in May 2002. At closing, Subsea 7 received \$200,000,000 proceeds from a bridge loan provided by a bank syndicate. Subsea 7 paid \$156,000,000 to DSND to equitize the contributions made by each of the owners. As part of the bridge loan agreement, DSND and Halliburton agreed to provide a \$50,000,000 working capital line of credit to Subsea 7 with drawdowns to be received from the owners on a pari passu basis. In a related agreement, the Company entered into an undertaking with DSND which stated that, if necessary, the Company would advance such funds as to satisfy DSND's obligations under the working capital line. The Company and DSND subsequently entered into a \$15,000,000 revolving loan agreement to set forth the terms for any advances that would be made to DSND pursuant to a drawdown request by Subsea 7.

In late May 2002, the Company increased its holding in DSND to 18,756,024 shares, or 31.1% of issued and outstanding shares, following the purchase of 2,300,000 shares of DSND for approximately \$6,720,000.

At the end of June 2002, the Company's Board of Directors declared an extraordinary dividend of \$0.05 per Common Share that was payable in August 2002.

In July 2002, the Company and other holders of the DSND Bonds met and agreed to modify certain terms of the underlying agreement. Specifically, the maturity date was extended from July 2002 to November 2002, the interest rate was increased from 7% p.a. to 9% p.a. and the conversion feature was terminated. As consideration for the changes, DSND paid the bondholders a fee of 0.2% with respect to the individual holdings. In connection with the extension of the maturity date of the DSND Bonds, the Company agreed to extend the maturity dates of the NOK100mm Note and \$9.3mm Note to October 2002.

Also in July 2002, the Company and Vroon entered into a settlement agreement for the sale of \$67,640,000 face amount of ARC Notes. The settlement terms provided for a price of \$0.67 per \$1.00 face value of bonds and the accrual of interest on the settlement amount until payment was received in full.

In late July 2002, STCC completed the purchase of the 3 car carriers and commenced operations. The \$106,500,000 purchase price was financed using the proceeds of a 5-year \$90,000,000 bank loan. As part of the agreement, the Company agreed to provide a \$15,000,000 guarantee to secure STCC's semiannual principal and interest payments in the event that STCC was unable to secure extensions to the existing charters or new charters at rates that could generate sufficient cash flow to satisfy payment obligations.

In September 2002, DSND requested an advance of \$2,000,000 pursuant to a drawdown request by Subsea 7. The advance was repaid in November 2002.

In October 2002, DSND Inc. issued an offer to exchange its shares for DSND Subsea ASA shares on a 1:1 basis. Shortly thereafter, the Company announced that 55,876,995 shares, or 92.6% of the total DSND Subsea shares issued and outstanding, had been tendered. DSND subsequently launched a combined mandatory offer and compulsory acquisition to acquire the remaining shares.

Later in October 2002, DSND announced a financial restructuring plan to refinance its short-term obligations. The final terms of the plan consisted of a private placement of shares at NOK17 per share for the amount of NOK370,000,000 and a convertible bond issue for the amount of NOK300,000,000. Following this announcement, the Company agreed to extend the maturity dates of the NOK100mm Note and \$9.3mm Note to the completion date of the restructuring plan.

At the end of October 2002, the Company increased its holding in DSND to 23,449,424 shares following the purchase of an additional 4,693,400 shares for \$11,055,000. Because it had exceeded the ownership threshold of 40%, the Company subsequently issued a mandatory offer for all issued and outstanding shares of DSND at NOK17.50 per share.

Also in October 2002, STAR purchased 5 reefer vessels from the Great White Fleet, a subsidiary of Chiquita International Brands, for approximately \$54,000,000. A bridge loan was used to finance the acquisition. The Company agreed to provide a \$53,000,000 guarantee to secure quick action on the closing of the bridge loan.

In November 2002, the Company acquired a net 16,556,761 additional shares of DSND with respect to its subscription in the private equity placement. The Company paid for the acquisition of additional shares using NOK40,000,000 cash and by offsetting a portion of the DSND Bonds which were due and payable. Following this, the Company agreed to convert the remaining balance of the DSND Bonds to a loan with interest payable at 12% p.a. and maturity at the completion date of the NOK300,000,000 bond issue.

Also in November 2002, the \$200,000,000 bridge loan received by Subsea 7 was refinanced with a long-term facility. Further, the Company reaffirmed its undertaking with DSND with respect to advances that DSND might require in order to satisfy its obligations under the working capital line provided to Subsea 7.

In November 2002, following a period of discussions with the owner of four vessels under charter to STAR, STAR successfully renegotiated certain onerous terms in charter contracts that had been acquired as part of the purchase of Albion Reefers in July 2001. The new terms resulted in lower rates in exchange for extensions of the charter periods to 2009 and 2010. In a related transaction, the Company agreed to assume a secondary guarantee made by the seller of Albion Reefers to the owner of the vessels in exchange for a payment of \$3,850,000.

STAR completed the refinancing of its long-term debt and the bridge loan used to finance the purchase of the 5 vessels from the Great White Fleet. As part of the refinancing, the Company agreed to provide a \$4,500,000 loan to STAR providing for interest at 7% p.a. and maturity in July 2003.

At closing of its mandatory offer in late December 2002, the Company acquired 18,343,468 shares of DSND to increase its holding to 58,349,653 shares, or 72.2% of the issued and outstanding shares of DSND.

During 2002, the Company purchased and retired 200,000 Common Shares at an aggregate cost of approximately \$1,550,000.

#### RESULTS OF OPERATIONS

##### *FISCAL YEARS ENDED DECEMBER 31, 2002, 2001 AND 2000*

Vessel operating revenues recorded during fiscal years 2002 and 2001 were \$116,875,000 and \$85,471,000. Vessel operating revenues were included within the consolidated financial statements following the Company's investment in STAR in January 2001. The increase from 2001 to 2002 is attributed to recording a full year of operations for the vessels acquired from Albion Reefers and to the commencement of operations of STCC.

Interest income recorded during fiscal years 2002, 2001 and 2000 were approximately \$16,986,000, \$18,874,000 and \$12,808,000, respectively. Major sources of interest recorded during 2002 included the significant cash holdings denominated in NOK that benefited from high interest rates and continued holdings in DSND bonds and notes. Interest income decreased from 2001 as the result of the sale and liquidation of certain of SARF's high yield investments during 2002 and the drop in interest-bearing cash amounts as NOK holdings were used to purchase DSND shares. Major sources of interest recorded during 2001 included the DSND bonds and notes receivable, a full year's investment in the high-yield debt securities owned by SARF, the consolidation of STAR Reefers and the overnight investments of large cash holdings. Major sources of interest recorded during 2000 included the DSND bonds and notes receivable, the overnight investments of the large cash holdings following the sale of the shareholding in Norwegian Cruise Line.

Net gains (losses) recorded during fiscal years 2002, 2001 and 2000 were approximately \$8,606,000, \$(28,328,000) and \$101,899,000, respectively. The net gains recorded during 2002 included \$3,577,000 gain on the sale of 115,000 shares of Transocean, \$4,672,000 gain on the sale of ARC Notes. The gains from the sales and liquidations of SARF's high yield investments were offset by the net losses incurred on, and the mark-to-market of, equity investments held by the Company. The net losses recorded during 2001 included the loss of \$18,279,000 recognized on the sale of Kvaerner shares pursuant to a tender offer in October 2001 and the impairments for \$9,615,000 established by SARF in December 2001. The net gains recorded during 2000 included \$100,032,000 earned on the sale of NCL Holding shares and the net gains resulting from the Company's investment of discretionary funds in trading securities. The net gains recorded during 1999 reflect the aggregate result obtained from the Company's investment of discretionary funds in trading securities.

Equity in the income (losses) of unconsolidated affiliates recorded during fiscal years 2002, 2001 and 2000 were approximately \$(2,826,000), \$(9,834,000) and \$(12,697,000), respectively. The major components of the net equity losses recorded in 2002 included an equity loss of \$(3,418,000) with respect to DSND prior to its consolidation by the Company at the end of November 2002, an equity loss of \$(1,745,000) with respect to Four Seasons and an equity income of \$3,127,000 on Overseas Drilling. The major components of the net equity losses recorded in 2001 and 2000 reflect the disappointing results recorded by DSND as it experienced cost overruns on several of its projects.

Significant other income recorded during fiscal year 2002 included dividend income and fees. Significant other income recorded during fiscal year ended December 31, 2001 included dividend income. Significant other income recorded during 2000 included underwriting and other fee income of approximately \$2,986,000 and dividend income of approximately \$826,000.

Vessel operating expenses recorded during the fiscal years 2002 and 2001 were \$82,005,000 and \$56,118,000. Vessel operating expenses were included within the consolidated financial statements following

the Company's investment in STAR in January 2001. The increase from 2001 to 2002 is attributed to recording a full year of operations for the vessels acquired from Albion Reefers and to the commencement of operations of STCC.

Depreciation and amortization expense for fiscal years 2002, 2001 and 2000 were \$20,380,000, \$12,872,000 and \$67,000. The increase from 2001 to 2002 is attributed to recording a full year of operations for the vessels acquired from Albion Reefers and to the commencement of operations of STCC.

Interest expense for fiscal years 2002, 2001 and 2000 were approximately \$15,805,000, \$17,616,000 and \$2,176,000, respectively. The decrease in interest expense for 2002 is a result of low interest rates for the full year as compared to 2001. This decrease offset the effect of higher debt balances in the later months of 2002. The increase in interest expense for 2001 is attributed to the net increase in drawdowns under the revolving credit agreements of approximately \$31,000,000, the obligations arising under the term loans of approximately \$13,356,000 and the consolidation of STAR Reefers debt. The fluctuations in interest expense for 2000 and 1999 reflect the changing levels of interest-bearing debt incurred for project financing and interest rates over the two-year period.

General and administrative expenses for fiscal years 2002, 2001 and 2000 were approximately \$7,978,000, \$4,992,000 and \$5,815,000, respectively. General and administrative expenses during 2002 included \$3,493,000 and \$163,000 of expenses incurred by STAR and STCC, respectively. The remaining \$4,322,000 includes a management fee expense of \$2,931,000. The amount of the management fee is based on the level of net income and is determined in accordance with provisions of a management service agreement. General and administrative expenses during 2001 included \$3,265,000 of expenses incurred by STAR Reefers. The remaining \$1,727,000 included a management fee expense of \$300,000. During 2000, the general and administrative expenses included a management fee expense of \$4,299,000.

Currency exchange losses for fiscal years 2002, 2001 and 2000 were \$35,246,000, \$(3,324,000) and \$(16,271,000), respectively. The net currency exchange gain for 2002 reflects the sharp reversal of the valuations between the USD and other currencies. As a result of the appreciation of NOK and other currencies relative to the USD, the Company recorded net currency gains on significant cash holdings and other investments that are not USD-denominated and, thus, recaptured some of the losses recorded in previous years. The net exchange losses for 2001 and 2000 reflected the Company's exposure to declines in the value of the NOK and other currencies relative to the United States dollar with respect to the significant amount of NOK and other non-U.S.-denominated assets held by the Company.

Income tax expense (benefit) for fiscal years ended December 31, 2002, 2001 and 2000 included withholding taxes ranging from 20-30% on dividends received from the Company's various equity investments and Norwegian tax expense (benefit) incurred with respect to the Company's activities in Norway.

#### *FINANCIAL CONDITION AND LIQUIDITY*

The current ratios were 1.48 and 4.4 at December 31, 2002 and 2001, respectively. The debt-to-total assets ratio were 0.52 and 0.49 at December 31, 2002 and 2001, respectively. The decrease in the current ratio and the increase in the debt-to-total assets ratio reflect the consolidations of STAR and STCC, both of which are fixed asset intensive businesses involving the ownership of vessels and the related financing used to acquire such vessels.

During 2002, the Company, exclusive of STAR and STCC, received drawdowns of \$45,000,000 under its revolving credit facilities and repaid \$63,000,000 of such facilities and a \$6,300,000 term loan. The Company used the drawdowns to finance a portion of its equity investment in STCC in July 2002, to finance the market purchase of DSND shares in October 2002, and to pay for the DSND shares tendered pursuant to the mandatory offer upon its completion in December 2002. The Company used proceeds from the sales of ARC Notes and other investments and amounts received on the exchange of NOK cash balances for USD to paydown its debt. SARF used proceeds from the sales and liquidation of certain investments to payoff its revolving credit facility. At the end of 2002, the Company had \$24,500,000 in available drawing capacity under its various revolvers.

#### *SUBSEQUENT EVENTS*

Upon the conclusion of its mandatory offer and the compulsory acquisition of remaining outstanding DSND Subsea shares in January 2003, DSND had acquired an additional 3,161,097 shares of DSND Subsea through the exchange of its own shares and had purchased the remaining shares in cash.

At the same time, DSND completed its NOK300,000,000 bond issue of which amount the Company had subscribed for NOK219,610,000. As payment for its subscription, the Company used approximately NOK10,345,000 cash and the principal and interest amounts outstanding under the DSND Bonds and the NOK100mm Note to offset subscription amounts payable. DSND used the payments from the remaining bond subscribers to repay the \$9.3mm Note in its entirety.

The Company used the proceeds from the payment of the \$9.3mm Note to pay \$6,000,000 of the revolving credit facility and payoff the \$3,000,000 term loan.

In February 2003, STCC made a prepayment of \$3,000,000 against its bank loan. The lenders agreed that the prepayment could be used to reduce the guarantee provided by the Company from \$15,000,000 to \$12,000,000 in order of maturity.

#### *MARKET RISKS DISCLOSURES*

The Company's balance sheet includes a substantial amount of assets whose fair values are subject to market risks. Due to the Company's significant level of investments in equity securities, fluctuations in equity prices represent the largest market risk factor affecting the Company's financial position. The following sections address the significant market risks associated with the Company's business activities.

##### *EQUITY PRICE RISK*

Strategically, the Company strives to invest at reasonable prices in businesses possessing good economics and competent management. The Company prefers to invest a meaningful amount in each investee and, as a result, the Company's equity investments are concentrated in relatively few investees.

The Company's primary investment strategy is to invest in businesses in which it possesses experience on a long-term basis. Thus, short-term price volatility with respect to its investments is understood and accepted by the Company provided that the underlying business, economic and management qualities of the investees remain favorable.

The carrying values of investments subject to equity price risks accounted for under the equity method of accounting are based on costs adjusted for the Company's proportionate share of investee earnings. The carrying values of investments which the Company has classified as available-for-sale securities are adjusted to reflect market prices at the end of the period with the appreciation or depreciation in the investments reflected as a component of comprehensive income. The carrying values of investments which the Company has classified as trading securities are adjusted to reflect market prices at the end of the period with the adjustment reflected as a gain or loss. Market prices are subject to fluctuation and, consequently, the amount realized in the subsequent sale of an investment may significantly differ from the reported market value. Fluctuation in the market price of a security may result from perceived changes in the underlying economic characteristics of the investee, the relative price of alternative investments and general market conditions. Furthermore, amounts realized in the sale of a particular security may be affected by the relative quantity of the security being sold.

##### *INVESTMENT CONCENTRATION RISK*

The Company believes that it may have investment concentration risks with respect to its investments in the oil and gas services industry. However, it believes that such risks are somewhat moderated because the oil and gas service companies that the Company has investments in are positioned at different stages of the oil and gas exploration and drilling cycle.

## FORWARD-LOOKING STATEMENTS

Investors are cautioned that certain statements contained in this document, as well as some statements made by the Company in periodic press releases and some oral statements made by its management during presentations about the Company, are "forward-looking" statements within the meaning of the United States' Private Securities Litigation Reform Act of 1995 (the "Act"). Forward-looking statements include statements which are predictive in nature, which depend upon or refer to future events or conditions, which include words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", or similar expressions. In addition, any statements concerning future financial performance (including future revenues, earnings or growth rates), ongoing business strategies or prospects, and possible future Company actions, which may be provided by management, are also forward-looking statements as defined by the Act. Forward-looking statements are based on current expectations and projections about future events and are subject to risks, uncertainties, and assumptions about the Company, economic and market factors and the industries in which the Company conducts business, among other things. These statements are not guarantees of future performance and the Company has no specific intention to update these statements.

Actual events and results may differ materially from those expressed or forecasted in forward-looking statements due to a number of factors. The principal important risk factors that could cause the Company's actual performance and future events and actions to differ materially from such forward-looking statements, include, but are not limited to, changes in market prices of the Company's significant equity investees, changes in income tax laws, and changes in general economic and market factors that affect the prices of securities or the industries in which the Company and its affiliates conduct business.

## DIRECTORS AND OFFICERS

The following persons are currently directors and executive officers of the Company:

### DIRECTORS

<i>Name</i>	<i>Position</i>	<i>Director Since</i>	<i>Present Term Expires</i>
M.D. Moross	Director (2)	1995	2003
Rune Holen	Director	2000	2003
Kristian Siem	Director and Chairman (1)	1982	2004
Barry W. Ridings	Director (1,2)	1993	2004
Frank Capstick	Director	1997	2005

(1) Member of Audit Committee.

(2) Member of Compensation Committee.

Directors are normally elected for terms of three years at the Annual General Meeting of Shareholders. Executive officers are appointed by and serve at the pleasure of the Board. Officer appointments are normally confirmed at the Board meeting which promptly follows the Annual General Meeting of Shareholders.

### EXECUTIVE OFFICERS

<i>Name</i>	<i>Office</i>	<i>Officer Since</i>
Kristian Siem	Chief Executive Officer	1988
Frank Capstick	President	1990
Michael J. Delouche	Vice-President, Controller and Secretary	1991

Kristian Siem is Chairman of STAR Reefers Inc., DSND Inc., Subsea 7 Inc. and Four Seasons Capital AB and a director on the Boards of Transocean Inc., Firmament AS and North Atlantic Small Companies Investment Trust plc.

M.D. Moross is a private investor and the father-in-law of Kristian Siem.

Barry W. Ridings is a Managing Director of Lazard Frères & Co. and a director on the Board of New Valley Corporation.

Rune Holen is a partner in Storebrand Alternative Investments ASA and director on the Boards of Alliance Venture I.P. and Industrifinans SMB III ASA.

Frank Capstick was vice-president of an oil trading company prior to joining the Company.

Michael Delouche was an audit manager with KPMG Peat Marwick LLP prior to joining the Company.

#### COMPENSATION OF DIRECTORS AND OFFICERS

The aggregate fees incurred by the Company for the services of its directors and officers for fiscal years ended December 31, 2002, 2001, 2000 were approximately \$3,154,000, \$643,000 and \$4,541,000, respectively. Messrs. Ridings and Holen receive a director's fee of \$12,000 per annum and reimbursements of expenses incurred on behalf of the Company; Mr. Moross waived his director's fee but receives reimbursements of expenses incurred on behalf of the Company. Specific agreements for the services of certain other directors and officers are as follows:

- (1) A management services agreement (the "MSA") between the Company and Mr. Siem commenced January 1, 2000. The MSA provides for Mr. Siem's employment and devotion of a minimum 50% of his professional time, skill and labor to perform his duties for and promote the interests of Siem Industries. The compensation consists of a base compensation in the amount of \$300,000 plus additional compensation equal to 5% of the audited net income for each year. The fees payable under the MSA were \$2,931,000, \$300,000 and \$4,299,000 for fiscal years 2002, 2001 and 2000.
- (2) Mr. Delouche is seconded to the Company under a separate management services agreement which provides for reimbursement for certain expenses incurred by him. The reimbursements for fiscal years 2002, 2001 and 2000 were approximately \$172,000, \$199,000 and \$198,000, respectively.

#### OPTIONS TO PURCHASE SECURITIES FROM COMPANY

Performance units have been awarded in accordance with the Company's 1987 Performance Unit Plan (the "Plan"), as amended, by the Compensation Committee of the Board of Directors. The Plan provides that performance units shall be granted at a value no less than 110% of the average closing price of the Company's Common Shares for the 20 trading days prior to the date of the award. The aggregate sum of the performance unit value, which is determined by multiplying the number of performance units by the value per performance unit, is credited to the individual's performance unit account on the date of the award. Grants of awards vest 20% per year in five-year award periods; however, all rights to the performance unit account are forfeited if the individual's employment ceases before the end of the award period with certain reasonable exceptions including the death, total disability or retirement after age 60 of the individual.

Under the Plan, the amount of payment to the individual after the end of the award period is equal to the number of vested performance units multiplied by the difference between the closing price of the Company's Common Shares on the date of payment and the value of the performance units awarded. At the Company's option, the payment can be made in either cash or Company Common Shares.

The term of the Plan is the earlier of the vesting of an aggregate 1,600,000 performance units by the participants or January 2007.

The following table summarizes the performance unit awards which have been granted and are currently outstanding:

#### PERFORMANCE UNITS

Name	No. of Performance Units Awarded and Outstanding	
	Granted May 1995 at \$3.00 per Unit	Granted May 1996 at \$5.50 per Unit
Kristian Siem	400,000	60,000
M.D. Moross	—	28,000
Barry W. Ridings	28,000	—
Michael Delouche	40,000	20,000

A total of 274,200 of the Performance Units originally granted in 1995 and 1996 have been forfeited.

#### INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS

As mentioned previously, the MSA between Kristian Siem and the Company became effective in 2000 and provide the terms for Mr. Siem's services.

Mr. Siem holds an option to purchase the property which houses the offices of Siem Offshore in Oslo, Norway. The option provides for a one-year period, commencing on the date that he is no longer an officer or director with the Company or any of its subsidiaries, during which time he can purchase the property at the price paid by Siem Offshore. This option is subject to review by the Compensation Committee.

**SIEM INDUSTRIES INC. AND SUBSIDIARIES**  
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## REPORT OF INDEPENDENT ACCOUNTANTS

The Board of Directors and Shareholders of Siem Industries Inc.:

In our opinion, based on our audits and the reports of other auditors, the accompanying consolidated balance sheets and the related consolidated statements of operations, shareholders' equity and comprehensive income and cash flows present fairly, in all material respects, the financial position of Siem Industries Inc. and subsidiaries (the "Company") at December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of STAR Reefers Inc., a majority-owned subsidiary acquired during 2001, as of and for the period ended December 31, 2001, which statements reflect total assets of approximately \$236,500,000 at December 31, 2001 and total revenues of approximately \$87,100,000 for the period ended December 31, 2001. The financial statements of STAR Reefers Inc. were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for STAR Reefers Inc., is based solely on the report of other auditors. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, the Company changed its methods of accounting for drydocking costs to the "expense as incurred" method and changed its method of accounting for goodwill and deferred credits arising from business combinations effective January 1, 2002.

/s/ PricewaterhouseCoopers LLP

Houston, Texas USA  
13 June 2003

**SIEM INDUSTRIES INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

<i>(Dollars in thousands, except per share amounts)</i>	2002	<i>For Years Ended December 31,</i>	
		2001	2000
<b>REVENUES:</b>			
Operating revenues	\$ 116,875	\$ 85,471	\$ —
Interest income	16,986	18,874	12,808
Gains (losses), net	8,606	(28,328)	101,899
Equity in income (loss) of unconsolidated affiliates	(2,826)	(9,834)	(12,697)
Other	2,722	1,044	4,038
Total revenues	142,363	67,227	106,048
<b>OTHER EXPENSES (INCOME):</b>			
Operating expenses	82,005	56,118	—
Depreciation and amortization	20,380	12,872	67
Interest expense	15,805	17,616	2,176
General and administrative	7,978	4,992	5,815
Currency exchange losses (gains), net	(35,246)	3,324	16,271
Other	628	—	—
Total other expenses	91,550	94,922	24,329
Minority interest	582	342	—
Income (loss) before income tax expense and cumulative effect of accounting changes	50,231	(28,037)	81,719
Income tax expense (benefit)	371	(154)	(271)
Income (loss) before cumulative effect of accounting changes	49,860	(27,883)	81,990
Cumulative effect of accounting changes, net of taxes	1,041	—	—
Net income (loss)	\$ 50,901	\$ (27,883)	\$ 81,990
<b>Basic income (loss) per common share:</b>			
Income (loss) before cumulative effect of accounting changes	\$ 2.94	\$ (1.64)	\$ 4.74
Cumulative effect of accounting changes, net of taxes	0.06	—	—
Net income (loss)	\$ 3.00	\$ (1.64)	\$ 4.74
<b>Diluted income (loss) per common share:</b>			
Income (loss) before cumulative effect of accounting changes	\$ 2.94	\$ (1.64)	\$ 4.74
Cumulative effect of accounting changes, net of taxes	0.06	—	—
Net income (loss)	\$ 3.00	\$ (1.64)	\$ 4.74
Weighted avg. no. of shares outstanding for period	16,959,384	17,000,727	17,289,194

See accompanying Notes to Consolidated Financial Statements.

**SIEM INDUSTRIES INC. AND SUBSIDIARIES**  
CONSOLIDATED BALANCE SHEETS

<i>(Dollars in thousands)</i>	<i>December 31,</i> 2002	<i>December 31,</i> 2001
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents	\$ 37,173	\$ 39,135
Restricted cash	17,019	33,537
Accounts receivable, other	37,284	4,218
Interest income receivable	650	2,589
Marketable equity securities	12,296	14,535
Inventories	776	1,628
Notes receivable	8,950	85,080
Due from affiliates	1,668	1,691
Prepaid expenses and other current assets	9,177	5,548
Total current assets	124,993	187,961
Senior secured notes, notes receivable and other investments	26,918	43,622
Marketable equity securities	33,030	52,040
Investments in unconsolidated affiliates	173,403	69,333
Property and equipment, net	298,803	193,523
Goodwill	38,397	—
Other assets	2,129	3,139
Total Assets	\$ 697,673	\$ 549,618
<b>LIABILITIES AND SHAREHOLDERS' EQUITY:</b>		
Current liabilities:		
Accounts payable	\$ 25,621	\$ 8,816
Income taxes payable	595	10
Accrued interest payable	7,352	4,711
Time charters	1,913	5,921
Due to affiliates	3,240	150
Current maturities and short-term notes	30,908	20,863
Other accrued costs and short-term liabilities	14,829	2,271
Total current liabilities	84,458	42,742
Long-term debt and notes payable	269,622	228,700
Deferred income taxes	37	7
Deferred liabilities related to Performance Unit Plan	2,599	2,599
Other	6,216	67
Minority interest	44,907	15,628
Shareholders' equity:		
Preferred shares, \$1.00 par value, 5,000,000 shares authorized	—	—
Redeemable preferred shares, \$0.01 par value, 50,000,000 shares authorized	—	—
Common shares, \$0.25 par value, 100,000,000 shares authorized, 16,796,644 and 16,996,644 shares issued and outstanding	4,199	4,249
Paid-in capital	12,578	12,578
Retained earnings	247,428	198,877
	264,205	215,704
Accumulated other comprehensive income	25,629	44,171
Total Shareholders' Equity	289,834	259,875
Total Liabilities and Shareholders' Equity	\$ 697,673	\$ 549,618

See accompanying Notes to Consolidated Financial Statements.

**SIEM INDUSTRIES INC. AND SUBSIDIARIES**  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

<i>(Dollars in thousands)</i>	Common Shares	Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Comprehensive Income
Balances at December 31, 1999	4,339	12,578	147,569	143,721	
Reacquisition and retirement of stock	(89)	—	(2,764)	—	
Net income	—	—	81,990	—	\$ 81,990
Other comprehensive income items:					
Unrealized appreciation on securities available-for-sale	—	—	—	18,945	18,945
Reclassification adjustment for appreciation included in net income	—	—	—	(102,387)	(102,387)
Currency translation adjustment	—	—	—	2,659	2,659
Other comprehensive income (loss)					(80,783)
Total comprehensive income					\$ 1,207
Balances at December 31, 2000	4,250	12,578	226,795	62,938	
Reacquisition and retirement of stock	(1)	—	(35)	—	
Net income (loss)	—	—	(27,883)	—	\$ (27,883)
Other comprehensive income items:					
Unrealized appreciation (depreciation) on securities available-for-sale	—	—	—	(18,742)	(18,742)
Currency translation adjustment	—	—	—	(25)	(25)
Other comprehensive income (loss)					(18,767)
Total comprehensive income (loss)					\$ (46,650)
Balances at December 31, 2001	4,249	12,578	198,877	44,171	
Reacquisition and retirement of stock	(50)	—	(1,500)	—	
Cash dividends	—	—	(850)	—	
Net income	—	—	50,901	—	\$ 50,901
Other comprehensive income items:					
Unrealized appreciation (depreciation) on securities available-for-sale	—	—	—	(14,764)	(14,764)
Reclassification adjustment for appreciation included in net income	—	—	—	(3,496)	(3,496)
Currency translation adjustment	—	—	—	(282)	(282)
Other comprehensive income (loss)					(18,542)
Total comprehensive income					\$ 32,359
Balances at December 31, 2002	\$ 4,199	\$ 12,578	\$ 247,428	\$ 25,629	

See accompanying Notes to Consolidated Financial Statements.

**SIEM INDUSTRIES INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)	For Years Ended December 31,		
	2002	2001	2000
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income (loss)	\$ 50,901	\$ (27,883)	\$ 81,990
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Cumulative effect of accounting change	1,041	—	—
Depreciation and amortization	20,380	12,872	67
Undistributed equity in loss (income) of unconsolidated affiliates	2,826	9,834	12,697
Net losses (gains) on investments	(8,606)	18,713	(101,899)
Minority interests in net income	582	342	—
Impairment of investments	—	9,615	—
Provisions for losses on time charters	(4,008)	(7,167)	—
Deferred income taxes	30	(92)	(360)
Currency exchange losses (gains)	(35,246)	3,324	16,271
Changes in assets and liabilities net of effect of acquired companies:			
(Increase) decrease in:			
Accounts receivable, other	(2,402)	6,233	(8,150)
Interest income receivable	(118)	864	(3,444)
Marketable equity securities	(301)	1,892	(377)
Inventories	852	394	—
Due from affiliated companies	23	(1,129)	387
Prepaid expenses and other current assets	969	(3,711)	(151)
Increase (decrease) in:			
Accounts payable	(1,700)	7,402	(4,668)
Taxes payable	27	—	—
Accrued interest	2,541	4,378	150
Other	(2,692)	438	(93)
Due to affiliated companies	3,090	(3,837)	2,845
Net cash provided by (used in) operating activities	28,189	32,482	(4,735)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Purchase of available-for-sale marketable equity securities	—	—	(2,242)
Proceeds from sale of available-for-sale marketable equity securities	4,246	—	163,815
Additions to notes receivable and other investments	(1,681)	(33,531)	(127,328)
Proceeds from repayment of notes receivable and other investments	50,881	27,885	9,663
Distributions from (investments in) unconsolidated affiliates	(67,529)	(8,043)	(8,830)
Proceeds from sale of investments in unconsolidated affiliates	—	—	2,840
Purchases of vessels and shipping related assets	(160,500)	(1,544)	—
Disposal of vessels and shipping related assets	60,151	5,698	—
Purchase of property and equipment	—	(5,664)	—
Acquisition of DSND, net of cash acquired	16,043	—	—
Acquisition of STAR Reefers and Albion Reefers, net of cash acquired	—	(27,165)	—
(Increase) decrease in restricted cash	16,518	(25,113)	—
Other	(67)	2,447	(347)
Net cash provided by (used in) investing activities	(81,938)	(65,030)	37,571
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Cash dividends paid to Company shareholders	(850)	—	—
Cash dividends paid to minority shareholders	(142)	—	—
Proceeds from long-term debt and notes payable	(144,576)	62,602	61,500
Repayment of long-term debt and notes payable	181,244	(25,539)	(68,000)
Repurchase of common stock	(1,550)	(36)	(2,853)
Contribution from minority interests of consolidated subsidiaries	2,200	1,311	—
Other	877	—	—
Net cash provided by (used in) financing activities	37,203	38,338	(9,353)
Effect of exchange rate changes on cash	14,584	(1,077)	(11,289)
Net increase (decrease) in cash and cash equivalents	(1,962)	4,713	12,194
Cash and cash equivalents, beginning of period	39,135	34,422	22,228
Cash and cash equivalents, end of period	\$ 37,173	\$ 39,135	\$ 34,422
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>			
Cash paid during the period for:			
Interest	\$ 13,164	\$ 13,238	\$ 2,026
Income taxes	\$ 61	\$ 52	\$ 127
<b>NONCASH INVESTING ACTIVITIES:</b>			
Purchase equity securities by offsetting notes receivable	\$ 34,444	\$ —	\$ —
Conversion of notes receivable to debt securities	\$ —	\$ —	\$ 39,430

See accompanying Notes to Consolidated Financial Statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (1) SUMMARY OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

#### INTRODUCTION

Siem Industries Inc. was incorporated in October 1980 under the laws of the Cayman Islands as Bahama Cruise Line, Inc. The name was changed to Bermuda Star Line, Inc. in 1986, to Norex America, Inc. in 1989, to Norex Industries Inc. in 1996 and to Siem Industries Inc. in 1998. The “Company” or “Siem Industries”, as used herein, refers to Siem Industries Inc. and its subsidiaries and affiliates unless the context indicates otherwise. The currency symbols “\$” (or “USD”), “NOK” and “GBP” refer to United States dollars, Norwegian kroner and British pounds representing the lawful currencies of the United States, Norway, and Great Britain, respectively, and “EUR” refers to Euros.

At December 31, 2002, the Company owned the following major investments: 58,349,653 shares, or 72.2%, of DSND Inc. (“DSND”; OSE Symbol: “DSND”; DSND refers equally to DSND Inc. and its predecessor, DSND Subsea Inc.), a publicly-traded Cayman Islands company, which is a major contractor in the subsea construction industry through its 50% ownership of Subsea 7, Inc.; 5,612,015 shares, or 73.4%, of STAR Reefers Inc. (“STAR”; OSE Symbol: “SRI”), a publicly-traded Cayman Islands company which is one of the major owners and operators of refrigerated vessels transporting fruits, vegetables, meats and other consumables; an 88% interest in Siem Thoen Car Carriers, Inc. (“STCC”), a Cayman Islands company, that is the owner of three car carrier vessels; and 1,423,720 shares of Transocean Inc., a publicly-traded Cayman Islands company which is the world’s predominant premium deepwater drilling contractor. The Company also held a portfolio of high-yield debt securities in its investment fund, Siem Acquisition and Reorganisation Fund, Inc. (“SARF”), and a 64% interest in Four Seasons Capital AB (“Four Seasons”), a Swedish company. Four Seasons holds interests in several industrial companies with the two largest investments including Broström AB (“Broström”), one of the leading logistics companies for the oil and chemical industry with a focus on industrial product and chemical tanker shipping and marine services, and EFG European Furniture Group AB, a developer and manufacturer of furniture for offices and public areas.

At December 31, 2002, Elderberry Holdings Limited (“Elderberry”) owned 8,852,688 shares, or approximately 52.7% of the issued and outstanding shares of the Company’s Common Stock. Elderberry is owned by a trust, whose potential beneficiaries include the mother and certain of the brothers of Mr. Kristian Siem, the Company’s Chairman and Chief Executive Officer. Mr. Siem personally owned 928,992 shares, or approximately 5.5% of the Common Stock. The Ores Trust beneficially owned 1,327,432 shares, or approximately 7.9% of the Common Stock. Potential beneficiaries of the Ores Trust include members of Mr. Siem’s immediate family. Mr. Siem and the trustee for the trust hold separate voting and dispositive powers over their respective holdings.

Siem Drilling Ltd., STAR, DSND, SARF and STCC are significant subsidiaries of the Company.

#### BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

The consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America (“US GAAP”) and are presented in United States dollars.

The consolidated financial statements of the Company include the accounts of all subsidiaries in which the Company owns 50% or more of the voting shares, either directly or indirectly, unless the Company is unable to exercise control over the subsidiary. All significant intercompany accounts have been eliminated in consolidation.

The Company uses the equity method of accounting to account for its investments in companies in which the Company owns an interest between 20% and 50% and over which the Company exercises significant influence. These investments are reflected in the consolidated balance sheets as “Investments in unconsolidated affiliates” and the Company’s share of the unconsolidated affiliates’ income or loss is reflected in the consolidated statements of operations as “Equity in income (loss) of unconsolidated affiliates”. The Company uses the cost method to account for its investments in companies in which the Company owns an interest less than 20% and does not exercise significant influence.

*USE OF ACCOUNTING ESTIMATES*

The preparation of consolidated financial statements in conformity with US GAAP requires management to make good faith estimates and assumptions that affect the reported amount of assets, liabilities, revenues, expenses and disclosure of contingent assets and liabilities. On an ongoing basis, the Company evaluates its estimates, including those related to investments, materials and supplies obsolescence, intangible assets, bad debts, income taxes, financing operations and contingent liabilities as of the date of the financial statements and the period then ended. The Company bases its estimates on historical experience and on various assumptions that are believed reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from the estimates and assumptions used in the preparation of the consolidated financial statements.

*CASH AND CASH EQUIVALENTS*

Cash and cash equivalents include cash, certificates of deposit and all highly liquid investments purchased with original maturities of three months or less. Cash equivalents are stated at cost plus accrued interest, which approximates fair value.

The Company is required to maintain minimum cash balances or to pledge securities and/or cash deposits as security for drawdowns under its revolving credit facilities. During 2002, the Company elected to place cash deposits rather than pledge additional securities for the purpose of maintaining adequate security for certain of its revolving credit facilities. Such pledged cash deposits and minimum cash balances required under other loan facilities are reported as restricted cash in the consolidated balance sheet. The restricted cash amounts at December 31, 2002 and 2001 were \$17,019,000 and \$33,537,000.

*ALLOWANCE FOR DOUBTFUL ACCOUNTS RECEIVABLE*

An allowance for doubtful accounts is established on a case-by-case basis when the Company believes that the required payment of the specific amount owed is unlikely to occur.

*INVENTORIES*

The major components of inventory include bunkers and lubrication oil. These inventories are recorded at the lower of cost or market. Cost is determined using the first-in, first-out ("FIFO") method.

*ACCOUNTING FOR SENIOR SECURED NOTES AND NOTES RECEIVABLE*

Senior secured notes and notes receivable are treated as loans and reported net of any unearned discount. Interest revenue on undiscounted notes is recognized based on the principal amount outstanding and the contractual rate. Interest revenue on discounted notes is recognized based on methods that approximate a level yield. Note origination and commitment fees and certain direct note origination and commitment costs are deferred and amortized as a yield adjustment over the lives of the related notes.

Senior secured notes and notes receivable that no longer pay in accordance with the contractual terms of their respective agreement or that have been restructured are reviewed for impairment and are deemed to be impaired when it is probable that all principal and interest amounts due pursuant to the underlying agreement will not be collected when due. Impaired notes are measured based upon the present value of expected future cash flows discounted at the note's initial effective interest rate or at either of the note's market price or fair value of the collateral if the note is collateral dependent. An impairment reserve is established for any difference between valuation of the note and its recorded value.

*ACCOUNTING FOR CERTAIN INVESTMENTS IN DEBT AND EQUITY SECURITIES*

Management designates equity securities that have readily determinable fair values and all investments in debt securities as either trading, available-for-sale or held-to-maturity. Trading securities are purchased and principally held for the purpose of selling them in the near future. Held-to-maturity securities are securities that the Company has both the ability and positive intent to hold to maturity. Available-for-sale securities are those securities not designated as either trading securities or held-to-maturity securities. Trading securities are classified as current assets and available-for-sale and held-to-maturity securities are classified as noncurrent assets.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Trading securities and available-for-sale securities are reported at fair value. Unrealized holding gains and losses for trading securities are recorded in income. Unrealized holding gains and temporary losses on available-for-sale securities are excluded from income and are reported net of income tax effect in other comprehensive income, a component of shareholders' equity, until such securities are sold. Held-to-maturity debt securities are reported at amortized cost net of any impairment in values that are deemed to have occurred. Gains and losses are derived using the weighted average method for determining the costs of securities.

### *PROPERTY AND EQUIPMENT*

Property and equipment consist primarily of vessels designed for the ocean-transport of refrigerated goods ("reefer vessels" or "vessels") and the ocean-transport of cars and high and heavy units ("car carriers"). The vessels and related equipment are valued in the consolidated balance sheets at cost plus the cost of upgrades less accumulated depreciation and write-downs. Vessel costs less residual values are depreciated on a straight-line basis over the estimated useful life of 15-30 years. Major modifications, which extend the useful life of the vessels, are capitalized and amortized over the adjusted remaining useful life of the vessel. Equipment costs less residual values are depreciated on a straight-line basis over the estimated useful life of 3-10 years.

Buildings are depreciated over a useful life of 20 years. Major betterments are capitalized and amortized over the remaining useful life. Remaining long-lived assets include furniture, fixtures and cars that are carried at cost and depreciated on a straight-line basis over a 3-5 year period.

Following the disposal or retirement of property and equipment, the costs and related accumulated depreciation are removed from the respective accounts and any resulting gains or losses are recorded in the statements of operations.

Property and equipment held for sale are recorded at the lower of book value or net realizable value and reclassified as current assets.

Maintenance and repairs are charged to expense as incurred.

### *IMPAIRMENT OF LONG-LIVED ASSETS*

Long-lived assets owned by the Company are reviewed for potential impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. This determination of recoverability for property and equipment held for use is based on the estimated undiscounted future net cash flows of the underlying asset.

### *DEFERRED FINANCING COSTS*

Loan costs, including debt arrangement fees, are deferred and amortized using the effective interest method of amortization over the term of the underlying facility agreement or on a straight-line basis over the term of the relevant facility which approximates the interest method. Amortization of loan costs is included in interest in the consolidated statements of operations.

### *GOODWILL*

Goodwill represents the excess of the purchase price over the fair value of assets acquired in business acquisitions under the purchase method of accounting. The Company evaluates goodwill at the reporting unit level on an annual basis unless circumstances require an interim evaluation. The evaluation compares the fair value of a reporting subsidiary against the carrying value of the reporting unit. If the fair value of the reporting unit is less than the carrying value, then additional analyses would be undertaken to determine the amount of the impairment.

### *REVENUE RECOGNITION*

Voyage revenues and expenses are recognized on the accrual basis. Revenues are generated from freight billings, time charter and bareboat charter hires. The operating results of voyages in progress are estimated and recorded pro-rata on a per day basis in the consolidated statements of operations. Probable losses on voyages are provided for in full at the time such losses can be estimated. Time charter and bareboat charter

revenues are recorded over the term of the charter as service is provided. Operating costs and costs in connection with freight-seeking activities are expensed as incurred.

Revenues generated by vessels in the NYK STAR Reefers Pool are booked on a gross basis. Voyage expenses such as fuel costs, port costs and other voyage-related expenses are deducted from gross revenue to reflect net charter earnings. Revenue from vessels deployed in third party pools are recorded on a net time charter basis because such vessels are operating either under a straight time charter or on pool-terms where STAR does not have access to gross revenues or voyage expense data.

Revenues generated on long-term construction, engineering and project management contracts are recognized using the percentage-of-completion method, based primarily on contract costs incurred-to-date compared to total estimated contract costs. Contracts are segmented between types of services and gross margin related to each activity is recognized as services are rendered. However, profit is not recognized until the work has reached 25% of completion. Changes to total estimated contract costs or losses on contracts, if any, are recognized in the period in which they are determined. Revenues recognized in excess of amounts billed are classified as current assets under contract work-in-progress and billings in excess of revenues recognized to date are classified as current liabilities under advance billings on contracts. The Company believes that substantially all incurred costs associated with contract work-in-progress at December 31, 2002 will be billed and collected.

Interest and dividend income are recognized on the accrual method as earned.

*TIME CHARTER CONTRACTS*

All time charter contracts are considered to be operating leases. Accordingly, charter hire is expensed as incurred.

*LEASES*

The Company holds a bareboat charter on a vessel under an agreement that is classified as a capital lease. A vessel under a capital lease is depreciated on either a straight-line basis over the vessel's remaining economic useful life or on a straight-line basis over the term of the lease. The method to be applied is determined by the criteria according to which the lease has been assessed to be a capital lease. Depreciation of vessels under capital leases is recorded in depreciation and amortization expense in the consolidated statements of operations.

All other leases are operating leases.

*PERFORMANCE UNITS*

The Company follows the Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), and related interpretations to account for its Performance Unit Plan and its employee stock option plan, as hereinafter described, which are variable and fixed compensation plans, respectively. Under APB 25, compensation is measured at the end of each period as the amount by which the fair value of the Company's Common Stock covering a grant of performance units exceeds the value specified under the plan and is charged to expense over the periods that the recipient of the grant performs the related services. Pro forma disclosures of net income (loss) as if fair value based method of accounting had been applied are presented (see Note 16).

*FOREIGN CURRENCY TRANSLATION*

The Company's functional and reporting currency is the USD. For those subsidiaries whose reporting currency is not the USD, the Company uses the current method of translation whereby the assets and liabilities are translated using the exchange rates reported at the balance sheet date and the statements of operations are translated using average exchange rates during the period. Currency translation gains and losses are reflected in other comprehensive income which is a component of equity.

Transactions in currencies other than USD's are translated into USD at the exchange rates in effect on the date of the transaction. At the balance sheet dates, monetary assets and liabilities denominated in currencies other than USD are translated using the exchange rate in effect on that date and nonmonetary

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

assets and liabilities are translated using historical rates of exchange. Currency transaction gains or losses are included in the consolidated statements of operations.

### *INCOME TAXES*

The Company is incorporated in the Cayman Islands and is exempt from income taxes in that jurisdiction. For the three years ended December 31, 2002, there was no Cayman Islands income or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable by a Cayman Islands company or its shareholders. The Company has received assurance from the Cayman Islands government under the Tax Concessions Law (1995 Revision) that, in the event that any legislation is enacted in the Cayman Islands imposing tax computed on profits or income, or computed on any capital assets, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, such tax shall not be applicable to the Company or to any of its operations or to the shares, debentures or other obligations of the Company. Therefore, there will be no Cayman Islands tax consequences affecting distributions under present law.

Income taxes have been provided based upon the tax laws and rates in the countries in which the operations are conducted and income is earned. The income tax rates imposed by these taxing authorities may vary substantially. Taxable income may differ from income before taxes for financial accounting purposes. There is no expected relationship between the provision for income taxes and income before income taxes because the countries have different tax regimes which vary not only with respect to the nominal rate, but also in terms of the availability of deductions, credits and other benefits. Variations may also arise because income earned and taxed in any particular country or countries may fluctuate from period to period. Deferred tax assets and liabilities are recognized for the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of the Company's assets and liabilities and the operating losses carried forward using the applicable tax rates in effect at year-end. A valuation allowance for deferred tax assets is recorded when it is more likely than not that some or all of the benefit from the deferred tax asset will not be realized.

### *NET EARNINGS, OR NET INCOME, PER COMMON SHARE*

The Company is required to report basic earnings per share and diluted earnings per share in accordance with US GAAP. Basic earnings per share is determined by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by using the average market price per common share when applying the treasury stock method to determine the number of common share equivalents which should be added to the weighted average number of shares outstanding. For the Company, diluted earnings per share is the same as basic earnings per share since there are no common share equivalents because the Performance Units, which are potentially common share equivalents, are expected to be settled in cash.

### *RECLASSIFICATIONS*

The Company has reclassified certain amounts in the prior period financial statements in order to conform to the current year presentation. Such reclassification had no effect on the Company's net income (loss), financial position or total shareholders' equity but cash flows from operations were decreased by \$377,000 and cash flows from investing activities were increased by the corresponding amount for the year ended December 31, 2000.

### *DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES*

The Company enters into certain derivative financial instruments to manage its exposure to fluctuations in foreign exchange rates and interest rates. Accordingly, the Company recognizes all currency exchange contracts and interest rate swap contracts in the financial statements and measures such contracts at fair value regardless of the purpose or intent for holding them. Changes in the fair market value of derivative financial instruments are either recognized periodically in income or in equity as a component of comprehensive income depending upon whether the derivative is being used to hedge changes in fair value or cash flows.

The Company uses forward currency exchange contracts to reduce the exchange rate risk for specific non-U.S. currency transactions. These contracts require the exchange of USD for non-U.S. currency at a fixed rate with maturities that are generally less than 6 months. The carrying amounts of these contracts are

adjusted to their market values at each reporting date and recorded to income. The Company has entered into forward contracts to sell USD and buy NOK to provide for administrative expenses in Oslo and to sell USD and buy GBP to provide for administrative expenses in London. Realized and unrealized gains and losses on contracts that are not designed for hedging purposes are recorded in net income in the current period.

Interest rate swaps are used to manage exposure to changes in interest rates by adjusting the proportion of total debt that is subject to variable and fixed interest rates. The interest rate terms under the outstanding bank loans provide for a variable, or floating, rate of interest based on LIBOR. Consequently, the Company has entered into interest rate swap contracts and agreed to pay an amount equal to a specified fixed rate of interest multiplied by the notional principal amount and to receive in return an amount equal to a specified variable rate of interest multiplied by the same notional principal amount

#### COMPREHENSIVE INCOME

Comprehensive income represents the change in equity of the Company during a period from transactions and other events and circumstances from nonshareholder sources. Components of comprehensive income include net income or loss, unrealized gains and losses on debt and equity securities classified as available-for-sale and unrealized gains and losses related to the translation of foreign currency financial statements.

#### RECENT ACCOUNTING PRONOUNCEMENTS

Effective July 1, 2001, the Company adopted SFAS 141, *Business Combinations*, that was issued by the Financial Accounting Standards Board (the "FASB"). SFAS 141 supercedes APB Opinion No. 16, *Business Combinations*, and requires that all business combinations initiated or completed after June 30, 2001 be accounted for using the purchase method of accounting. The adoption of the new statement had no effect on the consolidated results of operations or financial position of the Company.

Effective January 1, 2002, the Company adopted SFAS 142, *Goodwill and Other Intangible Assets*. SFAS 142 supercedes APB Opinion No. 17, *Intangible Assets*, and states that goodwill will no longer be amortized but will be tested at least annually for impairment using a fair value approach rather than an undiscounted cash flow approach. Further, goodwill will be tested for impairment at a level referred to as a reporting unit which is generally a level lower than that of the consolidated entity.

SFAS 142 requires that entities perform the first goodwill impairment test, by comparing the fair value with the book value of the reporting unit, on all reporting units within six months of adopting the statement. At the end of November 2002, the Company recorded goodwill following the acquisition of DSND when the Company acquired a controlling interest in DSND, accounted for the acquisition using the purchase method and commenced the consolidation of DSND's financial statements. The fair value analysis was based on reporting unit cash flows, industry segment ratios and other relevant assumptions. Although the Company believes that its analysis is reasonable, changes in industry conditions, geographic exploration, drilling and production demands and other variables possibly affecting estimated cash flows of the reporting units, comparable financial ratios and anticipated future performance can materially impact future impairment analyses. Goodwill of a reporting unit will be tested for impairment on an annual basis or sooner if an event occurs or circumstances change such that it has become more likely than not that the fair value of a reporting unit has been reduced below its book value.

A provision of the above-mentioned SFAS 141 states that, upon adoption of SFAS 142 and with respect to any business combination culminating before July 1, 2001, all amounts of unamortized deferred credit related to an excess of the fair value of assets acquired and liabilities assumed over the fair value of the consideration paid will be written off and recognized as the cumulative effect of a change in accounting principle. With respect to business combinations being completed after June 30, 2001, any excess amount of the fair value of assets acquired and liabilities assumed over the fair value of the consideration paid is recorded as an extraordinary item.

Effective January 1, 2002, the Company changed its method of accounting for deferred credits arising from the excess of the fair value of assets acquired and liabilities assumed over the fair value of the consideration paid. Under the previous method, STAR recorded the excess amount which arose in January

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2001 as a deferred credit and was amortizing such amount into income over a period of 10 years. Under the new method, the deferred credit was written off. The adjustment was reported as the cumulative effect of an accounting change and increased income by \$2,133,000 for the year ended December 31, 2002. The following table summarizes the historical results compared to unaudited pro forma effects of SFAS 142 had deferred credits not been amortized during 2001:

<i>(in thousands)</i>	<i>2001</i>
Net loss	\$ (27,883)
Add back: deferred credit amortization, net of taxes	(237)
Pro forma net loss	\$ (28,120)
Basic and diluted net loss per share	\$ (1.64)
Add back: deferred credit amortization, net of taxes	(0.01)
Pro forma basic and diluted net loss per share	\$ (1.65)

There was no proforma effect of the adoption of SFAS 142 for the year ended December 31, 2000.

In August 2001, the FASB issued SFAS 143, *Accounting for Asset Retirement Obligations*. Under SFAS 143, companies are required to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. The asset retirement costs must be capitalized as part of the carrying amount of the related long-lived asset and subsequently amortized to expense. SFAS 143 is effective for fiscal years beginning after June 15, 2002. The adoption of SFAS 143 is not expected to have a material impact on the consolidated results of operations, cash flows or financial condition.

Effective January 1, 2002, the Company adopted SFAS 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. SFAS 144 supersedes SFAS 121, *Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*, and the accounting and reporting provisions of APB 30, *Reporting the Results of Operations – Reporting the Effects of the Disposal of a Segment of a Business*, and *Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. SFAS 144 retains the fundamental provisions of SFAS 121 for recognition and measurement of long-lived asset impairment and for the measurement of long-lived assets to be disposed of by sale and the basic requirements of APB30. In addition to these fundamental provisions, SFAS 144 provides guidance for determining whether long-lived assets should be tested for impairment and specific criteria for classifying assets to be disposed of as held-for-sale.

In May 2002, the FASB issued SFAS 145, *Rescission of SFAS Nos. 4, 44, and 64, Amendment of SFAS 13, and Technical Corrections as of April 2002*. SFAS 145 rescinds FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*, and an amendment to that Statement, FASB Statement No. 64 *Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements*. SFAS 145 also amends other existing authoritative pronouncements to make various technical corrections, clarify meanings, or describe their applicability under changed conditions. SFAS 145 is effective for fiscal years beginning after May 15, 2002. The adoption of SFAS 145 is not expected to have a material effect on the results of operations, cash flows or financial position.

In July 2002, the FASB issued SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by this guidance include termination benefits provided to current employees that are involuntarily terminated under the terms of a benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract, costs to terminate a contract that is not a capital lease, and costs to consolidate facilities or relocate employees. SFAS 146 is effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. The adoption of SFAS 146 is not expected to have a material effect on the results of operations, cash flows or financial position.

In December 2002, the FASB issued SFAS 148, *Accounting for Stock-Based Compensation – Transition and Disclosure – an Amendment of FASB Statement No. 123*. SFAS 148 provides for alternative methods of transition for a voluntary change to the fair-value-based method of accounting for stock-based employee compensation.

In addition, this statement amends the disclosure requirements of SFAS 123 to require prominent disclosures in both annual and interim financial statements concerning the method of accounting for stock-based employee compensation and the effect of the method used on reported results. This statement requires that those effects be disclosed more prominently by specifying the form, content and location of those disclosures. SFAS 148 improves the prominence and clarity of the pro forma disclosures required by SFAS 123 by prescribing a specific tabular format and by requiring disclosure in the Summary of Significant Accounting Policies or its equivalent. In addition, this statement improves the timeliness of those disclosures by requiring their inclusion in interim financial reports. SFAS 148 is effective for financial for fiscal years beginning after December 15, 2002. The adoption of SFAS 148 is not expected to have a material effect on the results of operations, cash flows or financial position.

In April 2003, the FASB issued SFAS 149, *Amendments of Statement 133 on Derivative Instruments and Hedging Activities*. The changes in SFAS 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. In particular, SFAS 149: (1) clarifies the circumstances under which a contract with an initial net investment meets the characteristic of a derivative, (2) clarifies when a derivative contains a financing component, (3) amends the definition of an underlying to conform it to language used in FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* and (4) amends certain other existing pronouncements. This Statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The adoption of SFAS 149 is not expected to have a material effect on the results of operations, cash flows or financial position.

In May 2003, the FASB issued SFAS 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within the scope of SFAS 150 as a liability (or an asset in some circumstances). SFAS 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. The adoption of SFAS 150 is not expected to have a material effect on the results of operations, cash flows or financial position.

In November 2002, the FASB issued FASB Interpretation No. 45 ("FIN 45"), *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an Interpretation of FASB Statement Nos. 5, 57 and 107 and Rescission of FASB Interpretation No. 34*. FIN 45 clarifies the requirements of FASB Statement No. 5, *Accounting for Contingencies* ("FAS 5"), relating to the guarantor's accounting for and disclosure of certain types of guarantees. The disclosure provisions of FIN 45 are effective for financial statements of interim and annual periods that end after December 15, 2002; however, the provisions for initial recognition and measurement are effective on a prospective basis for guarantees that are issued or modified after December 31, 2002, irrespective of the guarantor's year-end. The adoption of FIN 45 for the year ended December 31, 2002 did not have an impact on the Company's financial position or results of operations.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), *Consolidation of Variable Interest Entities*. FIN 46 clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain entities in which the equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 applies immediately to variable interest entities created after January 31, 2003 and to variable interest entities in which an enterprise obtains an interest after that date. It applies to fiscal years beginning after June 15, 2003 to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. FIN 46 applies to public enterprises as of the beginning of the applicable interim or annual period. The Company believes that further evaluation is required in order to fully quantify the impact, if any, of this interpretation.

In June 2001, the Accounting Standards Executive Committee ("AcSEC") of the AICPA issued an exposure draft of a proposed Statement of Position (SOP), *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*. This SOP provides guidance on accounting for certain costs and activities

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

relating to property, plant, and equipment (PP&E). For purposes of this SOP, a project stage or timeline framework is used and PP&E assets are accounted for at a component level. Costs incurred for PP&E are classified into four stages: preliminary, preacquisition, acquisition-or-construction and in-service. The SOP requires, among other things, that preliminary, preacquisition and acquisition-or-construction stage costs, except for payments to obtain an option to acquire PP&E, should be charged to expense as incurred. Costs related to PP&E that are incurred during the in-service stage, including costs of normal, recurring, or periodic repairs and maintenance activities, should be charged to expense as incurred unless the costs are incurred for acquisition of additional PP&E or components of PP&E or the replacement of existing PP&E or components of PP&E. Costs of planned major maintenance activities are not a separate PP&E asset or component. Those costs should be charged to expense, except for acquisitions or replacements of components that can be capitalized under the in-service stage guidance of this SOP. The AcSEC is currently reviewing comment letters on the SOP and is expected to present it to the FASB by mid-2003. Accordingly, the SOP remains subject to change.

Effective January 1, 2002, the Company changed its method of accounting for drydocking costs to the "expense as incurred" method. Under the previous accounting method, STAR and DSND followed a program of classification and scheduled, periodic drydockings of the vessels. STAR accumulated, capitalized and amortized the costs incurred on these periodic dry-docking over the period until the next scheduled drydocking whereas DSND estimated the costs of future drydockings and accrued the expected cost by charging expense on a pro rata basis over the period until the next scheduled drydocking. The adjustments of the balances of capitalized drydocking costs and accrual for drydockings were reported as the cumulative effect of an accounting change and reduced net income by \$1,092,000 for the year ended December 31, 2002. It was impractical for the Company to obtain the amounts on a pro forma basis for the years ended December 31, 2001 and 2000. Management considers the expense as incurred method to be a more consistent and reliable approach to recognizing drydocking costs because it eliminates the uncertainties associated with estimating the costs and timing of future drydockings.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(2) UNCONSOLIDATED AFFILIATES

A summary of the equity in net income (losses) of and the investments in unconsolidated affiliates as of and for the years ended December 31 is presented below:

Year Ended	Affiliate	Percentage Ownership	Summary of Unconsolidated Affiliates (in thousands)	
			Equity in Net Income (Loss)	Investments in
December 31, 2002	Subsea 7	50.00%	\$ (67)	\$ 149,164
	Overseas Drilling Ltd.	50.00%	3,127	3,557
	NYK STAR Reefers	50.00%	212	212
	Four Seasons	64.00%	(1,745)	14,927
	DSND		(3,418)	—
	Other		(935)	5,543
			\$ (2,826)	\$ 173,403
December 31, 2001	DSND	27.28%	\$(12,923)	\$ 48,759
	Four Seasons	64.00%	1,709	16,672
	Other		1,380	3,902
			\$ (9,834)	\$ 69,333
December 31, 2000	DSND	26.51%	\$(12,324)	\$ 53,639
	Four Seasons	64.00%	—	14,963
	Other		(373)	2,652
			\$(12,697)	\$ 71,254

The Company accounted for its investment in DSND using the equity method from May 1994 when the investment originated until November 2002 when the Company acquired a controlling interest and commenced the consolidation of DSND's financial statements. The Company has used the equity method to account for its investments in Four Seasons and NYK STAR Reefers since February 1998 and November 2001, respectively.

DSND – The Company's ownership interest in DSND has fluctuated since its original investment in 1994 as the result of equity offerings by DSND and purchases by the Company. During 2002, 2001 and 2000, the Company made market purchases of 6,993,400 shares, 1,919,120 shares and 1,754,500 shares, respectively, of DSND. In November 2002, the Company underwrote and subscribed for shares in a private placement by DSND, eventually, acquiring a total of 16,556,761 shares at NOK17.00 per share. In December 2002, the Company completed a mandatory offer to existing shareholders for shares of DSND. The mandatory offer, which became necessary after the Company's ownership interest exceeded 40%, resulted in the acquisition of an additional 18,343,468 from shareholders who tendered their shares at the offer price of NOK17.50 per share.

The acquisition of a controlling interest was considered effective at the end of November 2002. Accordingly, the Company reported equity in the income (losses) of DSND for the 11-month period through November 2002; thereafter, the Company consolidated the financial position, results of operations and cash flows of DSND within its consolidated financial statements.

*Subsea 7 Inc. and Overseas Drilling Ltd.* – As a consequence of the consolidation of DSND, the investments that DSND accounted for under the equity method are now reflected as equity investments within the Company's consolidated financial statements. The most significant of these are Subsea 7 and Overseas Drilling. Due to the significance of DSND's investment in Subsea 7 at the end of 2002, the summarized statement of operations of Subsea 7 for the seven month period of operations from inception to December 31, 2002 and the balance sheet at December 31, 2002 are presented as follows:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(in thousands)	Inception-to-December 31, 2002
Operating revenues	\$ 457,454
Operating expenses	(452,672)
Net other	(4,344)
Income tax (expense) benefit	240
Net income	\$ 678
(in thousands)	December 31, 2002
Current assets	\$ 239,296
Property and equipment	352,364
Noncurrent assets	18,324
Total assets	\$ 609,984
Current liabilities	\$ 186,864
Noncurrent liabilities	209,948
Other	5,336
Shareholders' equity	207,836
Total liabilities and shareholders' equity	\$ 609,984

Subsea 7 commenced operations at the end of May 2002 and represents the consolidation of the offshore activities of DSND and Halliburton Subsea, a business unit of Halliburton Company's Energy Services Group, involving subsea pipelaying operations and the installation and maintenance of various types of subsea installations. Subsea 7 controls 20 vessels, many of which are highly-specialized, dynamically-positioned vessels, that perform deepwater reeled and flexible pipelaying, deepwater subsea construction, saturation diving and surveys. In addition, Subsea 7 owns and operates one of the world's largest fleets of remotely-operated vehicles ("ROV") and three pipeline construction yards. Subsea 7 is represented in all of the important, deep-water markets for subsea activities.

Overseas Drilling is a single-purpose joint venture that time charters the vessel, *Joides Resolution*, to the Ocean Drilling Program through the end of September 2003.

*NYK STAR Reefers* – Most of the reefer vessels owned by STAR and NYK are commercially operated by NYK STAR Reefers, a 50/50-owned pool company, that commenced operations in November 2002.

*Four Seasons* – The Company acquired a 64% interest in share capital and a 50% voting interest in Four Seasons for \$18,425,000 in February 1998. The remaining 36% share capital and 50% voting interest is held by the managers of Four Seasons. Terms of the agreement provide that the Company will receive the initial proceeds from the sale of Four Seasons' investments to reduce its share capital until such time that each of the parties hold a 50% interest; thereafter, the proceeds from additional sales will be split evenly. Since the acquisition, Four Seasons has continued to hold interests in several industrial companies, including Broström AB ("Broström"), a leading logistics company for the oil and chemical industries and owner of a global fleet of more than 60 vessels; and an interest in EFG European Furniture Group AB ("EFG"), a developer, manufacturer and marketer of furniture for offices and public areas and one of the largest such companies in Europe. The other companies are engaged in commercial activities based on proprietary and protected advanced technology products.

Four Seasons' ownership interests in its various investee companies ranges from 12% to 40% with only two exceptions that are considered to be immaterial.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(3) MARKETABLE EQUITY SECURITIES

At December 31, 2002 and 2001, the Company has classified its investments in marketable equity securities as either trading (shown in aggregate) or available-for-sale securities. Summaries of these securities at December 31 are presented below:

<i>(in thousands, except for no. of shares)</i>	<i>No. of Shares</i> 2002	2002	2001
Current:			
Trading securities		\$ 12,296	\$ 14,535
Net fair value of current marketable equity securities		\$ 12,296	\$ 14,535
Noncurrent:			
Transocean	1,423,720	\$ 9,247	\$ 9,996
Net cost of noncurrent marketable equity securities		9,247	9,996
Net unrealized appreciation on securities available-for-sale		23,783	42,044
Net fair value of noncurrent marketable equity securities		\$ 33,030	\$ 52,040

*Transocean* – The Company’s investment in *Transocean* originated in 1994 as an investment in a company that was subsequently merged into *Transocean*. The Company has sold some of its *Transocean* shares in the past. The most recent sale, and only sale during the past two years, involved the sale of 115,000 shares in May 2002 that generated a gain of \$3,496,000.

The fair value of marketable securities is estimated using quoted market prices of these or similar investments when available.

(4) SENIOR SECURED NOTES, NOTES RECEIVABLE AND OTHER INVESTMENTS

The summaries of the senior secured notes and notes receivable at December 31 are presented below:

<i>(in thousands)</i>	2002	2001
NOK100mm Note	\$ –	\$ 11,179
\$9.3mm Note	–	9,300
DSND Bonds	–	39,128
Planestation Note	3,512	3,722
ARC Notes	–	17,533
Other notes receivable	5,438	6,285
	8,950	87,147
Less impairment	–	(2,067)
Net cost of short-term senior secured notes and notes receivable	\$ 8,950	\$ 85,080
SARF Portfolio	\$ 29,704	\$ 47,010
Other notes receivable	4,763	4,161
	34,467	51,171
Less impairment	(7,549)	(7,549)
Net cost of long-term senior secured notes and notes receivable	\$ 26,918	\$ 43,622

*DSND* – In June 2000, *DSND*’s shareholders approved a proposal to issue subordinated convertible bonds in a minimum amount of NOK450,000,000 with shareholders as of that date holding preferential rights. Terms of the bond issue provided for interest at 7% p.a. with interest payable annually in arrears, maturity at July 19, 2002 and convertibility of the bonds plus accrued interest at a conversion price of NOK60 per shares (the “*DSND Bonds*”). The Company committed NOK375,000,000 to a syndicate formed to underwrite the *DSND Bonds*. At closing, the Company acquired NOK350,000,000 of the bond issue.

In November 2000, the Company advanced a NOK100,000,000 loan to *DSND*. Terms of the loan provided for interest at 12% p.a., a front fee of 1% and maturity in mid-February 2001 (the “*NOK100mm Note*”). Security was provided in the form of a Sale and Lease-Back Option on the *DSND Pelican*.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In June 2001, the Company advanced an unsecured loan of \$9,300,000 to DSND. Terms of the loan provided for interest at 12% p.a. and maturity in September 2001 (the "\$9.3mm Note"). At this time, the NOK100mm Note was extended to November 2001 to correspond to the maturity of the \$9.3mm Note. During the last quarter of 2001, DSND was engaged in extensive negotiations to merge its subsea assets with the subsea assets of Halliburton Subsea, a business unit of Halliburton Company's Energy Services Group and extensions of the maturity dates were granted to July 2002 to coincide with the maturity of the DSND Bonds.

In July 2002, the holders of DSND Bonds met and agreed to extend the maturity date of the bonds to November 2002. As consideration for the extension, DSND agreed to pay a 0.2% fee and increase the interest rate to 9% p.a. In conjunction with the extension of the maturity date for the DSND Bonds, the Company agreed to extend the maturity dates for both the NOK100mm Note and the \$9.3mm Note.

In October 2002, DSND proposed a financial restructuring plan to refinance its short-term loans. The final plan consisted of a private placement of equity in the amount of NOK370,000,000 at NOK17 per share and a new bond issue in the amount of NOK300,000,000. Following the completion of the private placement, the Company received a net 16,556,761 newly-issued DSND shares. The purchase price was paid by using NOK40,000,000 cash and by offsetting amounts outstanding under the DSND Bonds, including NOK244,061,000 of principal and all accrued and unpaid interest. The remaining NOK105,939,000 principal amount of DSND Bonds became a note payable at an interest rate of 12% p.a. and was secured with proceeds to be received from the new bond issue.

The Company's acquisition of DSND shares in the November private placement increased its interest in DSND to more than 50%. Thereafter, the financial position and results of operations of DSND were included in the Company's consolidated financial statements and, accordingly, the outstanding notes receivable recorded by the Company were eliminated, or offset, against the outstanding notes payable recorded by DSND.

In January 2003, the new bond issue for DSND for NOK300,000,000 was closed. The Company acquired a total of NOK219,610,000 of the bonds (the "Convertible DSND Bonds") that bear interest at 8% p.a., mature in January 2006 and are convertible into DSND shares at a rate of NOK20 per share. The purchase price was paid by using NOK10,345,000 cash and by offsetting principal and interest amounts outstanding under the NOK100mm Note and the remaining NOK105,939,000 of DSND Bonds. DSND used cash proceeds from the bond issue to repay the \$9.3mm Note in its entirety.

*Planestation Note* – In July 2001, the Company acquired an 83.33% interest in a joint venture whose sole purpose was to provide a loan in the amount of GBP3,000,000 to a company engaged in the development of properties surrounding regional airports in Europe (the "Planestation Note"). Terms of the loan provided for interest at 7.25% p.a., maturity in July 2002 and a backend fee. Security was in the form of property acquired for development purposes. The loan was refinanced in July 2002 by the company's parent, a publicly-traded U.K. company, which became the primary borrower. Terms of the refinancing included capitalization of the backend fee, an increase in the interest rate to 9% p.a., maturity in March 2003 and an increase in the properties placed as security for the loan. The Company determined that it would not recognize the capitalization of the backend fee until the collection became more probable and, thereby, established a reserve for the full amount of the capitalized backend fee.

*SARF Portfolio* – In June 2000, the Company activated SARF to commence the process of purchasing debt securities, both listed and unlisted securities, which are issued by companies operating in those industries in which the Company has gained wide experience. The initial focus of SARF's investments was on companies engaged in the shipping, energy services and financial services industries.

At the end of December 2001, the Company evaluated the investments in SARF. SARF held a small investment in a European telecommunications company that had submitted itself to bankruptcy proceedings. A second company engaged in the oil and gas industry was experiencing liquidity problems. Following this evaluation, the Company recorded an impairment on such investments during 2001 of \$9,615,000.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The portfolio for SARF decreased during 2002 as the underlying investments were either sold or refinanced. Also in 2002, SARF recovered an additional \$1,301,000 from the telecommunications company. SARF evaluated the remaining investment and wrote-off the balance against the impairment reserve.

*ARC Notes* – In September 2001, the Company together with Vroon B.V., acquired a total of \$67,640,000 face value of bonds issued by Amer Reefer Co. Limited (“ARC”), a holding company for shipowning companies controlling 7 reefer vessels. The purchase price was approximately \$35,067,000, or \$0.52 per dollar of face value (the “ARC Notes”). The Company and Vroon agreed that each partner would receive 50% of the ARC Notes, or \$33,820,000, and register the ARC Notes under their respective names. The ARC Notes, purchased after ARC had entered into Chapter 11 reorganization proceedings, represented 67.64% of the \$100,000,000 bond offering conducted by ARC in 1998.

The debtors, together with the largest minority bondholder, filed a plan of reorganization that provided for a recapitalization of the holding company and a payment of \$0.56 per dollar of face value of bonds. The Company and Vroon jointly filed a competing plan of reorganization that equitized the ARC Notes and continued ARC as an ongoing operation. In July 2002, the bondholders and related parties agreed to a settlement whereby the Company and Vroon would receive \$0.67 per dollar of face value of bonds and would be entitled to interest on such amounts at 3-month LIBOR plus a margin that increased over time. In October 2002, the Company and Vroon received payment in full of the agreed-upon settlement amounts.

The net recorded value of senior secured notes, notes receivable and other investments approximates the fair value of such notes at December 31, 2002.

### (5) GAINS (LOSSES) FROM INVESTMENTS AND SALES OF PROPERTY AND EQUIPMENT

A summary of the net gains (losses) related to the Company’s investments, both realized and unrealized, and the sales of property and equipment for the years ended December 31 is presented below:

<i>(in thousands)</i>	2002	<i>Year Ended December 31,</i>	
		2001	2000
Investments:			
Gross realized gains (losses), net	\$ 14,530	\$(15,523)	\$ 106,636
Gross unrealized gains (losses), net	(7,446)	(12,805)	(4,737)
Gains (losses) related to investments, net	7,084	(28,328)	101,899
Property and equipment	1,522	–	–
Gains (losses), net	\$ 8,606	\$(28,328)	\$ 101,899

Net aggregate currency exchange gains (losses) of approximately \$19,640,000, \$(538,000) and \$(1,188,000) were recognized during 2002, 2001 and 2000 on the sales of investments and on the adjustments of investments to fair value at the end of each reporting period.

### (6) BUSINESS COMBINATIONS

*Investment in DSND Inc.* – In October 2002, DSND Inc., a recently established Cayman Islands company whose sole purpose is to own the shares issued by both DSND Subsea ASA and its subsidiaries, made a voluntary offer to exchange one of its shares for each tendered share of DSND Subsea. By the end of October, a total of 55,876,995 shares, or 92.6%, of DSND Subsea’s shares had been tendered, including the 18,756,024 shares owned by the Company which consisted of the shares owned at the end of 2001 and the purchase of 2,300,000 additional shares in May 2002. In November 2002, DSND Inc. made a mandatory offer to remaining DSND Subsea shareholders to either tender their shares for NOK13.50 cash or exchange each DSND Subsea shares for one share of DSND Inc. In conjunction with the mandatory offer, DSND Inc. undertook a compulsory acquisition of any shares that remained outstanding following the mandatory offer. By the conclusion of the mandatory offer and compulsory acquisition, DSND Inc. had acquired an additional 3,161,097 shares of DSND Subsea through the share exchange and had purchased the remaining outstanding DSND Subsea shares.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In October 2002, DSND proposed a financial restructuring plan to refinance its short-term loans. The final details consisted of a private placement of NOK370,000,000 at NOK17 per share and a new bond issue in the amount of NOK300,000,000.

At the end of October 2002, the Company purchased an additional 4,693,400 shares of DSND at NOK17.50, to increase its ownership to approximately 40% of DSND. In November 2002, the Company acquired a net 16,556,761 additional shares in the private placement, thus increasing the Company's ownership to approximately 50%, of DSND.

As a result of the Company's increase in ownership in DSND to 40%, it became necessary for the Company to either reduce its ownership to below 40% or to extend a mandatory offer to all DSND shareholders to purchase tendered shares at the highest price by the Company for DSND shares during the previous six months. Therefore, in November 2002, the Company submitted its mandatory offer to purchase shares of DSND at NOK17.50 per share. By the conclusion of the mandatory offer in late December 2002, the Company had acquired an additional 18,343,468 shares to increase its ownership to 72.2% in DSND.

The recent series of acquisitions of DSND shares by the Company were accounted for using the purchase method of accounting. Accordingly, the fair values of DSND's assets were evaluated and a portion of the purchase price was allocated to the relevant assets and the balance was recorded as goodwill. DSND's results were accounted for under the equity method of accounting through the end of November 2002 and have been included in the Company's consolidated financial statements thereafter.

A summary of the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition is presented below:

<i>(in thousands)</i>	<i>November 30, 2002</i>
Current assets	\$ 51,397
Investments in unconsolidated affiliates	151,243
Net vessels and related assets	22,839
Goodwill	38,397
Other	181
Current liabilities	(73,366)
Long-term debt and current maturities	(15,776)
Other long-term liabilities	(1,916)
Net assets acquired	\$ 172,999

The investments in unconsolidated affiliates includes an increase of \$45,246,000 which is attributed to the increased value of Subsea 7.

*Investment in Siem Thoen Car Carriers Inc.* – In June 2002, the Company and a third party established STCC, a Cayman Islands company, with the Company's ownership interest being approximately 88.1%. In July 2002, STCC completed the acquisition of three car carrier vessels for approximately \$106,500,000 and financed the purchase with \$90,000,000 of bank loans. The vessels are sister ships delivered in 2000 with a carrying capacity of 4,300 cars and 400 high and heavy units. The vessels are currently under separate charters to the transport division of Volkswagen through mid-2005.

*Investment in STAR Reefers Inc.* – In January 2001, the Company participated in a \$44,250,000 bridge financing agreement for Swan Reefer ASA ("ASA" and "AS" denote publicly-traded and non-publicly-traded Norwegian companies, respectively; "Swan Reefer AS" will be used hereinafter to reflect the status of the company following its acquisition by Swan Reefer Inc.) which was made in a transaction concurrent with the refinancing of Swan Reefer AS's bank facilities. The participants in this bridge financing facility subsequently contributed the facility to a newly-incorporated Cayman Islands company, Swan Reefer Inc. (see "Purchase of Albion Reefers Limited" below for discussion on the change of name to "STAR Reefers Inc."), as cash payment for new shares that had been subscribed through an underwriting by the participants. At the end of January 2001, Swan Reefer Inc. and Swan Reefer AS entered into an agreement whereby the bridge financing agreement was refinanced with a convertible loan agreement in the amount of NOK392,046,150, that

was

equivalent to \$44,250,000. Terms of the agreement provided that the loan bears interest at LIBOR plus 4% p.a. with the interest accrued quarterly until the New Fortis Bank Syndicate credit facility is repaid (see Note 9). The loan matures no later than six years from the date of drawdown and can be fully or partially converted into new shares of Swan Reefer AS at a rate of NOK57.50 per share.

The Company's participation in the bridge financing facility was approximately \$35,950,000. Immediately following the contribution of the facility as payment for the subscription of new shares in Swan Reefer Inc., the Company held 81.3%. After the completion of the compulsory and mandatory offers that were undertaken in order for Swan Reefer Inc. to become the 100% owner of Swan Reefer AS, the Company's interest was reduced to 70.9%.

In July 2001, Swan Reefer Inc. purchased Albion Reefers Limited, a subsidiary of the Vestey Group that operated under the trade name "Star Reefers". The purchase included the acquisitions of six reefers built in the mid-1980's, the charters for an additional 18 vessels and the Star Reefers London marketing operation. The total purchase price of \$34,800,000 was paid using a \$19,000,000 bank loan (see Note 9), the issuance of 710,500 new shares of Swan Reefer Inc. and the assumption of time charter liabilities of approximately \$11,400,000. The purchase was accounted for using the purchase method of accounting and the purchase price reflected the estimated fair value of net assets acquired. Subsequent to this acquisition, the shareholders of Swan Reefer voted to change its name to STAR Reefers Inc.

The Company's ownership interest was diluted to 64.3% following the purchase of Albion Reefers Limited. In December 2001, the Company acquired 500,000 shares from the sellers of Albion Reefers to increase its ownership to 73.2%.

In October 2002, the Company issued a dividend that was payable at the option of the individual shareholders in either cash or newly-issued shares of STAR. The Company elected to take shares and received 69,347 shares to increase its holding to 5,612,015 shares, or 73.4%, of STAR.

*NYK STAR Reefers* – In the latter half of 2001, STAR and Nippon Yusen Kaisha ("NYK"), a large Japanese shipping conglomerate, established NYK STAR Reefers Limited to be owned on a 50/50 basis. NYK STAR Reefers operates as a joint pool and marketing vehicle that is responsible for all chartering activities of the fleet presently owned and operated by STAR and NYK. The pool commenced trading November 1, 2001, operates approximately 70 vessels and constitutes one of the most modern fleets available to charterers and shippers of fruit and other perishable food.

(7) PROPERTY AND EQUIPMENT

Summaries of the vessels and related shipping assets and property, plant and equipment at December 31 are presented below:

<i>(in thousands)</i>	2002	2001
Vessels and related assets	\$ 318,558	\$ 193,934
Property, plant and equipment	7,639	5,918
Other	3,489	846
Capitalized dry-docking, net of amortization	—	2,681
	329,686	203,379
Less accumulated depreciation	30,883	9,856
<b>Net vessels and related shipping assets</b>	<b>\$ 298,803</b>	<b>\$ 193,523</b>

In May 2002, STAR sold 2 vessels, each with a capacity of 691,000 cbft and built in 1983 and 1984, for a net amount of \$13,000,000 and recognized a loss of approximately \$700,000. Proceeds from the sale were used to make a prepayment on debt. The vessels were taken back on time charters for a 2 year period at prevailing market rates.

In October 2002, STAR purchased five vessels from the Great White Fleet, a subsidiary of Chiquita International Brands, Inc., for \$54,000,000. The vessels, with a capacity ranging from 426,000 cbft to 487,000 cbft, were built between 1992 and 1994.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In December 2002, STAR sold one of its subsidiaries, the owner of four vessels, for a net amount of \$10,400,000 and recognized a gain of approximately \$2,200,000. Three of the vessels had a capacity of 595,000 cbft and were built in 1991 and the remaining vessel had a capacity of 424,000 cbft and was built in 1992. All of the vessels were taken back on bareboat charters for an 8-year period with purchase options. The sale-leaseback is accounted for as an operating lease. STAR provided seller's credit in the amount of \$4,800,000 that bears interest at 5% p.a. with interest and principal payable in 48 monthly installments.

STAR owned 23 vessels at the end of 2002. The average values of three broker appraisals indicated that the appraised values approximate market values. An analysis prepared using undiscounted cash flows indicated that no writedown is necessary.

The portion of DSND's fleet that was not transferred to Subsea 7 consists of 13 fully-owned, 2 partly-owned and 2 chartered vessels. In addition, DSND acts as the manager for 3 other vessels.

DSND performed an analysis of the vessels for impairment and determined that an impairment charge of \$4,500,000 should be recorded for December 2002. The analysis used valuations obtained from shipbrokers. Such amount is recorded as a depreciation expense in the consolidated statements of operations.

### (8) OPERATING LEASES

Charter-hire payments to third parties for certain contracted-in vessels are accounted for as operating leases. The future minimum rental payments under the Company's non-cancelable operating leases are presented below:

<i>Years Ended December 31,</i>	<i>Minimum Lease Payments (in thousands)</i>
2003	\$ 65,703
2004	46,032
2005	23,689
2006	24,278
2007	24,278
2008 and thereafter	62,793
Total	\$ 246,773

The net present value of the minimum lease payments using a 6% discount rate is \$202,410,000.

Total lease expense for operating leases was approximately \$45,721,000 and \$29,324,000 for the years ended December 31, 2002 and 2001.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(9) LONG-TERM DEBT

A summary of long-term debt and notes payable, net of unamortized discounts, premiums and fair value adjustments, at December 31 is presented below:

<i>(in thousands)</i>	<i>Interest Rate</i>	2002	2001
\$53mm Revolver	LIBOR plus 1.25%	\$ 41,000	\$ 49,000
\$30mm Revolver	LIBOR plus 0.25%	18,000	23,000
\$20mm Revolver	LIBOR plus 1.625%	—	5,500
\$6.3mm Loan	LIBOR plus 0.50%	—	6,300
\$3mm Loan	12.00%	3,000	3,000
Fortis Bank Syndicate			
Tranche A	LIBOR plus 1.35%	—	76,000
Tranche B	LIBOR plus 1.35%	—	52,500
Tranche C	LIBOR plus 1.35%	—	19,000
Gjensidige NOR Syndicate		—	10,500
New Fortis Bank Syndicate			
Tranche A	LIBOR plus 1.625%	35,200	—
Tranche B	LIBOR plus 2.25%	8,100	—
Tranche C	LIBOR plus 1.625%	67,875	—
Tranche D	LIBOR plus 1.625%-2.00%	18,475	—
NOK36.5mm Loan	7.45%	5,089	4,042
\$90mm Syndicate			
Senior Tranche	LIBOR plus 1.375%	63,000	—
Junior Tranche	LIBOR plus 2.00%	27,000	—
Olympic Princess Loan		7,414	—
Other		6,377	721
		300,530	249,563
Less current maturities of long-term debt and notes payable		30,908	20,863
Long-term debt and notes payable		\$ 269,622	\$ 228,700

The scheduled maturities of the face values of the Company's debt and notes payable for each of the years ended December 31 are presented below:

<i>Years Ended December 31,</i>	<i>Maturities (in thousands)</i>
2003	\$ 30,908
2004	28,024
2005	86,040
2006	26,871
2007	122,851
2008 and thereafter	5,836
Total	\$ 300,530

*Revolving Credit Facilities* – Since April 1997, the Company has benefited from a \$53,000,000 revolving credit facility (the “\$53mm Revolver”) provided by NordlandsBanken ASA. Terms of the \$53mm Revolver provide for interest at a rate of LIBOR plus 1.25%, a commitment fee of 0.25% payable quarterly on any undrawn portion of the facility, maturity in April 2005 and security in the form of a pledge of marketable equity securities. The weighted average interest rate for this revolver during 2002 was 2.92%. During 2002 and 2001, the Company received drawdowns of \$45,000,000 and \$25,500,000, respectively, and repaid \$53,000,000 and \$5,500,000, respectively.

Since August 1998, the Company has benefited from a \$30,000,000 revolving credit facility (the “\$30mm Revolver”) provided by Nordea Bank S.A. Terms of the \$30mm Revolver provided for interest at LIBOR plus 0.25%, maturity in October 2005 and security in the form of a pledge of marketable equity

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

securities. The weighted average interest rate for this revolver during 2002 was 2.13%. During 2002 and 2001, the Company received drawdowns of \$0- and \$23,000,000, respectively, and repaid \$5,000,000 and \$0-, respectively. Due to changing values of securities in the portfolio and requirements to maintain diversity within the pledged assets, the Company maintained a cash collateral of approximately \$9,914,000 as additional security for the facility at the end of fiscal 2002.

Since September 2000, SARF had benefited from a \$20,000,000 revolving credit facility (the "\$20mm Revolver") provided by NordlandsBanken. Terms of the \$20mm Revolver provided for interest at LIBOR plus 1.625%, a commitment fee of 0.25% is payable at the end of each quarter on the undrawn balance of the facility, maturity in September 2003 and security in the form of a pledge of bonds and other marketable equity securities purchased by SARF. The weighted average interest rate for this revolver during 2002 was 3.58%. During 2002 and 2001, SARF repaid \$5,500,000 and \$12,000,000, respectively. By mutual agreement, the facility was terminated in December 2002.

*Term Loan Agreements* – In June 2001, the Company entered into an agreement with Privatbanken ASA for a \$6,300,000 term loan (the "\$6.3mm Loan"). Terms included interest at LIBOR plus 0.50%, maturity in December 2001 and security in the form of a pledge of cash. The Company requested and received a 6-month extension of the maturity date to June 2002 and a 6-month extension to December 2002. The weighted average interest rate for this floating rate loan during 2002 was 2.38%. The amounts outstanding under the loan facility were prepaid in October 2002.

In June 2001, the Company entered into an agreement with the Company's Chairman for a \$3,000,000 term loan (the "\$3mm Loan"). The proceeds from this loan were combined with the proceeds from the \$6.3mm Loan to provide the \$9.3mm Note to DSND (see Note 4). Because the security for the \$3mm Loan is a pro rata interest in the \$9.3mm Note without further recourse to the Company and because the lender therefore assumes the same risk as the Company, the terms of the loan reflect the terms of the \$9.3mm Note. That is, the terms included interest at 12% p.a. with principal and interest payable at maturity of the \$9.3mm Note. The amounts outstanding under the loan facility were repaid in January 2003 using proceeds from the collection of the \$9.3mm Note.

In April 2001, DSND Bygg AS, a Norwegian company established for the express purpose of constructing and owning an office building in Grimstad, Norway, entered into an agreement for a NOK36,500,000 term loan to finance the cost of the building (the "NOK36.5mm Loan"). The terms provide for a 20-year loan period and a fixed rate of interest of 7.45% p.a. with interest and principal payable semiannually. Security for the loan is in the form of a first mortgage on the building and assignments of earnings and insurance.

*STAR Credit Agreements* – The Company's agreement to participate in the recapitalization of STAR in January 2001 was contingent upon the refinancing of STAR's debt. The refinancing involved the issuance of a new credit facility in the amount of \$132,500,000 from a bank syndicate led by Fortis Bank (the "Fortis Bank Syndicate") and the forgiveness of \$55,000,000 debt by the former bank syndicate. A second credit facility in the amount of \$14,500,000 (the "Gjensidige NOR Syndicate") remained intact.

The Fortis Bank Syndicate increased its facility by \$19,000,000 in July 2002 in order to finance STAR's purchase of 100% of Albion Reefers Limited.

Security for the Fortis Bank Syndicate was in the form of first priority mortgages on 22 vessels and second priority mortgages on another 2 vessels, all owned by subsidiaries of the company, and by the assignments of earnings and insurances. STAR, furthermore, pledged shares in its subsidiaries and bank accounts in favor of the lenders.

Security for the Gjensidige NOR Syndicate was in the form of first priority mortgages on 2 vessels owned by subsidiaries of the company and by the assignments of earnings and insurances. Again, STAR pledged shares in its subsidiaries and bank accounts in favor of the lenders.

By the end of September 2002, STAR had reduced its interest-bearing debt from \$158,000,000 to \$124,100,000 as the result of scheduled repayments and prepayments of debt.

In October 2002, STAR purchased 5 reefer vessels from the Great White Fleet, a subsidiary of Chiquita International Brands, for approximately \$54,000,000. The purchase was completed using the proceeds from a bridge loan of \$53,000,000.

STAR used a \$129,650,000 facility received in December 2002 and a \$4,500,000 loan from the Company to refinance the bridge loan and the Fortis Bank Syndicate (the "New Fortis Bank Syndicate"). The amounts required for the refinancing were reduced by use of the funds generated by STAR from the sale of one of its vessel-owning subsidiaries for approximately \$51,900,000. Terms provide for four separate tranches: senior and junior tranches secured by the Chiquita vessels and senior and junior tranches secured by the other vessels. The interest rates vary from 1.625% to 2.25%, depending upon the tranche, and principal installments are made semiannually with balloon payments due in 2007. The New Fortis Bank Syndicate is secured by first and second mortgages on 23 vessels, by the assignment of earnings and insurances and by the pledges of shares in its subsidiaries and of its cash accounts. Furthermore, the underlying agreement contains restrictive covenants which limit the payment of dividends and capital expenditures and financial covenants on the market value of vessels, minimum liquidity and working capital. STAR expects to be in compliance with such covenants throughout 2003.

*Siem Thoen Car Carriers Agreement* – STCC financed the \$106,500,000 purchase price for the 3 vessels with a \$90,000,000 syndicated bank facility (\$90mm Syndicate). The facility is split into a senior tranche in the amount of \$63,000,000 and a junior tranche in the amount of \$27,000,000. The terms provide for interest rates of LIBOR plus 1.375% and LIBOR plus 2.00% for the senior and junior tranches, respectively, semiannual payments of principal and interest and balloon payments at maturity in 2007. The \$90mm Syndicate is secured by first mortgages on the three vessels and by the assignment of earnings and insurances.

The underlying agreement contains restrictive covenants which limit the payment of dividends and capital expenditures and financial covenants on the market value of vessels, minimum liquidity and working capital. STCC expects to be in compliance with such covenants throughout 2003.

*DSND Agreement* – DSND received a loan from BNDES in 2001 to finance the acquisition and installation of equipment aboard the *Olympic Princess*. Terms provide a fixed interest of 6.8125% p.a., semiannual interest payments and principal installments of \$459,582 and a balloon payment at maturity.

Taking into consideration the variable rate structure of the Company's long-term debt, the fair value of long-term debt approximates its carrying value.

#### (10) DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

*Foreign Exchange Risk* – The nature of the operations conducted by the Company exposes the Company to foreign exchange risk. This risk is primarily associated with compensation costs and purchases from suppliers that are denominated in currencies other than the USD. Gains and losses on foreign exchange derivative instruments which qualify as hedges for accounting purposes are deferred and recorded as other comprehensive income and recognized when the underlying foreign exchange exposure is realized. Gains and losses on foreign exchange derivative instruments which do not qualify as hedges for accounting purposes are recognized at the end of the current reporting period based on the change in the market value of the derivative instruments.

The Company has on occasion purchased foreign exchange contracts with contracts terms less than six months to protect against the adverse effects of exchange rate fluctuations. These derivatives did not qualify for hedge accounting because such contracts related to existing assets and liabilities denominated in a foreign currency. The gains and losses on both the derivatives and the existing foreign currency-denominated assets and liabilities were recorded as currency gains or losses in the statements of operations. With respect to foreign exchange contracts outstanding in 2002, the Company recorded aggregate currency gains of \$2,418,000.

STAR operates in an industry in which a majority of its transactions are denominated in USD, whether such activity involves revenues or operating expenses or assets or liabilities. STAR's overhead expenses, however, are denominated in either NOK or GBP. Although there were no such contracts outstanding at the end of 2002, STAR has hedged its exchange rate exposure by entering into forward contracts on behalf of its

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Oslo and London offices for approximately 50% of such overhead expenses for 2003. The contracts sell USD and buy NOK at average rates of NOK7.55/USD1.00 and sell USD and buy GBP at average rates of USD1.56/GBP1.00.

*Interest Rate Risk* – The Company’s use of debt exposes the Company to interest rate risk. Floating rate debt, in which the interest rate can change from one interest period to the next in periods as short as one month, exposes the Company to short-term changes in market interest rates. Fixed rate debt, in which the interest rate is fixed over the life of the facility, exposes the Company to changes in market interest rates if the Company should decide to refinance maturing debt with new debt.

The Company may, from time to time, use interest rate swap agreements to manage the effect of interest rate changes on future income. These derivatives are used as a hedge of underlying future interest payments and are not used for speculative or trading purposes. The agreements involve the exchange of amounts based on variable interest rates and amounts based on a fixed interest rate over the life of the agreement without an exchange of the notional amount upon which the payments are based. The interest rate differential to be paid or to be received on the swaps is recognized over the lives of the swaps as an adjustment to interest expense.

The major risks in using interest rate derivatives include changes in interest rates that affect the value of such instruments, potential increases in the interest expense of the Company due to market increases in floating interest rates in the case of derivatives which exchange fixed interest rates for floating interest rates and the creditworthiness of the counterparties in such transactions.

STAR’s and STCC’s loans are based on floating interest rates. STAR and STCC have therefore entered into swap agreements for a portion of the mortgage debt in order to reduce its exposure to interest rate fluctuations. The following agreements were outstanding at December 31, 2002 (in thousands):

<i>Principal Amount</i>	<i>Swap Rate</i>	<i>Termination Date</i>	<i>Market Value of Interest Gain (Loss)</i>
\$50,000	5.335%	February 2004	\$ (2,395)
\$25,000	4.911%	July 2006	(2,035)
\$45,000	2.410%	July 2004	(678)

STAR and STCC pay the fixed interest rates and receive the floating interest rates based on 3-month LIBOR for the \$50,000,000 and \$25,000,000 amounts and 6-month LIBOR for the \$45,000,000 amount.

STAR wrote two interest rate caps in April 2002. The premium received for writing the caps was applied to reduce the fixed interest rate paid under the swaps. The following agreements were outstanding at December 31, 2002 (in thousands):

<i>Cap Amount</i>	<i>Cap Rate</i>	<i>Termination Date</i>	<i>Market Value of Interest Gain (Loss)</i>
\$50,000	6.000%	February 2004	\$ (1)
\$25,000	6.000%	July 2006	(171)

STAR is obligated under the contracts for all interest over 6% based on 3-month LIBOR.

The requirements necessary to classify the interest rate swaps and interest rate caps as hedges in accordance with US GAAP were not satisfied; consequently, the losses were recorded in the consolidated statements of operations to reflect the changes in fair, or market, values. Such fair values are determined by estimating the cost of interest rate swaps to offset the outstanding swaps or cost of reversing the caps.

*Bunker Hedging* – STAR’s management has been authorized by its board of directors to enter into bunker hedge contracts. There were no such contracts outstanding at the end of 2002.

(11) GOODWILL

The summaries of goodwill at December 31 are presented below:

<i>(in thousands)</i>	2002	2001
Goodwill	\$ 38,397	\$ –

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company recorded goodwill under the purchase method of accounting following its acquisition of a controlling interest in DSND. The acquisition was considered effective at the end of November 2002.

(12) PENSION PLANS

The Norwegian offices of STAR and DSND maintain defined benefit pension plans that cover their 13 employees and 15 employees, respectively. Benefits are based primarily upon the participant's years of service and compensation at time of retirement (in thousands):

<i>Weighted Average Assumptions</i>	2002	2001
Discount rate	5.00 - 6.00%	6.50%
Expected return on funds	6.00 - 7.00%	7.50%
Expected increase in salaries	4.00 - 3.30%	3.30%
Expected pension regulation	2.50%	2.50%
Expected G-regulation/inflation	3.00 - 2.50%	3.30%
Social security tax	14.10%	14.10%
<i>Change in Benefit Obligation</i>	2002	2001
Benefit obligation at beginning of year	\$ 1,906	\$ 644
Service cost	110	60
Interest cost	54	40
Translation adjustment and other	362	(35)
Benefit obligation at end of year	\$ 2,432	\$ 709
<i>Change in Plan Assets</i>	2002	2001
Fair value of plan assets at beginning of year	\$ 2,121	\$ 1,190
Return on plan assets	88	87
Contributions	—	—
Benefits paid	(26)	—
Translation adjustment and other	235	(29)
Fair value of plan assets at end of year	\$ 2,418	\$ 1,248
<i>Status of Plan Funding</i>	2002	2001
Funded (Underfunded)	\$ (14)	\$ 539
Translation adjustment and other	330	105
Prepaid benefit cost	\$ 316	\$ 644
<i>Components of Net Periodic Benefit Cost</i>	2002	2001
Service cost	\$ 205	\$ 60
Interest cost	114	40
Return on plan assets	(140)	(87)
Social security contributions	103	—
Translation adjustment and other	25	—
Net periodic benefit cost	\$ 307	\$ 13

STAR London implemented a defined contribution plan for its employees in late 2001. Under this contribution plan, STAR London contributes a fixed percentage of the employee's base salary. The percentage is dependent on the number of years employed and the level of position within the company. The contribution is expensed when incurred and was approximately \$130,000 and \$21,000 for 2002 and 2001, respectively. The vested benefits obligation is calculated as the actuarial present value of the vested benefits to which employees are currently entitled based on the employees' date of separation or retirement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(13) INCOME TAXES

The Company is incorporated in the Cayman Islands and, as such, is not subject to income taxes in that jurisdiction. Income taxes have been provided based upon the tax laws and rates in the countries in which operations are conducted and income is earned. There is no expected relationship between the provision for or benefit from income taxes and income or loss before income taxes because the countries have taxation regimes that vary not only with respect to nominal rate, but also in terms of the availability of deductions, credits and other benefits. Variations also arise because income earned and taxed in any particular country or countries may fluctuate from year to year.

The Company does not accrue U.S. income taxes because it is not engaged in a U.S. trade or business. Accordingly, a reconciliation between the income tax expense resulting from the application of the U.S. Federal statutory income tax rate and the reported income tax expense is not presented herein as it would not provide additional useful information to users of the financial statements. Substantially all of the income tax expense (benefit) for 2001 is attributed to STAR.

<i>Income Tax Expense (Benefit), in thousands</i>	2002	2001	2000
Current	\$ 371	(154)	(271)
Deferred	—	—	—
Income tax expense (benefit)	\$ 371	\$ (154)	\$ (271)

<i>Deferred Tax Liabilities (Assets), in thousands</i>	2002	2001
Provision not deductible until paid	\$ 162	\$ —
Depreciation	—	9,986
Capital gains	—	343
Deferred tax liabilities	162	10,329
Depreciation	(1,961)	—
Capital gains	(1,543)	—
Net operating loss carryforwards	(30,348)	(34,174)
Provision not deductible until paid	—	(141)
Deferred tax assets	(33,852)	(34,315)
Net deferred tax liabilities (assets)	(33,690)	(23,986)
Valuation allowance	33,690	23,986
Net deferred tax liabilities (assets)	\$ —	\$ —

Deferred tax assets and liabilities are recognized for the anticipated future tax effects of temporary differences between the financial statement basis and the tax basis of the Company's assets and liabilities using the applicable tax rates in effect at year-end. A valuation allowance for deferred tax assets is recorded when it is more likely than not that some or all of the benefit from the deferred tax asset will not be realized.

Valuation allowances have been provided to offset deferred tax assets on net operating losses incurred during the year in certain jurisdictions where, in the opinion of management, it is more likely than not that the financial statement benefits will not be realized. Tax losses can be carried forward for a maximum of 10 years and loss carryforwards related to STAR will expire on various dates commencing 2008.

As mentioned above, the Company is not subject to income taxes in the Cayman Islands. Further, for the 3 years ended December 31, 2002, there were no Cayman Islands income or profits taxes, withholding taxes, capital gains taxes, capital transfer taxes, estate duties or inheritance taxes payable by a Cayman Islands company or its shareholders. The Company has received assurances from the Cayman Islands government that, in the event that any legislation is enacted in the Cayman Islands imposing taxes on profit or income, taxes on capital assets, either gain or appreciation, or any taxes in the nature of estate duties or inheritance taxes, such tax shall not be applicable to the Company or to any of its operations or to the shares or other

obligations of the Company. Consequently, under present law, there will be no Cayman Islands tax consequences affecting distributions.

#### (14) COMMITMENTS AND CONTINGENCIES

The Company or any of its subsidiaries or affiliates may become involved in various legal proceedings during the ordinary course of business. It is the Company's policy to accrue for amounts related to these legal matters if it is probable that a liability has been incurred and an amount can be reasonably estimated. DSND had certain disputes outstanding at December 31, 2002 and has established reserves of approximately \$4,000,000. Other than the DSND matters, the Company is not aware of any litigation which, in the opinion of management, is likely to have a material adverse effect on the Company's financial position, results of operations or cashflows.

In May 2001, SARF entered into an arrangement with the major creditor of a non-United States company that was in bankruptcy proceedings. SARF agreed to recapitalize the company and acquire 100% of the newly-issued share capital and to provide management advisory services and other assistance in an effort to make the company viable as a going-concern. As consideration for this undertaking, the creditor agreed to provide a loan to finance the full amount of the new capitalization that would be required to bring the company out of bankruptcy and to provide working capital. Terms of the loan provided for interest at a rate of 5% p.a. payable quarterly in arrears and maturity thirty-six months from the date of the drawdown. The loan is unsecured and non-recourse to SARF or any of its affiliated companies except for the amount of any dividends paid to SARF or the proceeds from the sale of any or all of the share capital. Upon maturity of the loan, SARF has six months to use its best efforts to repay the loan. If the loan remains unpaid after forty-two months after the date of drawdown, then the creditor is entitled to make formal demand for repayment against SARF. In a related agreement, the creditor has granted SARF a put option that, upon exercise, requires the creditor to purchase all of the share capital of the company as full payment of the loan. The put option, expiring in May 2004, may be exercised upon six months prior written notice.

A supervisory panel comprised of three members, one of whom is appointed by SARF, has installed new management. Constructive actions have been taken since the company emerged from bankruptcy and significant operational improvements made. Based on the availability of the put option and the probability that losses will continue in the short-term, the Company has determined that it will have no economic interest in the company unless and until the company has established a clear trend of profitability. Accordingly, the Company has elected to account for the investment on the cost basis in its consolidated financial statements until such time that an economic interest can be demonstrated and supported.

In connection with the start-up of the Subsea 7 joint venture in May 2002, the lenders of a \$200,000,000 bridge loan facility to Subsea 7 required that the shareholders of Subsea 7 enter into a Subordinated Shareholder Support Facility (the "Support Facility") for the aggregate amount of \$50,000,000, or \$25,000,000 from each shareholder. The Company entered into an undertaking with DSND that it would make the funds available to DSND in the event that Subsea 7 issued a proper drawdown notice and DSND could not raise the requested funds on a timely basis. The Company and DSND thereby entered into a revolving credit facility to address any advances that may be required by DSND to satisfy its obligations under the Support Facility. Terms of the revolving credit facility provide for interest at 1 month LIBOR plus 2.50%, a commitment fee of 1% on any undrawn commitment amounts and security in the form of a pledge of the Subsea 7 receivable that generated the drawdown. In November 2002, the Subsea 7 bridge facility was refinanced with a longer term facility and the Company reaffirmed its undertaking with DSND until the expiration of the new facility in November 2007.

In connection with the closing of the \$90mm Syndicate for STCC to provide the financing necessary for the purchase of the three car carriers, the lenders required that the Company provide an Irrevocable First Demand Guarantee in the amount of \$15,000,000. The guarantee will be available to the lenders to satisfy principal payments due by STCC through November 2005 or, if either the vessel charters are not extended from the respective expiry dates in 2005 on terms acceptable to the lenders or if alternative employment is not found on terms acceptable to the lenders, then the lenders can call on the guarantee for funds that may be necessary to satisfy principal payments on the \$90mm Syndicate in the order of maturity. STCC made a

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

\$3,000,000 prepayment in February 2003 and the lenders agreed to reduce the guarantee amount to \$12,000,000.

In September 2002, one of DSND's banks agreed to provide a bank guarantee to a customer in Brazil. However, as security for its guarantee, the bank required that the Company provide a counter-guarantee in the amount of \$2,836,050 and the Company complied with this request. As consideration for any calls upon its guarantee, DSND has agreed to pay interest at one-month LIBOR plus 6% and a commitment fee of 1.25% of the maximum guaranteed amount until the expiration in December 2003 or its earlier termination.

Following the sale of its interest in Albion Reefers Ltd. to STAR in July 2001, the seller retained an obligation that it had entered into that guaranteed certain charter rates to the owner of four vessels that were chartered to Albion Reefers. The guarantee is a secondary guarantee that may be called upon if STAR is unable to make the charter payments. In November 2002, the Company agreed to assume the secondary guarantee in exchange for a payment of \$3,850,000. In connection with this assumption, STAR and the Company negotiated an extension of the charter terms at lower rates. The guarantees extend through 2009 for two of the vessels and through 2010 for the other two vessels. The maximum amount of the guarantee was \$27,000,000 at the end of 2002 and reduces by \$750,000 per quarter, or \$3,000,000 per year. The Company recorded the \$3,850,000 as a deferred credit and will not recognize any portion of it into income until it becomes probable that no losses will be sustained in connection with the guarantee.

### (15) CAPITALIZATION

The Company has purchased Common Shares at times from its shareholders who have made offer for such shares. During 2002 and 2001, the Company purchased and retired 200,000 and 5,600 Common Shares at an average cost of \$7.75 and \$6.59 per share, respectively.

In June 2002, the Board of Directors declared that an extraordinary dividend of \$0.05 per Common Share be payable on August 26, 2002 to shareholders of record as of August 2, 2002.

At its Annual General Meeting in August 2002, STAR declared a \$0.10 per share dividend, payable in either cash or shares which option was at the shareholder's discretion. The dividend was payable on October 30, 2002 to shareholders of record as of August 30, 2002. Approximately \$142,000 was paid to shareholders electing the payment of dividends in cash and 77,054 shares were distributed to shareholders electing the payment of dividends in shares.

### (16) PERFORMANCE UNIT PLAN AND STOCK OPTION PLANS

A summary of the performance unit awards which have been granted and are currently outstanding is presented below:

#### PERFORMANCE UNITS

<i>Name</i>	<i>No. of Performance Units Awarded and Outstanding</i>	
	<i>Granted May 1995 at \$3.00 per Unit</i>	<i>Granted May 1996 at \$5.50 per Unit</i>
Kristian Siem	400,000	60,000
M.D. Moross	—	28,000
Barry W. Ridings	28,000	—
Michael Delouche	40,000	20,000

Performance units have been awarded pursuant to provisions of the Company's 1987 Performance Unit Plan (the "Plan"), as amended, by the Compensation Committee of the Board of Directors. The Plan provides that performance units shall be granted at a value no less than 110% of the average closing market price of the Company's Common Shares for the 20 trading days preceding the date of the award. The aggregate sum of the performance unit value, which is determined by multiplying the number of performance units by the value per performance unit, is credited to the individual's performance unit account on the date of the award. Grants of awards vest over a five-year award periods at 20% per year; however, all rights to the performance unit account are forfeited if the individual's employment ceases before the end of the award

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

period with certain reasonable exceptions including the death, total disability or retirement after age 60 of the individual.

Under the Plan, the amount of payment to the individual after the end of the award period is equal to the number of vested performance units multiplied by the difference between the average closing market price of the Common Shares and the value of the performance units awarded. The Company has the option to make the payment in either cash or Common Shares.

The Plan will expire on the earlier of the vesting of an aggregate 1,600,000 performance units by the participants or January 2007.

The Company records compensation expense with respect to the Plan. This expense is determined using the number of units which have vested and the closing market price of Common Shares at the end of the reporting period. The Company did not record any compensation expense during 2002, 2001 and 2000.

At the end of 2000, a payment of approximately \$27,000 was made to the estate of a participant in the Plan. At the time of his death, the participant had vested in 85%, or 10,200 units, of the 12,000 units which he had been awarded.

An aggregate 274,200 units of those originally awarded in 1995 and 1996 have been forfeited.

In 2001, STAR launched a stock option program as part of the Company's long-term incentive plan. Options to purchase 150,000 shares of STAR were granted in May 2001 with a strike price at \$6.60 per share. Additional options to purchase 100,000 shares of STAR were granted in November 2001 with a strike price at \$7.20 per share. The strike prices were equal to the market rates at the date of the grants and are fixed. The options vested 50% in February 2003 and the remaining 50% vest in February 2005. The closing market price for STAR's shares for 2002 was \$7.89 per share.

The fair value of each stock option granted during 2001 was estimated to be \$3.0049 using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants in 2001: no dividend yield, 50% volatility, risk-free interest rate of 4.63% and expected option life of four years. If the fair value based method of accounting in SFAS 123 had been applied, the Company would have recognized a compensation expense of approximately \$188,000 and \$69,000 in 2002 and 2001, respectively, and the pro forma net income (loss) would have been approximately \$50,713,000 and \$(27,952,000), respectively.

In 2002, DSND issued options to purchase 205,000 shares of DSND with a strike price of NOK17.50 per share. The closing market price DSND's shares for 2002 was NOK15.10 per share.

(17) ACCUMULATED OTHER COMPREHENSIVE INCOME

The composition of accumulated other comprehensive income as of and for the years ended December 31 is provided below:

(in thousands)	Accumulated Other Comprehensive Income		
	Unrealized Appreciation (Depreciation) on Securities Available-for-Sale	Currency Translation Adjustment	Total
Balances at December 31, 1999	\$ 144,227	\$ (506)	\$ 143,721
2000 Changes	(83,442)	2,659	(80,783)
Balances at December 31, 2000	60,785	2,153	62,938
2001 Changes	(18,742)	(25)	(18,767)
Balances at December 31, 2001	42,043	2,128	44,171
2002 Changes	(18,260)	(282)	(18,542)
Balances at December 31, 2002	\$ 23,783	\$ 1,846	\$ 25,629

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### (18) CUMULATIVE EFFECT OF ACCOUNTING CHANGES

The summary of the effects of accounting changes as of and for the years ended December 31 is presented below:

<i>(in thousands)</i>	2002	2001	2000
Change in accounting for drydocking costs	\$ (1,092)	\$ —	\$ —
Change in accounting for deferred costs arising as the excess of fair value of assets acquired and liabilities assumed over fair value of consideration paid	2,133	—	—
Cumulative effect of accounting change	\$ 1,041	\$ —	\$ —

### (19) RELATED PARTY TRANSACTIONS

*DSND* – In connection with the start-up of Subsea 7's operations in May 2002 and at the request of the lenders of a \$200,000,000 bridge loan facility to Subsea 7, *DSND* became a party to the Support Facility (see Note 14 for further details) whereby the two 50% owners of Subsea 7, *DSND* and Halliburton, agreed to provide loans up to \$50,000,000 on a pro rata basis as requested by Subsea 7. In a related but separate transaction, the Company entered into an undertaking with *DSND* according to which it agreed that it would make the funds available to *DSND* to satisfy any drawdowns properly requested by Subsea 7. Shortly thereafter, the Company and *DSND* entered into a revolving credit facility to establish the terms of any drawdowns by *DSND*.

In July 2002, the Company and other holders of *DSND* bonds met and agreed to extend the maturity date of the bonds from July 2002 to November 2002 in exchange for an increase in the interest rate from 7% to 9% p.a. and a one-time fee of 0.2% based on the value held by each bondholder (see Note 4 for further details). In connection with this extension, the Company agreed to extend the maturities of the NOK100mm Note and the \$9.3mm Note to October 2002.

At the end of September 2002, the Company agreed to provide a counter guarantee in the amount of \$2,836,050 to a bank who was issuing a bank guarantee to one of *DSND*'s customers (see Note 14 for further details). The counter-guarantee will remain outstanding until December 2003 unless terminated earlier.

Also at the end of September 2002, the Company provided \$2,000,000 to *DSND* pursuant to a drawdown request by Subsea 7 under the Support Facility. The principal and interest were repaid in November 2002.

In October 2002, *DSND* Inc. offered to exchange its shares for shares of *DSND* Subsea ASA on a 1:1 basis. Approximately 92.6% of *DSND* Subsea's shareholders ultimately accepted this offer, including the Company. Later in the month, the Company agreed to underwrite a portion of the financial restructuring plan proposed by *DSND* to refinance its short-term loans. At the end of October 2002, the Company purchased 4,693,400 shares of *DSND* and financed the acquisition with a drawdown of \$6,000,000 under its revolving credit facility. The purchase exceeded the 40% threshold and, once such threshold is exceeded, the Company became subject to a given time frame in which to decide whether it would make an offer for all of the outstanding shares of *DSND* at the highest price it had paid in the previous 6 months or it would sell shares to reduce its holding below 40%.

In November 2002, the Company announced that it would make a mandatory offer for all outstanding shares of *DSND* and obtained the required bank guarantee to secure such offer. Later in November, the Company paid for its subscription of shares and acquired a net 16,556,761 shares. The payment for these shares was made in the form of cash and an offset of principal and interest amounts payable by *DSND* under the *DSND* Bonds.

Also in November, Subsea 7 refinanced its \$200,000,000 bridge facility with a long-term facility. At closing, the Company reaffirmed its undertaking with *DSND* that it would make funds available to *DSND* if necessary following a drawdown request by Subsea 7 under the Support Facility.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In December 2002, the Company purchased 18,343,468 shares of DSND that had been tendered pursuant to the terms of the Company's mandatory offer. The Company used drawdowns of \$29,500,000 under its revolving credit facility to finance the payment.

STAR – Following STAR's declaration of a \$0.10 dividend payable in cash or shares at the discretion of the shareholders, the Company elected to receive shares whereupon it received 69,347 shares to increase its holding to 5,612,015 shares of STAR.

In connection with a \$53,000,000 bridge facility provided in October 2002 by a syndicate of banks for the purpose of financing STAR's acquisition of 5 reefer vessels, the Company agreed to provide a guarantee to secure repayment of the loan. The bridge facility was refinanced in December 2002 and the Company's guarantee terminated. To facilitate the closing of the new facility, the Company provided a \$4,500,000 loan to STAR with interest payable at 7% p.a. and maturing in July 2003.

STCC – As part of the closing of the \$90mm Syndicate, the Company agreed to provide a \$15,000,000 guarantee.

Other – A management agreement between Kristian Siem and the Company became effective January 1, 2000. Terms of the agreement provided that Mr. Siem will serve as Chief Executive Officer and devote a minimum of 50% of his professional time to the furtherance of the Company's interests. As payment for his services, Mr. Siem receives a base compensation equal to \$300,000 for each of the first three years and such greater amounts thereafter as may be agreed by Mr. Siem and the Company. Mr. Siem receives additional compensation equal to 5% of the net income greater than \$2,000,000 during each year of the agreement. The total fees incurred by the Company under this agreement for 2002, 2001 and 2000 were \$2,931,000, \$0- and \$4,299,000.

The Company's Chairman and CEO holds an option to purchase the property which houses the offices of Siem Offshore located in Oslo, Norway. The option provides for a one-year option period, which commences on the date that he is no longer an officer or director with the Company or any of its subsidiaries, during which time he can purchase the property at the price paid by Siem Offshore. This option is subject to review by the Compensation Committee.

A summary of receivables and payables with affiliates at December 31 is presented below:

<i>(in thousands)</i>	2002	2001
Due from affiliates:		
Horncastle Executive Travel plc	\$ –	\$ 364
Aage Thoen Ltd. AS	1,455	1,125
Other	213	202
Total due from affiliates	1,668	1,691
Due to affiliates:		
Kristian Siem	\$ 3,240	\$ 150
Total due to affiliates	\$ 3,240	\$ 150

(20) SUBSEQUENT EVENTS

In January 2003, the Company paid for its subscription of NOK219,610,000 Convertible DSND Bonds. The payment for these bonds was made in the form of cash and an offset of principal and interest amounts payable by DSND under the NOK100mm Note and the remaining DSND Bonds. DSND used the proceeds from the bond issue to repay the \$9.3mm Note in its entirety. The Company, in turn, used the proceeds to paydown \$6,000,000 of the outstanding principal balance under one of its revolving credit facilities and payoff the \$3,000,000 term loan in its entirety.

In February 2003, STCC used its cash resources to prepay \$3,000,000 of the \$90mm Syndicate. The lenders agreed to reduce the amount of the guarantee from \$15,000,000 to \$12,000,000 with the guarantee, if called upon, to apply against the principal payments in order of maturity.



# **SIEM INDUSTRIES**

## SUBSIDIARIES AND AFFILIATES

DSND Inc.  
STAR Reefers Inc.  
Siem Thoen Car Carriers Inc.  
Siem Acquisition and Reorganisation Fund, Inc.  
Siem Drilling Ltd.  
Four Seasons Capital AB  
Siem Offshore AS  
Aston Financial International Ltd.  
Aston Financial Ltd.  
Hopemount Shipping Co. Ltd.  
Siem Oceanic Limited  
Norex Drillco AS  
DSND Bygg AS  
KS Containership

## DIRECTORS

Kristian Siem, Chairman  
M.D. Moross  
Barry W. Ridings  
Rune Holen  
Frank Capstick

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[www.siemindustries.com](http://www.siemindustries.com)

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