K2 INC
Form 10-K
March 16, 2006
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# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-K

## ANNUAL REPORT

## PURSUANT TO SECTION 13 OR 15(d)

## OF THE SECURITIES EXCHANGE ACT OF 1934

**For the Year Ended December 31, 2005**

**Commission File No. 1-4290**

# K2 INC.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware**<br>**(State of Incorporation)** | **95-2077125**<br>**(I.R.S. Employer Identification No.)** |
| **5818 El Camino Real** | **92008** |
| **Carlsbad, California**<br>**(Address of principal executive offices)** | **(Zip Code)** |

**Registrant s telephone number, including area code (760) 494-1000**

**Securities registered pursuant to Section 12(b) of the Act:**

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, par value $1 | New York Stock Exchange<br>Pacific Exchange |
| Series A Preferred Stock Purchase Rights | New York Stock Exchange<br>Pacific Exchange |

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15 (d) of the Act. Yes ¨ No x

Indicate by an X whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ¨ Accelerated Filer x Non-Accelerated Filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The aggregate market value of the voting stock of the registrants held by nonaffiliates was approximately $594,021,329 based on the closing price of such voting stock on June 30, 2005, of $12.68.

At February 28, 2006 there were 47,687,819 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant s proxy statement for its Annual Meeting of Shareholders to be held May 11, 2006 are incorporated by reference in Part III.

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**K2 INC.**

**FORM 10-K**

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**FORM 10-K ANNUAL REPORT**

## PART I

### ITEM 1. BUSINESS:

### General

K2 Inc. is a premier, branded consumer products company with a portfolio of leading brands including *Shakespeare, Pflueger, Stearns, Sospenders* and *Hodgman* in the Marine and Outdoor segment; *Rawlings, Miken* and *Worth* in the Team Sports segment*; K2, Völkl, Marker, Ride* and *Brass Eagle* in the Action Sports segment; and *Adio, Marmot* and *Ex Officio* in the Apparel and Footwear segment. K2 s diversified mix of products is used primarily in team and individual sports activities such as fishing and hunting, outdoor water sports activities, baseball, softball, alpine skiing, snowboarding and in-line skating. Among K2 s other branded products are *Tubbs, Atlas* and *Little Bear* snowshoes, *Madshus* nordic skis, *JT* and *Worr Games* paintball products and *Planet Earth* apparel. Founded in 1946, K2 has grown to $1.3 billion in 2005 annual sales through a combination of internal growth and strategic acquisitions. For segment and geographic information, see Note 14, Segment Data, in the Notes to Consolidated Financial Statements.

K2 has expanded its presence in several sporting goods markets in the U.S., Europe and Japan, including skateboard shoes, fishing tackle reels and kits and combos, outdoor marine accessories, hunting accessories, outdoor apparel, ski accessories, paintball products, baseball and softball bats and All-Terrain Vehicle ( ATV ) accessories. Management believes its products have benefited from the brand strength, reputation, distribution, and the market share positions of other K2 products, several of which are now among the top brands in their respective markets. K2 s product portfolio contains some of the most widely recognized brands in their respective market segments. K2 believes it has leading market positions with many of our branded products based on revenue or unit sales as follows:

| Product | Brand | Ranking |
|---|---|---|
| Alpine skis | *K2* and *Völkl* | #1 |
| Alpine ski bindings | *Marker* | #1 |
| Snowboards | *K2, Ride, Liquid, Morrow* and *5150* | #2 |
| Snowboard bindings | *K2, Ride, Liquid, Morrow* and *5150* | #2 |
| Snowshoes | *TUBBS* and *Atlas* | #1 |
| Paintball products | *Brass Eagle, JT, Viewloader* and *Worr Games* | #1 |
| Baseballs and gloves | *Rawlings* | #1 |
| Softballs | *Worth* | #1 |
| Fishing kits and combos | *Shakespeare* | #1 |
| Fishing rods | *Shakespeare* and *Ugly Stik* | #1 |
| Personal Flotation Devices | *Stearns* | #1 |

In order to implement its strategy for growth, K2 has embarked upon a program to leverage its existing operations and to complement and diversify its product offerings within the sporting goods and recreational products. K2 intends to implement its internal growth strategy by continuing to improve operating efficiencies, extending its product offerings through new product launches and maximizing its extensive distribution channels. In addition, K2 will seek strategic acquisitions of other sporting goods companies with well-established brands and with complementary distribution channels. K2 believes that the growing influence of large format sporting goods retailers and retailer buying groups, as well as the consolidation of certain sporting goods retailers worldwide, is leading to a consolidation of sporting goods suppliers. K2 also believes that the most successful sporting goods suppliers will be those with greater financial and other resources, including those with the ability to produce or source high-quality, low cost products and deliver these products on a timely basis, to invest in product development projects and to access distribution channels with a broad array of products and brands. In addition, as the influence of large sporting goods retailers grows, K2 believes these retailers will prefer to rely on fewer and larger sporting goods suppliers to help them manage the supply of products and the allocation of shelf space.

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K2 s common stock was first offered to the public in 1959 and is currently traded on the New York and Pacific Stock Exchanges (symbol: KTO).

**2005 Acquisitions**

On April 22, 2005, K2 completed the acquisition of substantially all of the assets of Hodgman, Inc., a business engaged in the design, selling and distribution of hunting and fishing waders. The transaction consideration consisted of cash. Hodgman, Inc. is included in K2 s Marine and Outdoor segment.

On April 18, 2005, K2 completed the acquisition of JRC Products Limited, a business engaged in the design, selling and distribution of carp fishing tackle products. The transaction consideration consisted of cash. JRC Products Limited is included in K2 s Marine and Outdoor segment.

**2004 Acquisitions**

On January 23, 2004, K2 completed the acquisition of Fotoball USA, Inc. ( Fotoball ), a marketer and manufacturer of souvenir and promotional products, principally for team sports, in a stock-for-stock exchange offer/merger transaction. Subsequent to the completion of the merger, K2 changed the name of Fotoball to K2 Licensed Products, Inc. K2 Licensed Products, Inc. is included in K2 s Team Sports segment.

On April 19, 2004, K2 completed the acquisition of substantially all of the assets of Worr Game Products, Inc. and All-Cad Manufacturing, Inc. (collectively, Worr Games ), businesses engaged in the design, manufacturing, selling and distribution of paintball markers and paintball-related products and accessories. The transaction consideration consisted of cash and the issuance of shares of K2 Inc. common stock. Worr Games is included in K2 s Action Sports segment.

Also on April 19, 2004, K2 completed the acquisition of substantially all of the assets of IPI Innovations, Inc. ( IPI ), a business engaged in the design, manufacturing, selling and distribution of gun and bow mounting systems, and other products and accessories for all-terrain vehicles. The transaction consideration consisted of cash and the issuance of shares of K2 Inc. common stock. IPI is included in K2 s Marine and Outdoor segment.

On May 12, 2004, K2 also completed the acquisition of substantially all of the assets of Ex Officio, a leader in the design and manufacture of men and women s apparel for the outdoor and adventure travel markets, in an all cash transaction. Ex Officio s products are characterized by technical features, performance fabrics and outdoor styles, and are used in a variety of activities including fishing, kayaking, trekking, exploring and other leisure activities. Ex Officio also markets a line of insect repellent clothing under the *Buzz Off* brand. Ex Officio is included in K2 s Apparel and Footwear segment.

On June 30, 2004, K2 completed the acquisition of Marmot Mountain Ltd. ( Marmot ). Marmot, founded in 1971, is a leader in the premium technical outdoor apparel and equipment market. Marmot s product lines include performance jackets, technical rainwear, expedition garments, fleeces, softshells, skiwear outerwear and accessories, gloves, and expedition quality tents, packs and sleeping bags. The transaction consideration consisted of cash and the issuance of shares of K2 Inc. common stock. Marmot is included in K2 s Apparel and Footwear segment.

On July 7, 2004, K2 completed the acquisitions of Völkl Sports Holding AG ( Völkl ) and The CT Sports Holding AG ( Marker ). Founded in 1889, Völkl is a well established and recognized brand in the worldwide alpine ski market. Marker was founded in 1952 and has gained worldwide recognition for its patented ski-bindings. The transaction consideration consisted of cash and the issuance of shares of K2 s common stock. Völkl and Marker are included in K2 s Action Sports segment.

During 2004, K2 also completed three smaller acquisitions. Two of these acquisitions are reported within the Marine and Outdoor segment and one within the Team Sports segment.

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For additional information on these acquisitions see Note 2 to Notes to Consolidated Financial Statements.

K2 classifies its business into the following four segments based on similar product types and distribution channels: Marine and Outdoor, Action Sports, Team Sports and Apparel and Footwear. The Marine and Outdoor segment includes *Shakespeare fishing tackle* and monofilament products as well as *Stearns* outdoor products. The Action Sports segment includes skis, bindings, snowboards, snowshoes, in-line skates and paintball products. The Team Sports segment includes baseball and softball products and K2 Licensed Products merchandise. The Apparel and Footwear segment includes skateboard shoes and apparel, technical apparel and equipment and outdoor and adventure travel apparel.

**Marine and Outdoor**

Net sales for the Marine and Outdoor segment were $392.2 million in 2005, $336.9 million in 2004 and $324.0 million in 2003. The following table lists K2 s principal Marine and Outdoor products and the brand names under which they are sold.

| Product | Brand Name |
|---|---|
| Fishing rods, reels and fishing kits and combos | *Shakespeare, Ugly Stik, All Star* and *Pflueger* |
| Active water and outdoor sports products | *Stearns, Mad Dog, Hodgman* and *Sospenders* |
| Monofilament line | *Shakespeare* |
| Marine and military radio antennas | *Shakespeare* |

*Fishing rods, reels and fishing kits and combos*. K2 sells fishing rods, reels and fishing kits and combos throughout the world. K2 believes Shakespeare s *Ugly Stik* models have been the best selling fishing rods in the U.S. for over 20 years. The success of these fishing rods has allowed K2 to establish a strong position with retailers and mass merchandisers, thereby increasing sales of new rods, reels and kits and combos and allowing K2 to introduce new products such as the expansion of its *Pflueger* product line and licensed children s kits and combos. K2 s rods and reels are manufactured principally in China. *Shakespeare* products are sold directly by K2 and through independent sales representatives to mass merchandisers and sporting goods retailers in the U.S., Europe and Australia and through independent and K2-owned distributors in Europe and Australia.

*Active water and outdoor sports products*. K2 sells *Stearns* and *Sospenders* flotation vests, jackets and suits ( personal flotation devices ), cold water immersion products, wet suits, *Hodgman* waders, outdoor products, rainwear and inflatable and towable water products and *Mad Dog* hunting and ATV accessories in the U.S. and in certain foreign countries. In the U.S., occupants of boats are required by law either to wear or have available personal flotation devices meeting U.S. Coast Guard standards. *Stearns* and *Sospenders* personal flotation devices are manufactured to such standards and are subject to rigorous testing for certification by Underwriters Laboratories, an independent, not-for-profit product-safety testing and certifying organization. K2 manufactures most of its personal flotation devices in the U.S., manufactures certain components in China and sources its other products from Asia. *Stearns*, *Sospenders, Hodgman* and *Mad Dog* products are sold principally through an in-house sales department and independent sales representatives to mass merchandisers, specialty shops and chain stores and to the off-shore oil industry, commercial fishermen and other commercial users through independent sales representatives.

*Monofilament line*. Nylon and polyester monofilament line is manufactured in the U.S. and the U.K. and sold by K2 in a variety of diameters, tensile strengths and softness. Monofilament is used in various applications including the manufacture of woven mats for use by paper producers in the U.S., Europe and South America, as fishline and for use as line in weed trimmers in the U.S. and is sold directly to paperweavers, directly to retailers of fishline and distributors of cutting line and to others through independent sales representatives. Monofilament sold in Europe for woven mats is manufactured primarily in K2 s U.K. facility. *Shakespeare* monofilament also manufactures various products for industrial applications.

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*Marine and military radio antennas*. K2 manufactures fiberglass radio antennas in the U.S. and in China for marine, citizen band and military application under the *Shakespeare* name. The products are sold primarily in the U.S. K2 also distributes marine accessories under the *Shakespeare* name that are manufactured in Asia to K2 s specifications. An in-house sales department and independent sales representatives sell the antennas, radios and other marine accessories to specialty marine dealers.

During 2005, one customer accounted for more than 10% of the net sales of the Marine and Outdoor segment. The loss of this customer could have a material adverse affect on the Marine and Outdoor segment.

**Action Sports**

Net sales for Action Sports products were $482.5 million in 2005, $502.7 million in 2004 and $247.0 million in 2003. The following table lists K2 s principal Action Sports products and brand names under which they are sold.

| Product | Brand Name |
|---|---|
| Alpine skis | *K2,* and *Völkl* |
| Alpine ski bindings | *Marker* |
| Snowboards and accessories | *K2, Ride, Morrow, 5150,* and *Liquid* |
| Snowshoes and accessories | *TUBBS, Atlas* and *Little Bear* |
| In-line skates | *K2* |
| Paintball markers, paintballs and accessories | *Brass Eagle, Viewloader, JT, Worr Games* and *Autococker* |
| Nordic skis | *Madshus* |

*Alpine and nordic skis and bindings*. K2 sells its alpine skis under the names *K2* and *Völkl* and its alpine ski bindings under the name *Marker* in the three major ski markets of the world the U.S., Europe and Japan. K2 believes that participation rates for alpine skiing have been relatively flat in Europe and the U.S., but have been declining in Japan over the last several years. K2 believes that industry retail sales have in general mirrored these participation trends in the worldwide market during the same period. K2 believes that participation rates, together with the impact of the weather conditions, the high cost of skiing, the opportunity to participate in alternative activities such as snowboarding, the increased use of rental or demo skis and general economic conditions all have an impact on retail sales of alpine ski equipment. *K2* skis, however, have benefited from their increasing popularity among retail purchasers, resulting from growing market acceptance of *K2 s* women s ski line, positioning at popular price points and from attractive graphics and creative marketing. *Völkl* has benefited, principally in the U.S. and Europe, from its positioning as a premium-priced, highly innovative producer of well-engineered, high quality skis with a well-respected race program. Each brand is also benefiting from exclusive integrated bindings and systems developed exclusively with *Marker* bindings. K2 sells Nordic skis and boots under the *Madshus* name, which has been in existence since 1906.

*K2* skis are manufactured by K2 primarily in its facility in China. *Völkl* skis are manufactured primarily by K2 in its facility in Germany. *Madshus* skis are manufactured in Norway. *Marker* bindings are manufactured by K2 primarily in its facility in the Czech Republic. The skis, bindings and accessories, including helmets and ski poles, are sold to specialty retail shops and sporting goods chains in the U.S. by independent sales representatives and in Europe and Japan through independent and K2-owned distributors. *K2* and *Völkl* alpine skis are marketed to skiers ranging from beginners to top racers to meet the performance, usage and terrain requirements of the particular consumer.

From a pricing perspective, K2 positions the *K2* brand in the mid-level and higher price points, and positions the *Völkl* brand at generally higher price points reflecting the quality of materials used in construction, the continual incorporation of technological innovations and the type of skiing it is intended for. To assist in its marketing efforts, K2 sponsors mainly freestyle skiers while Völkl sponsors primarily well-known professional and amateur race-oriented skiers.

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*Snowboards and accessories*. K2 sells snowboards, boots, bindings and snowboard outerwear under the *K2*, *Ride, Morrow, 5150* and *Liquid* brands. Accessories, including backpacks for carrying snowboards and other gear when hiking into the back country and snowboard apparel are being marketed under the *K2* and *Ride* brands. Growth in retail sales in the snowboard market has slowed, resulting in fewer, larger, better capitalized brands. K2 manufactures most of its own snowboards in its manufacturing facility in China. K2 believes its manufacturing capability and ability to innovate provide it a competitive advantage. Like its alpine skis, *K2* and *Ride* snowboards are of high quality and have innovative features.

K2 s snowboard brands are sold to specialty retail shops and sporting goods chains in the U.S. by independent sales representatives and in Europe and Japan through independent and K2-owned distributors. Like *K2* skis, *K2, Ride, Morrow, 5150* and *Liquid* snowboard products are marketed using youthful and energetic advertising, and K2 sponsors well-known professional and amateur snowboarders.

*In-line skates.* K2 introduced its *K2* soft boot in-line skates in 1994. Although the worldwide market underwent several years of growth, it has declined in recent years with the sharpest decline occurring in 2001, resulting in a consolidation of brands.

K2 s in-line skates target the enthusiast and are priced at the mid to upper end of the industry s price points. *K2* skates are attractive and of high quality and have innovative features such as a soft mesh and leather upper designed for improved comfort, with a rigid plastic cuff for support. K2 s skates incorporate several innovations, including K2 s soft boot skate with no laces. The patented product line is designed for performance as well as superior comfort and support. K2 also sells women s-specific skates and adjustable-size, soft boot skates for children.

*K2* in-line skates are manufactured to its specifications and are primarily assembled by a third party vendor in China. They are sold to specialty retail shops and sporting goods chains in the U.S. by independent sales representatives and in Europe and Japan through independent and K2-owned distributors.

*Paintball products.* Brass Eagle designs and distributes throughout the world a full line of paintball markers with a variety of performance characteristics. There are three primary classifications of paintball markers: pump action, semi-automatic and ultra high performance paintball markers. Brass Eagle currently offers all three types of paintball markers under its *Brass Eagle, JT, Worr Games Products*, *Autococker* and *Viewloader* brand names to the mass merchant, sporting goods and specialty markets, as appropriate. To assist in its marketing efforts, Brass Eagle, JT and Worr Games Products sponsor key professional paintball teams. Paintball markers are generally sourced by Brass Eagle in Asia from third party suppliers, while the ultra high performance markers, such as the *Autococker* brand, are machined and assembled at the Worr Games Products facility in Corona, California. *Brass Eagle, JT, Worr Games* and *Viewloader* products are sold directly by Brass Eagle and through independent sales representatives to mass merchandisers, sporting goods retailers and to specialty shops and paintball venues in North America, as well as through independent distributors in Europe, and to other customers around the world. During 2005 the paintball market experienced a significant decline. The decline in sales of paintball products reflects soft consumer demand in the industry.

Paintballs are made of a gelatinous material: the paint is non-toxic, biodegradable and washable. Paintballs are manufactured using an encapsulation process principally in Brass Eagle s manufacturing facilities in the U.S., requiring special equipment and certain technical knowledge. Brass Eagle sells its paintballs in multiple colors and packages.

Brass Eagle markets a broad product line of paintball accessories complementary to its paintball markers and paintballs. These accessory products include goggle systems, paintball loaders, cleaning squeegees and refillable CO2 tanks. Goggle systems, a requirement for safe paintball play, are a primary component of Brass Eagle s accessory product line. The goggle systems are designed to provide full face, eye and ear protection.

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**Team Sports**

Net sales for Team Sports products were $265.2 million in 2005, $250.4 million in 2004 and $116.9 million in 2003. The following table lists K2 s principal Team Sports products and brand names under which they are sold.

| Product | Brand Name |
| --- | --- |
| Baseballs, softballs, bats, gloves, softballs, basketballs, footballs, soccer balls, volleyballs, team sports apparel and accessories | *Rawlings, Worth* and *Miken* |
| Lacrosse | *deBeer* and *Gait by deBeer* |

*Baseball and softball.* K2 believes that Rawlings is a leading supplier of baseball equipment in North America and, through its licensee, in Japan. *Rawlings* products in this area include baseball gloves, baseballs, softballs, batters helmets, catchers and umpires protective equipment, aluminum, composite and wood baseball bats, batters gloves and miscellaneous accessories. Rawlings is a major supplier to professional, collegiate, interscholastic and amateur organizations worldwide and is also the official baseball supplier to Major League Baseball ( MLB ), Minor League Baseball and National Collegiate Athletic Association ( NCAA ), as well as the official helmet supplier to Major League Baseball. In addition, *Rawlings* products are endorsed by college coaches, sports organizations and numerous athletes, including more than 275 Major League Baseball players. *Rawlings* products are manufactured principally in Asia and Costa Rica. Our marketing efforts are supported by endorsements from several major professional athletes, including Álex Rodríguez, Derek Jeter, Albert Pujols and Michael Vick.

Worth and Miken are leading suppliers of softball products with market leading positions in collegiate and amateur slow pitch and fast pitch softball. *Worth* products are widely used in NCAA Division I fast pitch softball programs. *Worth* is the official softball of all Canadian major associations and the official softball and softball bat of the U.S. Specialty Sports Association. *Worth and Miken* products include aluminum, exterior shell technology and 100% composite softball bats, softballs, softball gloves and miscellaneous accessories. *Worth* products are manufactured principally in China and *Miken* products are manufactured principally in the U.S.

*Rawlings, Worth* and *Miken* products are sold directly by K2 and through independent sales representatives to mass merchandisers and sporting goods retailers in the U.S. as well as through independent distributors in Europe and Japan.

*Basketball, football, soccer and volleyball.* Rawlings sells 30 different models of basketballs, including full-grain, composite and synthetic leather and rubber basketballs for men and women in both the youth and adult markets. Rawlings is the official supplier of basketballs to the National Association of Intercollegiate Athletics and the National Junior College Athletic Association Championships. Worth is the official softball of the National Collegiate Athletic Association. Rawlings sells stock and custom team uniforms for baseball, football and basketball.

*Team sports apparel.* Rawlings has been selling team uniforms for approximately 100 years. Rawlings believes it has growth opportunities in its current team apparel business.

*Souvenir and promotional products.* K2 Licensed Products manufactures and markets souvenir and promotional products to national and regional retailers; professional sports franchises and concessionaires across the nation; and entertainment destinations such as theme parks, resorts and restaurants. The Company currently holds several sports licenses including MLB, the National Football League ( NFL ), over a hundred NCAA colleges and universities and various entertainment properties.

During 2005, one customer accounted for more than 10% of the net sales of the Team Sports segment. The loss of this customer could have a material adverse affect on the Team Sports segment.

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**Apparel and Footwear**

Following the 2004 acquisitions of Marmot and Ex Officio, K2 created a new Apparel and Footwear segment consisting of the *Marmot, Marker*, *Ex Officio, Adio* and *Planet Earth* product lines. The year ended 2003 reflects the operations of the *Adio* and *Planet Earth* product lines.

Net sales for Apparel and Footwear products were $173.7 million in 2005, $110.7 million in 2004 and $30.6 million in 2003. The following table lists K2 s principal Apparel and Footwear products and the brand names under which they are sold.

| Product | Brand Name |
|---|---|
| Technical apparel and equipment | *Marmot* and *Marker* |
| Outdoor and adventure travel apparel | *Ex Officio* |
| Skateboard shoes | *Adio* |
| Skateboard apparel | *Adio* and *Planet Earth* |
| Snowboard apparel | *Planet Earth* and *Holden* |

*Marmot.* Marmot, founded in 1971, is a leader in the premium-priced, high performance technical outdoor apparel and equipment market. Marmot designs, manufactures, markets and distributes performance jackets, technical rainwear, expedition garments, fleeces, softshells, skiwear outerwear and accessories, gloves, and expedition quality tents, packs and sleeping bags and related accessories sold under the *Marmot* brand name and apparel sold under the *Marker* brand name. Outdoor professionals and enthusiasts associate the *Marmot* brand with high-performance, high-technology apparel and equipment. Marmot has been the gear of choice on thousands of the most challenging expeditions and pursuits, including numerous treks to the highest summits on all seven continents. Marmot has continued to strengthen its brand image by heavily investing in product development, which has produced a steady stream of new and innovative products. *Marmot* products are sold to specialty retail shops and sporting goods chains in the U.S., Canada and Europe by independent sales representatives and elsewhere through independent distributors. *Marmot* products are manufactured to its specifications by third party vendors in Asia.

*Ex Officio.* Ex Officio is a leader in the design, manufacture, sale and distribution of men and women s apparel for the outdoor and adventure travel apparel for men and women. Ex Officio s products are characterized by technical features, performance fabrics, and outdoor styles, and are used in a variety of activities including fishing, kayaking, trekking, exploring, and other leisure activities. *Ex Officio* products include the only Environmental Protection Agency -approved line of insect-repellent clothing, which are sold in conjunction with *Buzz Off* brand insect repellent under a licensing agreement. Ex Officio products are sold to specialty sporting goods chains in the U.S. by independent sales representatives and in Europe and elsewhere through independent distributors. Ex Officio products are also sold via the internet and a retail store in the Seattle-Tacoma airport. Ex Officio products are manufactured to its specifications by third-party vendors in Asia.

*Skateboard and snowboard apparel and skateboard shoes*. Skateboard and snowboard apparel and skateboard shoes are sold to specialty retailers in the U.S., Canada, Europe and Japan. Suppliers, primarily located in Asia, manufacture these products to K2 s specifications. Independent sales representatives sell the products to retailers in the U.S. and Canadian markets and through K2-owned and independent distributors in Europe and Asia. K2 s skateboard shoes are designed with significant assistance from a group of well-known professional skateboarders. Skateboard shoes are marketed under the *Adio* brand names, and models are named after the specific skateboarder who aided in the design.

During 2005, two customers each accounted for more than 10% of the net sales of the Apparel and Footwear segment. The loss of one or both of these customers could have a material adverse affect on the Apparel and Footwear segment.

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**Competition**

K2 s competition varies among its business lines. The sporting goods products, recreational products, apparel and footwear markets are generally highly competitive, with competition centering on product innovation, performance and styling, price, marketing and delivery. Competition in these products (other than for active wear) consists of a relatively small number of large producers, some of whom have greater financial and other resources than K2. A relatively large number of companies compete for sales of active wear. While K2 believes its well-recognized brand names, low cost China manufacturing and sourcing base, established distribution channels and reputation for developing and introducing innovative products have been key factors in the successful introduction and growth of its sporting goods and other recreational products, there are no significant technological or capital barriers to entry into the markets for many sporting goods, recreational products, apparel and footwear. These markets face competition from other leisure activities, and sales of leisure products are affected by economic conditions, weather patterns and changes in consumer tastes, which are difficult to accurately predict.

K2 believes certain of its marine and outdoor products compete based on product quality, service and delivery, however, certain of K2 s marine and outdoor products are, in most instances, subject to price competition, ranging from moderate in marine antennas and monofilament line to intense for commodity-type products. Certain industrial competitors have greater financial and other resources than K2.

**Manufacturing, Foreign Sourcing and Raw Materials**

K2 believes that, for the products within its core categories, it is of strategic importance for it to develop the capability to source and manufacture high-quality, low cost products. As a result, K2 currently manufactures products in the People s Republic of China, including most of its fishing rods and reels, snowboards, skis, shells for flotation devices, bats, batting helmets and certain marine antennas. K2 manufactures *Völkl* skis and *Marker* bindings in Europe. Additionally, K2 currently purchases in-line skates, baseball gloves, paintball markers and other products in accordance with K2 specifications from a few vendors in China. Certain other products are sourced from various vendors in Asia, Latin America and Europe. The remaining products are manufactured by K2 in the United States and Costa Rica.

K2 has not experienced any substantial difficulty in obtaining raw materials, parts or finished goods inventory for its businesses, although the cost of certain raw materials has fluctuated. Certain components and finished products, however, are manufactured or assembled abroad and therefore could be subject to interruption as a result of local unrest, currency exchange fluctuations, increased tariffs, trade difficulties and other factors. Timely supply of sporting goods products from K2 s factories and suppliers in the People s Republic of China is dependent on uninterrupted trade with China. Should there be an interruption in trade with or imposition of taxes and duties by China, it could have a significant adverse impact on K2 s business, results of operations or financial position. Additionally, the gross margins on K2 s products manufactured or sourced in the U.S., Europe or in Asia and distributed in the U.S. and Europe will depend on the relative exchange rates between the U.S. dollar, the Yuan and the euro.

**Seasonality and Cyclicality; Backlog**

Sales of K2 s sporting goods are generally highly seasonal and in many instances are dependent on weather conditions. This seasonality causes K2 s financial results to vary from quarter to quarter, and K2 s sales and earnings are usually lower in the first and second quarters. In addition, the nature of K2 s baseball, softball, paintball, ski, snowboard, in-line skate, apparel, fishing and water sports products businesses requires that, in anticipation of the selling season for these products, it make relatively large investments in inventory. The primary selling season, in the case of baseball and softball, runs from January through April, paintball runs from September through November, skis, snowboards and winter apparel runs from July through December, in-line skates runs primarily from October through May and fishing tackle and water sports products runs primarily from

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January through June. Relatively large investments in receivables consequently exist during and after such seasons. The rapid delivery requirements of K2 s customers for its sporting goods products and other recreational products also result in investment in significant amounts of inventory. K2 believes another factor in its level of inventory investment is the shift by certain of its sporting goods customers from substantial purchases of pre-season inventories to deferral of deliveries until the products retail seasons and ordering based on rates of sale.

Sales of sporting goods and other recreational products depend largely on general economic conditions including the amount of discretionary income available for leisure activities, consumer confidence and favorable weather conditions. Sales of apparel and footwear often depend on fashion trends that can be difficult to predict. Sales of K2 s monofilament products are dependent to varying degrees upon economic conditions in the paper industry and lawn and garden market.

Because of the nature of many of K2 s businesses, backlog is generally not significant.

**Customers**

K2 believes that its customer relationships are excellent. Net sales to Wal-Mart Stores, Inc. and its affiliates accounted for approximately 15% of K2 s consolidated net sales for 2005, compared to 16% in 2004 and 15% in 2003.

**Research and Development**

Consistent with K2 s business strategy of continuing to develop innovative brand name products and improving the quality, cost and delivery of products, K2 maintains decentralized research and development departments at several of its manufacturing centers, which are engaged in product development and the search for new applications and manufacturing processes. Expenditures for research and development activities totaled approximately $20.7 million in 2005, $14.5 million in 2004 and $9.6 million in 2003.

**Environmental Factors**

K2 is one of several named potentially responsible parties ( PRP ) in three Environmental Protection Agency matters involving discharge of hazardous materials at old waste sites in South Carolina and Michigan. Although environmental laws technically impose joint and several liability upon each PRP at each site, the extent of K2 s required financial contribution to the cleanup of these sites is expected to be limited based upon the number and financial strength of the other named PRP s and the volume and types of waste involved which might be attributable to K2.

Environmental and related remediation costs are difficult to quantify for a number of reasons including the number of parties involved, the difficulty in determining the extent of the contamination, the length of time remediation may require, the complexity of environmental regulation and the continuing advancement of remediation technology. K2 accrues for liabilities of this nature when it is probable a liability has been incurred and the amount can be reasonably estimated. At December 31, 2005 and 2004, K2 had recorded an estimated liability of approximately $800,000 for environmental liabilities. The estimates are based on K2 s share of the costs to remediate as provided by the PRP s consultants and in connection with a consent decree entered into in November 2004. The ultimate outcome of these matters cannot be predicted with certainty, however, and taking into consideration the recorded reserves, management does not believe these matters will have a material adverse effect on K2 s financial statements or its operations going forward.

**Employees**

K2 had approximately 4,700 employees at December 31, 2005 and 2004.

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**Patents and Intellectual Property Rights**

While product innovation is a highly important factor and many of K2 s innovations have been patented, K2 does not believe the loss of any one patent would have a material effect on its business, financial position, results of operations or prospects. Certain of its brand names, such as *Rawlings, Miken, Worth, Shakespeare*, *Ugly Stik*, *Pflueger, Stearns, Sospenders, Hodgman, Mad Dog, K2*, *Völkl*, *Marker*, *Madshus, Marmot*, *Ex Officio*, *Ride, Morrow*, *Liquid, 5150, Tubbs, Atlas, Little Bear, Brass Eagle, Viewloader, JT, Worr Games* and *Adio* are believed by K2 to be well-recognized by consumers and therefore important in the sales of these products. Rawlings®, Worth®, Miken®, deBeer®, Gait , Ten, Hilton®, Shakespeare®, Pflueger®, Ugly Stik®, All Star, Brass Eagle®, Viewloader®, Autococker®, Stearns®, Sospenders®, Mad Dog®, Hodgman®, K2®, Völkl ®, Marker®, Madshus®· Ride®, Morrow®, 5150®, Liquid®, Marmot®, Ex Officio®, Planet Earth®, Adio®, Holden, Tubbs®, Atlas®, Little Bear®, JT® and Worr Games® are protected trademarks or registered trademarks of K2 or its subsidiaries in the United States and other countries worldwide. Buzz Off® is a registered trademark owned by Buzz Off Insect Shield, LLC.

Registered and other trademarks and trade names of K2 s products are italicized in this Form 10-K.

**Executive Officers of K2**

| Name | Position | Age |
|---|---|---|
| Richard J. Heckmann | Chairman of the Board and Chief Executive Officer | 62 |
| J. Wayne Merck | President and Chief Operating Officer | 45 |
| John J. Rangel | President K2 Inc. European Operations | 51 |
| Dudley W. Mendenhall | Senior Vice President and Chief Financial Officer | 51 |
| Monte H. Baier | Vice President, General Counsel and Secretary | 37 |
| David Y. Satoda | Vice President and Director of Taxes | 40 |
| Brian R. Anderson | Director of Business Development | 52 |
| Thomas R. Hillebrandt | Corporate Controller and Chief Accounting Officer | 44 |

Mr. Heckmann has been Chief Executive Officer of K2 since October 2002 and Chairman of the Board of Directors of K2 since April 2000. Mr. Heckmann served as a director of MPS Group, Inc. from April 2003 to March 2004, Philadelphia Suburban Corporation from August 2000 through February 2002, United Rentals, Inc. from October 1997 through May 2002, Waste Management Inc. from January 1994 through January 1999 and Station Casinos, Inc. from April 1999 through March 2001. Mr. Heckmann retired as Chairman of Vivendi Water, an international water products group of Vivendi S.A., a worldwide utility and communications company with headquarters in France, in June 2001. Mr. Heckmann was Chairman, President and Chief Executive Officer of U.S. Filter Corporation, a worldwide provider of water and wastewater treatment systems and services, from 1990 to 1999. Vivendi acquired US Filter on April 29, 1999. He has served as the associate administrator for finance and investment of the Small Business Administration in Washington, DC and was the founder and Chairman of the Board of Tower Scientific Corporation.

Mr. Merck has been President and Chief Operating Officer of K2 since November 2003. Prior to that, he was Executive Vice President and Chief Operating Officer of K2 from October 2002. He served as Executive Vice President of Operations of K2 from July 2000, Vice President of K2 from January 1996 and President of Shakespeare Composites & Electronics, a division of Shakespeare, a wholly-owned subsidiary of K2 from June 1996. Mr. Merck served as President of K2 s former business, Anthony Pools, from February 1994 to June 1996.

Mr. Rangel, has been President K2 Inc. European Operations of K2 since August 2004. Prior to that, he served as Senior Vice President Finance and Chief Financial Officer since April 2003, Senior Vice President Finance of K2 since 1988 and Corporate Controller from 1985 to 1988.

Mr. Mendenhall is Senior Vice President and Chief Financial Officer of K2. Prior to joining K2 in April 2003, he was Managing Director of Ernst & Young s west coast Corporate Finance Group from March 2001.

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From January 1990 through March 2001, Mr. Mendenhall held a number of executive positions at Bank of America: from January 1996 to March 2001, as Managing Director and Group Head of the entertainment and media industry group in Los Angeles and New York; from June 1993 to December 1995, as Managing Director of the Corporate Finance Group; and from January 1990 to June 1993, as Managing Director of the Leveraged Finance Group.

Mr. Baier is Vice President, General Counsel and Secretary of K2. Prior to joining K2 in April 2003, he was Associate General Counsel at Asia Global Crossing from April 2000. From 1995 through April 2000, Mr. Baier was as an Associate in the New York law firm of Simpson Thacher & Bartlett. Mr. Baier received a juris doctor degree from the New York University School of Law.

Mr. Satoda has been a Vice President of K2 Inc. since May 2001 and Director of Taxes since joining K2 in August 2000. Prior to that time, Mr. Satoda was a Senior Manager with Ernst & Young LLP, an international auditing and tax consulting firm for more than five years.

Mr. Anderson has been Director of Business Development since February 2005. Prior to holding that position, Mr. Anderson was the Director of Financial Accounting for K2 since he joined the company in March 2003. Prior to that, Mr. Anderson served as the Corporate Controller of US Filter Corporation, a provider of water and waste treatment systems and services since May 2000 and served as Assistant Corporate Controller from January 1997 through May 2000.

Mr. Hillebrandt has been Corporate Controller and Chief Accounting Officer of K2 since May 2004. Prior to joining K2, he was Senior Vice President and Chief Financial Officer of Fotoball USA, a publicly held souvenir and promotional products company, since July 2001 and was Vice President and Chief Financial Officer of Fotoball from July 2000 through May 2001. Fotoball was acquired by K2 in January 2004. From August 1998 through July 2000, Mr. Hillebrandt served as the Vice President and Chief Financial Officer of ChatSpace, Inc., a privately held Internet software and services company.

Officers of K2 are elected for one year by the directors at their first meeting after the annual meeting of shareholders and hold office until their successors are elected and qualified.

**Available Information**

K2 s website is http://www.k2inc.net. K2 makes available, free of charge, on or through the website, its annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with, or furnishing such reports to, the Securities and Exchange Commission. In addition, copies of the written charters for the committees of the Board of Directors, K2 s Principles of Corporate Governance, K2 s Code of Business Conduct and Ethics are also available on this website and can be found under the Investor Information and Corporate Governance links. Copies are also available in print, free of charge, by writing to Investor Relations, K2 Inc., 5818 El Camino Real, Carlsbad, California 92008. This website address is intended to be an inactive textual reference only, and none of the information contained on the website is part of this report or is incorporated in this report by reference.

**ITEM 1A. RISK FACTORS**

**K2  s strategic plan, involving growth through the acquisition of other companies, may not succeed.**

K2  s strategic plan involves growth through the acquisition of other companies. Such growth involves a number of risks, including:

the difficulties related to combining previously separate businesses into a single unit;

the substantial diversion of management  s attention from day-to-day operations;

the assumption of liabilities of an acquired business, including unforeseen liabilities;

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- the failure to realize anticipated benefits, such as cost savings and revenue enhancements;

- the dilution of existing stockholders and convertible note holders due to the issuance of equity securities, utilization of cash reserves, or incurrence of debt in order to fund the acquisitions;

- the potentially substantial transaction costs associated with acquisitions;

- the difficulties related to assimilating the products, personnel and systems of an acquired business and to integrating distribution and other operational capabilities; and

- the difficulties in applying K2 s internal controls to an acquired business.

**Current and future financings may place a significant debt burden on K2.**

K2 has incurred substantial indebtedness. At December 31, 2005, K2 had $437.3 million of outstanding debt, including $95.3 million of borrowings outstanding under its $250.0 million revolving credit facility, $43.0 million outstanding under various foreign lending arrangements, outstanding convertible debentures of $100.0 million in the aggregate less $1.0 million of unamortized value associated with warrants and $200.0 million outstanding in senior notes. In addition, as of December 31, 2005 K2 had available borrowings under its revolving credit facility of $145.3 million. K2 s substantial indebtedness, as well as potential future financings, could, among other things:

- adversely affect K2 s ability to expand its business, market its products and make investments and capital expenditures;

- adversely affect the cost and availability of funds from commercial lenders, debt financing transactions and other sources;

- adversely affect the ability of K2 to pursue its acquisition strategy; and

- create competitive disadvantages compared to other companies with lower debt levels.

**K2 faces intense competition and potential competition from companies with greater resources, and, if it is unable to compete effectively with these companies, its business could be harmed.**

The markets for sporting goods and recreational products in which K2 competes are generally highly competitive, especially as to product innovation, performance and styling, price, marketing and delivery. Competition regarding these products, other than active wear, consists of a relatively small number of large producers, some of whom have greater financial and other resources than K2. In addition, many of K2 s competitors offer sports and recreational equipment not currently sold by K2 and may be able to leverage these broader product offerings to adversely affect K2 s competitive market position. Further, there are no significant technological or capital barriers to entry into the markets for many sporting goods and recreational products. The sales of leisure products are also affected by changes in the economy and consumer tastes, and sporting goods and recreational products face competition from other leisure activities.

K2 s Marine and Outdoor segment products are, in most instances, subject to price competition, ranging from moderate in marine antennas and monofilament line to intense for commodity-type products. Many of K2 s marine and outdoor competitors have greater financial and other resources than K2.

**Certain K2 businesses are highly seasonal**

Certain K2 businesses are highly seasonal. Historically, certain of K2 s businesses, such as fishing tackle and water sports products, baseball and softball, skis and snowboards, winter apparel, bikes, and in-line skates have experienced seasonal swings in their businesses. This seasonality impacts K2 s working capital requirements and hence overall financing needs. In addition, K2 s borrowing capacity under the revolving credit facility is impacted by the seasonal change in receivables and inventory. The seasonality of K2 s businesses has also led to higher income levels in the second half of the year compared to the first half of the year.

A large portion of K2 s sales are to sporting goods retailers. Many of K2 s smaller retailers and some larger retailers are not strongly capitalized. Adverse conditions in the sporting goods retail industry can adversely impact the ability of retailers to purchase K2 products, or could lead retailers to request credit terms that would adversely affect K2 s cash flow and involve significant risks of nonpayment.

**Purchasing decisions made by a small number of large format sporting goods retailers can have a significant impact on K2 s results.**

Although the sporting goods manufacturing industry is highly fragmented, many of the retail customers that purchase sporting goods are highly concentrated. Large format sporting goods retailers are important to K2 s results of operations, and Wal-Mart accounted for approximately 15% of K2 s net sales for the year ended December 31, 2005. Due to their size, these retailers may demand better prices and terms from K2, and these demands may have an adverse impact on K2 s margins. In addition, if any of these large format sporting goods retailers were to decide to materially reduce the amounts or types of K2 products that they purchase, such decision would have a material adverse impact on K2 s business, financial condition, results of operations and prospects.

**Changing consumer tastes and styles as well as adverse economic developments could harm K2 s business.**

Consumer demand for recreational products is strongly influenced by matters of taste and style. K2 cannot assure you that K2 will successfully develop new products to address new or shifting consumer demand. An unexpected change in consumer tastes or product demand could seriously harm K2 s business. K2 s inability to timely and successfully respond to developments and changing styles could hurt its competitive position or render its products noncompetitive.

K2 cannot assure you that demand for its products will remain constant. The sales of leisure products are affected by changes in the economy and consumer tastes, both of which are difficult to predict. Continued adverse developments affecting economies throughout the world, including a general tightening of the availability of credit, increasing energy costs, declining consumer confidence and significant declines in the stock market could lead to a further reduction in discretionary spending for K2 s products.

**K2 s financial results vary from quarter to quarter, which could hurt K2 s business and the market price of its stock.**

Various factors affect K2 s quarterly operating results and some of them are not within K2 s control. They include, among others:

weather and snow conditions;

| | | | |
|---|---|---|---|
| Other long term assets | 5 | 195 | 306 |
| | | 719,328 | 847,289 |

| | | | | | |
|---|---|---|---|---|---|
| Total non-current assets | | | | | |
| **Total Assets** | | $ | 776,257 | $ | 904,920 |
| **Liabilities and Stockholders Equity** | | | | | |
| **Liabilities** | | | | | |
| Current portion of long term debt | 5 | $ | 30,290 | $ | 35,160 |
| Intangible liability charter agreements | | | 1,807 | | 2,104 |
| Deferred revenue | | | 1,940 | | 796 |
| Accounts payable | | | 963 | | 622 |
| Due to related party | 6 | | 1,315 | | 1,256 |
| Accrued expenses | | | 11,664 | | 13,694 |
| Total current liabilities | | | 47,979 | | 53,632 |
| Long term debt | 5 | | 389,583 | | 442,913 |
| Intangible liability charter agreements | | | 9,782 | | 11,589 |
| Deferred tax liability | | | 20 | | 20 |
| Total long term liabilities | | | 399,385 | | 454,522 |
| **Total Liabilities** | | $ | 447,364 | $ | 508,154 |
| Commitments and contingencies | 7 | | | | |
| **Stockholders Equity** | | | | | |
| | 8 | $ | 476 | $ | 475 |

| | | | |
|---|---|---|---|
| Class A Common stock authorized 214,000,000 shares with a $0.01 par value; 47,575,609 shares issued and outstanding (2015 47,541,484) | | | |
| Class B Common stock authorized 20,000,000 shares with a $0.01 par value; 7,405,956 shares issued and outstanding (2015 7,405,956) | 8 | 74 | 74 |
| Series B Preferred shares authorized 16,100 shares with $0.01 par value; 14,000 shares issued and outstanding (2015 14,000) | 8 | | |
| Additional paid in capital | | 386,708 | 386,425 |
| (Accumulated deficit) Retained earnings | | (58,365) | 9,792 |
| **Total Stockholders Equity** | | 328,893 | 396,766 |

| | | | | |
|---|---|---|---|---|
| **Total Liabilities and Stockholders Equity** | $ | 776,257 | $ | 904,920 |

See accompanying notes to interim unaudited consolidated financial statements

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**Global Ship Lease, Inc.**

**Interim Unaudited Consolidated Statements of Income**

(Expressed in thousands of U.S. dollars except share data)

| | Note | Three months ended December 31, 2016 | Three months ended December 31, 2015 | Year ended December 31, 2016 | Year ended December 31, 2015 |
|---|---|---|---|---|---|
| **Operating Revenues** | | | | | |
| Time charter revenue | | $ 9,444 | $ 10,412 | $ 37,567 | $ 31,568 |
| Time charter revenue related party | 6 | 31,982 | 33,617 | 128,956 | 133,351 |
| | | 41,426 | 44,029 | 166,523 | 164,919 |
| **Operating Expenses** | | | | | |
| Vessel operating expenses | | 10,814 | 11,851 | 44,096 | 48,238 |
| Vessel operating expenses related party | 6 | 400 | 400 | 1,599 | 1,866 |
| Depreciation | 4 | 10,415 | 10,935 | 42,805 | 44,859 |
| Impairment of vessels | 4 | 63,065 | | 92,422 | 44,700 |
| General and administrative | | 1,675 | 1,594 | 6,297 | 6,478 |
| Other operating income | | (41) | (164) | (216) | (475) |
| Total operating expenses | | 86,328 | 24,616 | 187,003 | 145,666 |
| **Operating (Loss) Income** | | (44,902) | 19,413 | (20,480) | 19,253 |
| **Non Operating Income (Expense)** | | | | | |
| Interest income | | 59 | 16 | 198 | 62 |
| Interest expense | | (9,450) | (12,419) | (44,767) | (48,152) |
| **(Loss) Income before Income Taxes** | | (54,293) | 7,010 | (65,049) | (28,837) |
| Income taxes | | (14) | 1 | (46) | (38) |
| **Net (Loss) Income** | | $ (54,307) | $ 7,011 | $ (65,095) | $ (28,875) |
| Earnings allocated to Series B Preferred Shares | 8 | (765) | (765) | (3,062) | (3,062) |
| **Net (Loss) Income available to Common Shareholders** | | $ (55,072) | $ 6,246 | $ (68,157) | $ (31,937) |
| **Earnings per Share** | | | | | |
| Weighted average number of Class A common shares outstanding | 10 | 47,867,266 | 47,841,484 | 47,854,351 | 47,785,388 |

| | | | | | |
|---|---|---|---|---|---|
| Basic (including RSUs without service conditions) | | | | | |
| Diluted | 10 | 47,867,266 | 47,841,484 | 47,854,351 | 47,785,388 |
| Net (loss) income per Class A common share | | | | | |
| Basic (including RSUs without service conditions) | 10 | $ (1.15) | $ 0.13 | $ (1.42) | $ (0.67) |
| Diluted | 10 | $ (1.15) | $ 0.13 | $ (1.42) | $ (0.67) |
| Weighted average number of Class B common shares outstanding Basic and diluted | 10 | 7,405,956 | 7,405,956 | 7,405,956 | 7,405,956 |
| Net income per Class B common share | | | | | |
| Basic and diluted | 10 | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 |

See accompanying notes to interim unaudited consolidated financial statements

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**Global Ship Lease, Inc.**

**Interim Unaudited Consolidated Statements of Cash Flows**

(Expressed in thousands of U.S. dollars)

| | Note | Three months ended December 31, 2016 | Three months ended December 31, 2015 | Year ended December 31, 2016 | Year ended December 31, 2015 |
|---|---|---|---|---|---|
| **Cash Flows from Operating Activities** | | | | | |
| Net income (loss) | | $ (54,307) | $ 7,011 | $ (65,095) | $ (28,875) |
| **Adjustments to Reconcile Net income (loss) to Net Cash Provided by Operating Activities** | | | | | |
| Depreciation | 4 | 10,415 | 10,935 | 42,805 | 44,859 |
| Vessel impairment | 4 | 63,065 | | 92,422 | 44,700 |
| Gain on sale of vessels | 4 | | (93) | | (93) |
| Amortization of deferred financing costs | 5 | 941 | 943 | 3,622 | 3,374 |
| Amortization of original issue discount | 5 | 402 | 346 | 1,651 | 1,178 |
| Amortization of intangible liability | | (515) | (530) | (2,104) | (2,119) |
| Share based compensation | 9 | 83 | | 283 | 75 |
| Gain on repurchase of secured notes | 5 | (1,938) | | (2,865) | |
| Decrease (increase) in accounts receivable and other assets | | 681 | (194) | 219 | 1,517 |
| Decrease (increase) in inventory | | 37 | 36 | 57 | (160) |
| Increase (decrease) in accounts payable and other liabilities | | 9,330 | 9,798 | (1,751) | (1,571) |
| Increase in unearned revenue | | 233 | 204 | 1,144 | 334 |
| (Decrease) increase in related party balances | 6 | (699) | (428) | 738 | (868) |
| Unrealized foreign exchange loss (gain) | | 33 | (6) | 26 | (14) |
| **Net Cash Provided by Operating Activities** | | 27,761 | 28,022 | 71,152 | 62,337 |
| **Cash Flows from Investing Activities** | | | | | |
| Cash paid for vessels | | | (168) | | (108,187) |
| Net proceeds from sale of vessels | | | 9,513 | (254) | 9,513 |
| Cash paid for other assets | | | | (6) | (3) |
| Cash paid for drydockings | | (2,513) | | (6,681) | (2,548) |
| **Net Cash (Used in) Provided by Investing Activities** | | (2,513) | 9,345 | (6,941) | (101,225) |
| **Cash Flows from Financing Activities** | | | | | |
| Repurchase of secured notes | 5 | (16,061) | | (50,997) | (350) |
| Proceeds from drawdown of revolving credit facility | 5 | | | | 75,000 |
| Deferred financing costs incurred | 5 | | (162) | | (971) |
| Repayment of credit facilities | 5 | (2,925) | (1,925) | (9,500) | (1,925) |

| | | | | | |
|---|---|---|---|---|---|
| Class A common shares dividends paid | 8 | | (4,754) | | (9,508) |
| Series B Preferred Shares dividends paid | 8 | (765) | (765) | (3,062) | (3,062) |
| **Net Cash Used in Financing Activities** | | (19,751) | (7,606) | (63,559) | 59,184 |
| **Net increase in Cash and Cash Equivalents** | | 5,497 | 29,761 | 652 | 20,296 |
| **Cash and Cash Equivalents at Start of Period** | | 48,746 | 23,830 | 53,591 | 33,295 |
| **Cash and Cash Equivalents at End of Period** | | $ 54,243 | $ 53,591 | $ 54,243 | $ 53,591 |
| **Supplemental information** | | | | | |
| Total interest paid | | $ 881 | $ 634 | $ 43,134 | $ 43,103 |
| Income tax paid | | $ 13 | $ 15 | $ 50 | $ 69 |

See accompanying notes to interim unaudited consolidated financial statements

**Global Ship Lease, Inc.**

**Interim Unaudited Consolidated Statements of Changes in Stockholders Equity**

(Expressed in thousands of U.S. dollars except share data)

| | Number of Common Stock at $0.01 Par value | Number of Series B Preferred Shares at $0.01 Par value | Common Stock | Series B Preferred Shares | Additional Paid in Capital | Retained Earnings / Accumulated Deficit | Stockholders Equity |
|---|---|---|---|---|---|---|---|
| **Balance at January 1, 2015** | 54,947,440 | 14,000 | $ 549 | $ | $ 386,350 | $ 51,237 | $ 438,136 |
| Restricted Stock Units (note 9) | | | | | 75 | | 75 |
| Net loss for the period | | | | | | (28,875) | (28,875) |
| Dividends on Class A common shares (note 8) | | | | | | (9,508) | (9,508) |
| Series B Preferred Shares dividend (note 8) | | | | | | (3,062) | (3,062) |
| **Balance at December 31, 2015** | 54,947,440 | 14,000 | $ 549 | $ | $ 386,425 | $ 9,792 | $ 396,766 |
| Restricted Stock Units (note 9) | | | | | 283 | | 283 |
| Class A common shares issued (note 8) | 34,125 | | 1 | | | | 1 |
| Net loss for the period | | | | | | (65,095) | (65,095) |
| Series B Preferred Shares dividend (note 8) | | | | | | (3,062) | (3,062) |
| **Balance at December 31, 2016** | 54,981,565 | 14,000 | $ 550 | $ | $ 386,708 | $ (58,365) | $ 328,893 |

See accompanying notes to interim unaudited consolidated financial statements

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**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements**

(Expressed in thousands of U.S. dollars)

## 1. General

On August 14, 2008, Global Ship Lease, Inc. (the Company or GSL ) merged indirectly with Marathon Acquisition Corp. ( Marathon ), a company then listed on The American Stock Exchange. Following the merger, the Company became listed on the New York Stock Exchange on August 15, 2008.

## 2. Nature of Operations and Basis of Preparation

### (a) Nature of Operations

The Global Ship Lease group owns and charters out containerships. As of December 31, 2016, the group owned 18 vessels; 15 were time chartered to CMA CGM and three to Orient Overseas Container Lines with remaining charter periods ranging from 1.00 to 9.00 years.

The following table provides information about the 18 vessels owned as at December 31, 2016:

| Vessel Name | Capacity in TEUs (1) | Year Built | Purchase Date by GSL | Charterer | Charter Remaining Duration (years) (2) | Daily Charter Rate |
|---|---|---|---|---|---|---|
| CMA CGM Matisse | 2,262 | 1999 | December 2007 | CMA CGM | 3.00 | $ 15.300 |
| CMA CGM Utrillo | 2,262 | 1999 | December 2007 | CMA CGM | 3.00 | $ 15.300 |
| Delmas Keta | 2,207 | 2003 | December 2007 | CMA CGM | 1.00 | $ 18.465 |
| Julie Delmas | 2,207 | 2002 | December 2007 | CMA CGM | 1.00 | $ 18.465 |
| Kumasi (3) | 2,207 | 2002 | December 2007 | CMA CGM | 4.00 | $ 13.000 |
| Marie Delmas (3) | 2,207 | 2002 | December 2007 | CMA CGM | 4.00 | $ 13.000 |
| CMA CGM La Tour | 2,272 | 2001 | December 2007 | CMA CGM | 3.00 | $ 15.300 |
| CMA CGM Manet | 2,272 | 2001 | December 2007 | CMA CGM | 3.00 | $ 15.300 |
| CMA CGM Alcazar | 5,089 | 2007 | January 2008 | CMA CGM | 4.00 | $ 33.750 |
| CMA CGM Château d lf | 5,089 | 2007 | January 2008 | CMA CGM | 4.00 | $ 33.750 |
| CMA CGM Thalassa | 11,040 | 2008 | December 2008 | CMA CGM | 9.00 | $ 47.200 |
| CMA CGM Jamaica | 4,298 | 2006 | December 2008 | CMA CGM | 6.00 | $ 25.350 |
| CMA CGM Sambhar | 4,045 | 2006 | December 2008 | CMA CGM | 6.00 | $ 25.350 |
| CMA CGM America | 4,045 | 2006 | December 2008 | CMA CGM | 6.00 | $ 25.350 |
| CMA CGM Berlioz | 6,621 | 2001 | August 2009 | CMA CGM | 4.75 | $ 34.000 |
| OOCL Tianjin | 8,063 | 2005 | October 2014 | OOCL | 1.00 | $ 34.500 |
| OOCL Qingdao | 8,063 | 2004 | March 2015 | OOCL | 1.25 | $ 34.500 |
| OOCL Ningbo | 8,063 | 2004 | September 2015 | OOCL | 1.75 | $ 34.500 |

(1) *Twenty-foot Equivalent Units.*

(2) *Plus or minus 90 days, other than (i) OOCL Tianjin which is between October 28, 2017 and January 28, 2018, (ii) OOCL Qingdao which is between March 11, 2018 and June 11, 2018, and (iii) OOCL Ningbo which is between September 17, 2018 and December 17, 2018, all at charterer s option.*

(3) *The charters on these two vessels were amended in July 2016 to provide for a revised charter rate of $13,000 per day with effect from August 1, 2016 until September 14, 2017 for Marie Delmas and September 21, 2017 for Kumasi, and to provide for three option periods, all at the Company s option, at a charter rate of $9,800 per day. The option periods are (i) September 15 or 22, 2017 for Marie Delmas and Kumasi respectively to December 31, 2018, (ii) January 1, 2019 to December 31, 2019 and (iii) January 1, 2020 to December 31, 2020.*

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars)

## 2. Nature of Operations and Basis of Preparation (continued)

### (b) Basis of Preparation

**Counterparty risk**

The majority of the Company s revenues are derived from charters to CMA CGM. The Company is consequently highly dependent on the performance by CMA CGM of its obligations under these charters. The container shipping industry is volatile and has been experiencing a sustained cyclical downturn. Many container shipping companies have reported financial losses.

If CMA CGM ceases doing business or fails to perform its obligations under the charters, the Company s business, financial position and results of operations would be materially adversely affected as it is probable that, even if the Company was able to find replacement charters, such replacement charters would be at significantly lower daily rates and shorter durations. If such events occur, there would be significant uncertainty about the Company s ability to continue as a going concern.

These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets, nor to the amounts and classification of liabilities that may be necessary should the Company be unable to continue as a going concern.

## 3. Accounting Policies and Disclosure

The accompanying financial information is unaudited and reflects all adjustments, consisting solely of normal recurring adjustments, which, in the opinion of management, are necessary for a fair statement of financial position and results of operations for the interim periods presented. The financial information does not include all disclosures required under United States Generally Accepted Accounting Principles ( US GAAP ) for annual financial statements. These interim unaudited consolidated financial statements should be read in conjunction with the Company s financial statements as of December 31, 2015 filed with the Securities and Exchange Commission on April 15, 2016 in the Company s Annual Report on Form 20-F.

*Impairment testing*

Due to continuing poor industry conditions, impairment tests were performed on a vessel by vessel basis as at December 31, 2016 and December 31, 2015. Based on the assumptions made, an impairment charge on four vessels, totalling $63,065, has been recognised in the financial statements for the three months ended 31 December 2016. No impairment was recognised after the impairment tests performed as at December 31, 2015, as, based on the assumptions made, the expected undiscounted future cash flows exceeded the vessels carrying amounts.

The agreement to amend the charters on two of the Company s vessels in July 2016 (see note 2(a)) was seen as an indicator of potential impairment of their carrying value. Accordingly, an impairment test was performed for these two vessels as at July 31, 2016, giving rise to an impairment charge of $29,357.

The redelivery and potential sale of two of the Company s vessels in late 2015 (see note 4) was seen as an indicator of potential impairment of their carrying value. Accordingly, an impairment test, based on the fair value less estimated costs to sell, was performed for these two vessels as at September 30, 2015 which lead to an impairment charge of $44,700 being recognised.

The assumptions used involve a considerable degree of estimation. Actual conditions may differ significantly from the assumptions and thus actual cash flows may be significantly different to those expected with a material effect on the recoverability of each vessel s carrying amount. The most significant assumptions made for the determination of expected cash flows are (i) charter rates on expiry of existing charters, which are based on forecast charter rates, where relevant, for the four years from the date of the test and a reversion to the historical mean for each vessel thereafter (ii) off-hire days, which are based on actual off-hire statistics for the Company s fleet (iii) operating costs, based on current levels escalated over time based on long term trends (iv) dry docking frequency, duration and cost and (v) estimated useful life which is assessed as a total of 30 years. In the case of an indication of impairment, the results of a recoverability test would also be sensitive to the discount rate applied.

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars)

## 3. Accounting Policies and Disclosure (continued)

*Revenue recognition*

If a time charter contains one or more consecutive option periods, then subject to the options being exercisable solely by the Company, the time charter revenue will be recognized on a straight-line basis over the total remaining life of the time charter, including any options which are more likely than not to be exercised. Any difference between the charter rate invoiced and the time charter revenue recognized is classified as, or released from, deferred revenue within the Consolidated Balance Sheets.

*Recently issued accounting standards*

The Company has adopted the new Going Concern standard under ASU 2014-15.

Management does not believe that any other recently issued, but not yet effective accounting pronouncements, if currently adopted, would have a material impact on the interim unaudited consolidated financial statements of the Company.

## 4. Vessels in Operation, less Accumulated Depreciation

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| Cost | $ 1,095,275 | $ 1,095,245 |
| Accumulated depreciation | (283,743) | (248,306) |
| Vessel impairment | (92,422) | |
| **Net book value** | **$ 719,110** | $ 846,939 |

Due to continuing poor industry conditions, impairment tests were performed on a vessel by vessel basis as at December 31, 2016 (see note 3), which resulted in an impairment charge on four vessels, totalling $63,065, being recognised in the three months ended December 31, 2016.

Impairment tests were performed on two of the group s vessels as at July 31, 2016, following amendments to the terms of their charters (see note 3), which resulted in an impairment charge of $29,357 being recognised in the three months ended September 30, 2016.

Ville d Aquarius and Ville d Orion were redelivered at the end of their charters during the fourth quarter of 2015 and the sales of the vessels were agreed and completed in November 2015 and December 2015, respectively. The vessels were impaired as at September 30, 2015, by $22,203 and $22,497 respectively, to their fair value less estimated costs to sell.

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars)

## 5. Long-Term Debt

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| 2019 Notes | $ 420,000 | $ 420,000 |
| Less repurchase of Notes (note 5(a)) | (54,212) | (350) |
| Less original issue discount | (6,300) | (6,300) |
| Amortization of original issue discount | 3,910 | 2,259 |
| 2019 Notes (note 5(a)) | 363,398 | 415,609 |
| Revolving Credit Facility (note 5(b)) | 39,200 | 40,000 |
| Secured Term Loan (note 5(c)) | 24,375 | 33,075 |
| Less: Deferred financing costs (note 5(e)) | (7,100) | (10,611) |
| Balance | **419,873** | 478,073 |
| Less: Current portion of 2019 Notes (note 5(a)) | (18,765) | (26,660) |
| Less: Current portion of Revolving Credit Facility (note 5(b)) | | (800) |
| Less: Current portion of Secured Term Loan (note 5(c)) | (11,525) | (7,700) |
| **Non-current portion of Long-Term Debt** | **$ 389,583** | $ 442,913 |

**a) 10.0% First Priority Secured Notes Due 2019**

On March 19, 2014 the Company completed the sale of $420,000 of 10.0% First Priority Secured Notes which mature on April 1, 2019. Proceeds after the deduction of the original issue discount, but before expenses, amounted to $413,700.

Interest on the 2019 Notes is payable semi-annually on April 1 and October 1 of each year, commencing on October 1, 2014. As at December 31, 2016 the 2019 Notes were secured by first priority ship mortgages on 16 of the Company s 18 vessels (the Mortgaged Vessels ) and by assignments of earnings and insurances, a pledge over certain bank accounts, as well as share pledges over each subsidiary owning a Mortgaged Vessel. In addition, the 2019 Notes are fully and unconditionally guaranteed, jointly and severally, by the Company s 18 vessel owning subsidiaries and Global Ship Lease Services Limited.

The original issue discount is being amortised on an effective interest rate basis over the life of the 2019 Notes.

Under the terms of the 2019 Notes the Company is required within 120 days following the end of each financial year, in which the Company has at least $1,000 of Excess Cash Flow, as defined, to offer to purchase up to a maximum offer amount of $20,000, such amount being the aggregate of 102% of the principal amount plus any accrued and unpaid interest thereon, up to, but not including, the purchase date. The first such offer, for 2014, in the maximum amount of $20,000, was launched on April 21, 2015. At the close of this offer, $350 nominal amount of 2019 Notes was tendered and accepted.

Following the sale of two vessels (see note 4) secured to the 2019 Notes in November and December 2015, the Company was required to offer the net sale proceeds, less a proportion to be used to repay part of the associated Revolving Credit Facility (see note 5(c)), to Noteholders ( Collateral Sale Offer ) within 90 days of receipt of the sale proceeds. The terms of the Collateral Sale Offer are the same as those of the annual Excess Cash Flow Offer. Consequently, on February 2, 2016, the Company launched a combined Excess Cash Flow Offer for 2015 and the Collateral Sale Offer in an aggregate amount of $28,417 ( Maximum Offer Amount ), at a purchase price of 102% of the aggregate principal amount plus any accrued and unpaid interest thereon, up to, but not including, the purchase date. At the close of this offer, the nominal amount of 2019 Notes tendered exceeded the Maximum Offer Amount and $26,662 were accepted on a pro rata basis.

In May, August and November, 2016, the Company purchased $4,200, $5,000 and $18,000 of Notes respectively, in the open market. This gave rise to gains of $452, $475 and $1,938, which are included within Interest Expense in the Consolidated Statements of Income. These Notes were subsequently cancelled.

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars)

**5. Long-Term Debt (continued)**

**b) Revolving Credit Facility**

On March 19, 2014, and in connection with the 2019 Notes, the Company entered into a $40,000 senior secured revolving credit facility with Citibank N.A. (the Revolving Credit Facility ). This facility matures on October 1, 2018. The interest rate under the facility is USD LIBOR plus a margin of 3.25% and is payable at least quarterly. A commitment fee of 1.30% per annum is due quarterly on undrawn amounts.

The collateral provided to the 2019 Notes also secures on a first priority basis the Revolving Credit Facility. Up to and including December 31, 2015, the Company was required to have had a minimum cash balance of $15,000 on each test date, being June 30 and December 31 in each year. After this date, the minimum cash balance on each test date increased to $20,000.

Amounts outstanding under this facility can be prepaid without penalty, other than breakage costs in certain circumstances. During the quarter ended March 31, 2015, $40,000 was drawn down under the Revolving Credit Facility to assist with the purchase of OOCL Qingdao on March 11, 2015. Following the sale of two secured vessels (see note 4) in November and December 2015, $800 of the net sale proceeds was applied to reduce amounts outstanding under the facility.

**c) Secured Term Loan**

On July 29, 2015, the Company entered into a $35,000 secured term loan with DVB Bank SE (the Secured Term Loan ). This facility matures five years after drawdown, with early repayment, inter alia, if the 2019 Notes are not refinanced by November 30, 2018, or if the secured vessel ceases to be employed on a charter for a period in excess of 90 days. The interest rate under the loan is USD LIBOR plus a margin of 2.75%, until November 30, 2018 and 3.25% thereafter, and is payable at least quarterly.

The Secured Term Loan is secured by a first priority ship mortgage on OOCL Tianjin and by assignment of earnings and insurances for the same vessel.

The Secured Term Loan is repayable in 20 equal quarterly instalments, commencing three months after drawdown. $35,000 was drawn down under the Secured Term Loan on September 10, 2015. The loan agreement requires an additional $1,400 to be repaid over eight equal quarterly instalments to provide a reserve for potential enhancement expenditure on the secured vessel ahead of the expiry of the initial charter to OOCL. These additional instalments reduce the debt balance and can be redrawn to fund the enhancement work, or utilized to permanently reduce the quarterly instalments for the remainder of the term of the loan if no such work is required.

The Secured Term Loan has the same Cash Balance financial covenant as that in the Revolving Credit Facility. In addition, there is a minimum Shareholders Equity covenant of $200,000, also to be tested semi-annually on June 30 and December 31. The Secured Term Loan was amended on November 30, 2016 to exclude from the definition of

Shareholders Equity the effect of any impairment charges recognised after July 1, 2016. The amendment also provided for accelerated amortization totalling $5.0 million to be paid equally in five quarterly instalments, commencing fourth quarter 2016. Repayments from March 2018 are to be reduced pro rata for the accelerated amortization.

**d) Repayment Schedule**

Based on scheduled and estimated repayments from January 1, 2017 the long term debt will be reduced in each of the relevant periods as follows:

| **Year ending December 31,** | |
|---|---|
| 2017 | $ 30,290 |
| 2018 | 62,638 |
| 2019 | 332,930 |
| 2020 | 3,505 |
| Less: amortization of original issue discount | (2,390) |
| Less: amortization of deferred financing costs | (7,100) |
| | **$ 419,873** |

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars)

## 5. Long-Term Debt (continued)

### e) Deferred Financing Costs

| | **December 31, 2016** | December 31, 2015 |
|---|---|---|
| Opening balance | $ 10,611 | $ 12,913 |
| Expenditure in the period | | 971 |
| Amortization included within interest expense | (3,511) | (3,273) |
| **Closing balance** | **$ 7,100** | $ 10,611 |

The Company incurred costs during 2015 in relation to the drawdown of the Revolving Credit Facility (see note 5(b)) amounting to $370 and in relation to the drawdown of the Secured Term Loan (see note 5(c)) amounting to $601, which have been deferred.

Deferred financing costs are amortized on an effective interest rate basis over the life of the financings for which they were incurred.

The Company has adopted the accounting standards update issued by FASB in April 2015 Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs . Effective December 31, 2015, debt issuance costs, other than the up-front arrangement fee for the Revolving Credit Facility, related to our recognized debt liabilities are presented as a direct deduction from the carrying amount of that debt. The arrangement fee for the Revolving Credit Facility is presented as Other Long Term Assets.

## 6. Related Party Transactions

CMA CGM is presented as a related party as it was, until the merger referred to in note 1, the parent company of Global Ship Lease, Inc. and at December 31, 2016 is a significant shareholder of the Company, owning Class A and Class B common shares representing a 44.4% voting interest in the Company.

Amounts due to and from CMA CGM companies are shown in the Consolidated Balance Sheets. The current account balances at December 31, 2016 and 2015 relate to amounts payable to or recoverable from CMA CGM group companies. The majority of the Company s charter arrangements are with CMA CGM and one of its subsidiaries provides the Company with ship management services on the majority of its vessels.

**Time Charter Agreements**

The majority of the Company s time charter arrangements are with CMA CGM. Under these time charters, hire is payable in advance and the daily rate is fixed for the duration of the charter. The charters are for remaining periods as at December 31, 2016 of between 1.00 and 9.00 years (see note 2(a)). Of the $638,530 maximum contracted future charter hire receivable (including all periods at the Company s option) for the fleet set out in note 7, $586,849 relates to the 15 vessels that were chartered to CMA CGM as at December 31, 2016. Revenues generated from charters to CMA CGM are shown separately in the Consolidated Statements of Income.

**Ship Management Agreements**

At December 31, 2016, the Company outsourced day to day technical management of 13 of its vessels to CMA Ships Limited ( CMA Ships ), a wholly owned subsidiary of CMA CGM. The Company pays CMA Ships an annual management fee of $123 per vessel (2015: $123) and reimburses costs incurred by CMA Ships on its behalf, mainly being for the provision of crew, lubricating oils and routine maintenance. Such reimbursement is subject to a cap per day per vessel, depending on the vessel. The impact of the cap is determined annually on a vessel by vessel basis for so long as the initial charter remains in place; no claims have been made under the cap agreement. Ship management fees related to CMA Ships are shown separately in the Consolidated Statements of Income.

Except for transactions with CMA CGM companies, the Company did not enter into any other related party transactions.

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars except share data)

**7. Commitments and Contingencies**
**Charter Hire Receivable**

The Company has entered into time charters for its vessels. The charter hire is fixed for the duration of the charter. The maximum contracted annual future charter hire receivable (not allowing for any offhire and assuming expiry at the mid-point between the earliest and latest possible end dates) for the 18 vessels as at December 31, 2016, and assuming the options included in the charters for Kumasi and Marie Delmas are exercised, is as follows:

| **Year ending December 31,** | |
|---|---|
| 2017 | 163,201 |
| 2018 | 126,050 |
| 2019 | 110,439 |
| 2020 | 89,432 |
| 2021 | 53,917 |
| Thereafter | 95,491 |
| | **$ 638,530** |

**8. Share Capital**
At December 31, 2016 the Company had two classes of common shares. The rights of holders of Class B common shares are identical to those of holders of Class A common shares, except that the dividend rights of holders of Class B common shares are subordinated to those of holders of Class A common shares. Dividends, when declared, must be paid as follows:

firstly, to all Class A common shares at the applicable rate for the quarter;

secondly, to all Class A common shares until they have received payment for all preceding quarters at the rate of $0.23 per share per quarter;

thirdly, to all Class B common shares at the applicable rate for the quarter;

then, to all Class A and B common shares as if they were a single class.

The Class B common shares remain subordinated until the Company has paid a dividend at least equal to $0.23 per quarter per share on both the Class A and Class B common shares for the immediately preceding four-quarter period. Due to the requirements described above, Class B common shares cannot receive any dividend until all Class A common shares have received dividends representing $0.23 per share per quarter for all preceding quarters. Should the notional arrearages of dividend on the Class A common shares be made up and a dividend at the rate of $0.23 per share be paid for four consecutive quarters, the Class B common shares convert to Class A common shares on a one-for-one basis. Also, each Class B common share will convert into a Class A common share on a change of control of the Company.

A dividend of $0.10 per Class A common share was paid on August 24, 2015 and on November 24, 2015. Prior to these, the last quarter for which a dividend was paid was the fourth quarter 2008 at $0.23 per Class A common share.

Restricted stock units have been granted periodically to the Directors and management, under the Company s 2008 Equity Incentive Plan, as part of their compensation arrangements (see note 9). On August 28, 2015, the Company adopted the 2015 Equity Incentive Plan. The 2008 Equity Incentive Plan was closed. The 2015 Plan permits a maximum issuance of 1,500,000 shares. On March 31, June 30, September 30 and December 30, 2016, 8,529, 8,534, 8,534 and 8,528 shares respectively, were issued under the 2015 Plan, representing 20% of directors base fee for the quarters ended March 31, June 30, September 30, and December 31, 2016. The number of shares to be issued was determined on the basis of a notional value per share of $4.00 rather than market values.

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars except share data)

## 8. Share Capital (continued)

On August 20, 2014, the Company issued 1,400,000 depositary shares, each of which represents 1/100$^{th}$ of one share of the Company s 8.75% Series B Cumulative Redeemable Perpetual Preferred Shares (the Series B Preferred Shares ). Dividends are payable at 8.75% per annum in arrears on a quarterly basis. At any time after August 20, 2019 (or within 180 days after the occurrence of a fundamental change), the Series B Preferred Shares may be redeemed, at the discretion of the Company, in whole or in part, at a redemption price of $2,500.00 per share (equivalent to $25.00 per depositary share). The net proceeds from the offering were $33,497. These shares are classified as Equity in the Consolidated Balance Sheets. The dividends payable on the Series B Preferred Shares are presented as a reduction of Retained Earnings in the Consolidated Statements of Equity, when and if declared by the Board of Directors. An initial dividend was declared on September 22, 2014 for the third quarter 2014. Subsequent quarterly dividends have been declared, the last of which was on December 9, 2016 for the fourth quarter 2016.

## 9. Share-Based Compensation

Share based awards since January 1, 2015, are summarized as follows:

| | Restricted Stock Units | | |
|---|---|---|---|
| | Number of Units | Weighted Average Fair Value on Grant Date | Actual Fair Value on Vesting Date |
| **Unvested as at January 1, 2015** | **300,000** | **$ 3.25** | **n/a** |
| Vested in 2015 | | | |
| **Unvested as at December 31, 2015** | **300,000** | **$ 3.25** | **n/a** |
| Granted March 3, 2016 | 200,000 | $ 1.18 | |
| **Unvested as at December 31, 2016** | **500,000** | **$ 2.42** | **n/a** |

Using the graded vesting method of expensing the restricted stock unit grants, the calculated weighted average fair value of the stock units is recognized as compensation cost in the Consolidated Statements of Income over the vesting period. During the three months and year ended December 31, 2016, the Company recognized a total of $83 (2015: $ nil) and $283 (2015: $75) share based compensation cost. As at December 31, 2016, there was no unrecognized compensation cost relating to the above share based awards (December 31, 2015: $ nil).

Restricted stock units granted to four members of management on September 2, 2011 were to vest over two years; half during September and October 2012 and the remaining half during September and October 2013. In March 2012, these grants were amended and restated to provide that vesting would occur only when the individual leaves employment, for whatever reason, provided that this was after September 30, 2012 in respect of half of the grant and after September 30, 2013 for the other half of the grant. Restricted stock units granted to management on March 13, 2012 are expected to vest when the individual leaves employment, provided that this is after September 30, 2014 and is not as a result of resignation or termination for cause. Restricted stock units granted to management on March 7, 2013 are expected to vest when the individual leaves employment, provided that this is after September 30, 2015 and is not as a result of resignation or termination for cause.

On August 28, 2015, the Company adopted the 2015 Equity Incentive Plan which allows the Board of Directors to grant employees, consultants and directors of the Company and its subsidiaries, options, stock appreciation rights, stock grants, stock units and dividend equivalents on substantially the same terms as the 2008 Plan, which was closed for further awards. The 2015 Plan permits a maximum issuance of 1,500,000 shares.

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars except share data)

**9. Share-Based Compensation (continued)**

Under the 2015 Plan, restricted stock units granted to four members of management on March 3, 2016 were divided into two tranches. The first tranche (100,000 restricted stock units)) will vest when the individual leaves employment, provided that this is after December 31, 2016 and is not for cause. The second tranche (100,000 restricted stock units) also vests after December 31, 2016 on the same terms, but, in addition, only if and when the stock price has been at or above $5.00 for 20 consecutive trading days and provided that this has occurred before December 31, 2019.

During the year ended December 31, 2016, 34,125 shares were issued under the 2015 Plan, representing 20% of directors base fee for 2016. The number of shares to be issued was determined on the basis of a notional value per share of $4.00 rather than market values.

**10. Earnings per Share**

Basic earnings per common share is presented under the two-class method and is computed by dividing the earnings applicable to common stockholders by the weighted average number of common shares outstanding for the period.

Under the two class method, net income available to common stockholders, if any, is first reduced by the amount of dividends declared in respect of common shares for the current period, if any, and the remaining earnings are allocated to common shares and participating securities to the extent that each security can share the earnings assuming all earnings for the period are distributed. The Class B common shareholders dividend rights are subordinated to those of holders of Class A common shares (see note 8). Net income for the relevant period is allocated based on the contractual rights of each class of security and as there was insufficient net income to allow any dividend on the Class B common shares no earnings were allocated to Class B common shares.

Losses are only allocated to participating securities in a period of net loss if, based on the contractual terms, the relevant common shareholders have an obligation to participate in such losses. No such obligation exists for Class B common shareholders and, accordingly, losses would only be allocated to the Class A common shareholders.

At December 31, 2016, there were 500,000 restricted stock units granted and unvested as part of management s equity incentive plan. As of December 31, 2016 only Class A and B common shares are participating securities.

For the three months and years ended December 31, 2016 and December 31, 2015, the diluted weighted average number of Class A common shares outstanding is the same as the basic weighted average number of shares outstanding. The diluted weighted average number of shares excludes the outstanding restricted stock units as these would have had an antidilutive effect.

**Global Ship Lease, Inc.**

**Notes to the Interim Unaudited Consolidated Financial Statements (continued)**

(Expressed in thousands of U.S. dollars except per share data)

## 10. Earnings per Share (continued)

| (In thousands, except share data) | Three months ended December 31, 2016 | Three months ended December 31, 2015 | Year ended December 31, 2016 | Year ended December 31, 2015 |
|---|---|---|---|---|
| **Class A common shares** | | | | |
| Basic weighted average number of common shares outstanding (B) | 47,567,266 | 47,541,484 | 47,554,351 | 47,541,484 |
| Weighted average number of RSUs without service conditions (note 9) (B) | 300,000 | 300,000 | 300,000 | 243,904 |
| Dilutive effect of share-based awards | | | | |
| Common shares and common share equivalents (F) | 47,867,266 | 47,841,484 | 47,854,351 | 47,785,388 |
| **Class B common shares** | | | | |
| Basic weighted average number of common shares outstanding (D) | 7,405,956 | 7,405,956 | 7,405,956 | 7,405,956 |
| Dilutive effect of share-based incentive awards | | | | |
| Common shares (H) | 7,405,956 | 7,405,956 | 7,405,956 | 7,405,956 |
| **Basic Earnings per Share** | | | | |
| Net (loss) income available to common shareholders | $ (55,072) | $ 6,246 | $ (68,157) | $ (31,937) |
| Available to: | | | | |
| - Class A shareholders for period | $ (55,072) | $ 6,246 | $ (68,157) | $ (31,937) |
| - Class A shareholders for arrears | | | | |
| - Class B shareholders for period | | | | |
| - allocate pro-rata between Class A and B | | | | |
| Net (loss) income available for Class A (A) | $ (55,072) | $ 6,246 | $ (68,157) | $ (31,937) |
| Net income (loss) available for Class B (C) | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Basic Earnings per share: | | | | | | | | |
| Class A (A/B) | $ | (1.15) | $ | 0.13 | $ | (1.42) | $ | (0.67) |
| Class B (C/D) | | | | | | | | |
| **Diluted Earnings per Share** | | | | | | | | |
| Net (loss) income available to common shareholders | $ | (55,072) | $ | 6,246 | $ | (68,157) | $ | (31,937) |
| Available to: | | | | | | | | |
| - Class A shareholders for period | $ | (55,072) | $ | 6,246 | $ | (68,157) | $ | (31,937) |
| - Class A shareholders for arrears | | | | | | | | |
| - Class B shareholders for period | | | | | | | | |
| - allocate pro rata between Class A and B | | | | | | | | |
| Net (loss) income available for Class A (E) | $ | (55,072) | $ | 6,246 | $ | (68,157) | $ | (31,937) |
| Net income (loss) available for Class B (G) | | | | | | | | |
| Diluted Earnings per share: | | | | | | | | |
| Class A (E/F) | $ | (1.15) | $ | 0.13 | $ | (1.42) | $ | (0.67) |
| Class B (G/H) | | | | | | | | |

**11. Subsequent Events**

There are no subsequent events other than those disclosed elsewhere in the consolidated financial statements.