FREESEAS INC.
Form 20-F
May 15, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

(Mark One)

¨ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2017

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

OR

¨ **SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Date of event requiring this shell report. Not applicable

For the transition period from _____________ to ____________

Commission file number 000-51672

FREESEAS INC.
(Exact name of the Registrant as specified in its charter)

Republic of the Marshall Islands
(Jurisdiction of incorporation or organization)

20, Amerikis Street., 10671 Athens, Greece
(Address of principal executive offices)

Dimitris Filippas, Chief Financial Officer
FreeSeas Inc.
20, Amerikis Street,
10671 Athens, Greece
011-30-210-729-7015
(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

None
(Title of Class)

Securities registered or to be registered pursuant to Section 12(g) of the Act.

Title of Each Class
Common Stock, par value $0.001 per share

Preferred Share Purchase Rights (attached to Common Stock)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None
(Title of Class)

Indicate the number of outstanding shares of each of the issuer’s classes of capital or common stock as of the close of the period covered by the annual report. 798,423 common shares, par value $0.001 per share, as of December 31, 2017.

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

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. x Yes ¨ No

Note - Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark 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. x Yes ¨ No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes ¨ No

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

¨ Large Accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP x	International Financial reporting Standards as issued by the International Accounting Standards Board	Other ¨

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. ¨ Item 17 ¨ Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). ¨ Yes x No

Table of Contents

INTRODUCTION

FreeSeas Inc. is a Republic of the Marshall Islands company that is referred to in this annual report on Form 20-F, together with its subsidiaries, as “FreeSeas Inc.,” “FreeSeas,” “the Company,” “we,” “us,” or “our.”

We use the term “deadweight tons,” or “dwt,” in describing the capacity of our drybulk carriers. Dwt, expressed in metric tons, each of which is equivalent to 1,000 kilograms, refers to the maximum weight of cargo and supplies that a vessel can carry. Drybulk carriers are generally categorized as Handysize, Handymax, Panamax and Capesize. The carrying capacity of a Handysize drybulk carrier typically ranges from 10,000 to 39,999 dwt and that of a Handymax drybulk carrier typically ranges from 40,000 to 59,999 dwt. By comparison, the carrying capacity of a Panamax drybulk carrier typically ranges from 60,000 to 79,999 dwt and the carrying capacity of a Capesize drybulk carrier typically is 80,000 dwt and above.

Unless otherwise indicated:

All references to “$” and “dollars” in this annual report are to U.S. dollars;

Financial information presented in this annual report is derived from financial statements for the fiscal year ended December 31, 2017 appearing elsewhere in this annual report; and

All references to dollar amounts in this annual report, except share price, per share data, daily hire and fee rates are expressed in thousands of U.S. dollars.

All share-related and per share information in this annual report have been adjusted to give effect to the (i) one share for ten (10) share reverse stock split that was effective on February 14, 2013, (ii) one share for five (5) share reverse stock split that was effective on December 2, 2013, (iii) one share for seven and one-half share (7.5) reverse stock split that was effective on May 11, 2015, (iv) one share for fifty (50) share reverse stock split that was effective on June 26, 2015, (v) one share for sixty (60) share reverse stock split that was effective on January 15, 2016, (vi) one share for two hundred (200) share reverse stock split that was effective on April 14, 2016, (vii) one share for five thousand (5,000) share reverse stock split that was effective on February 7, 2017 and (viii) one share for five thousand (5,000) share reverse stock split that was effective on February 6, 2018.

This report should be read in conjunction with our audited consolidated financial statements and the accompanying notes thereto, which are included in Item 18 to this annual report.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This annual report contains certain forward-looking statements. These forward-looking statements include information about possible or assumed future results of our operations and our performance. Our forward-looking statements include, but are not limited to, statements regarding us or our management's expectations, hopes, beliefs, intentions or strategies regarding the future and other statements other than statements of historical fact. In addition, any statements that refer to projections, forecasts or other characterizations of future events or circumstances, including any underlying assumptions, are forward-looking statements. The words "anticipates," "forecasts," "believe," "continue," "could," "estimate," "expect," "intends," "may," "might," "plan," "possible," "potential," "predicts," "project," "should," "would" and s expressions may identify forward-looking statements, but the absence of these words does not mean that a statement is not forward-looking. Forward-looking statements in this annual report may include, for example, statements about:

our future operating or financial results;

our financial condition and liquidity, including our ability to comply with our loan covenants, to repay our indebtedness and to continue as a going concern;

potential liability from future litigation and incidents involving our vessels, including seizures by pirates, and our expected recoveries of claims under our insurance policies;

our ability to comply with the continued listing standards on the exchange or trading market on which our common stock is listed for trading;

our ability to find employment for our vessels;

drybulk shipping industry trends, including charter rates and factors affecting vessel supply and demand;

- business strategy, areas of possible expansion, and expected capital spending or operating expenses and general and administrative expenses;
- the useful lives and value of our vessels;
- our ability to receive in full or partially our accounts receivable and insurance claims;
- greater than anticipated levels of drybulk vessel new building orders or lower than anticipated rates of drybulk vessel scrapping;
- changes in the cost of other modes of bulk commodity transportation;
- availability of crew, number of off-hire days, dry-docking requirements and insurance costs;
- changes in condition of our vessels or applicable maintenance or regulatory standards (which may affect, among other things, our anticipated dry-docking costs);
- competition in the seaborne transportation industry;
- global and regional economic and political conditions;
- fluctuations in currencies and interest rates;
- the overall health and condition of the U.S. and global financial markets;
- changes in seaborne and other transportation patterns;
- changes in governmental rules and regulations or actions taken by regulatory authorities;
- our ability to pay dividends in the future;
- acts of terrorism and other hostilities; and
- other factors discussed in the section titled “Risk Factors” in this annual report.

The forward-looking statements contained in this annual report are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. These risks and uncertainties include, but are not limited to, those factors described under the heading “Risk Factors.” Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements contained in this annual report, or the documents to which we refer you in this annual report, to reflect any change in our expectations with respect to such statements or any change in events, conditions or circumstances on which any statement is based.

iii

PART I

Item 1. Identity of Directors, Senior Management and Advisers

Not required.

Item 2. Offer Statistics and Expected Timetable

Not required.

Item 3. Key Information

A. Selected Financial Data

The selected consolidated financial information set forth below has been derived from our audited financial statements for the years ended December 31, 2017, 2016, 2015, 2014 and 2013. The information is only a summary and should be read in conjunction with our audited consolidated financial statements for the years ended December 31, 2017, 2016, and 2015 and notes thereto contained elsewhere herein. The financial results should not be construed as indicative of financial results for subsequent periods. See "Item 4. Information on the Company" and "Item 5. Operating and Financial Review and Prospects."

	Year Ended December 31,				
	2017	2016	2015	2014	2013
Statement of Operations Data:					
Operating revenues	$-	$506	$2,304	$3,773	$6,074
Income/ (loss) from operations	(3,931)	(16,814)	(45,354)	(26,460)	(47,968)
Other income/(expense)	(3,190)	(3,697)	(7,595)	13,772	(737)
Net loss	(7,121)	(20,511)	(52,949)	(12,688)	(48,705)
Earnings Per Share Data:					
Net income /(loss) per share:					
Basic earnings/ (loss) per share	$(49)	$(4,102,200)	$-	$-	$-

Diluted earnings/ (loss) per share	$(49)	$(4,102,200)	$-	$-	$-
Weighted average number of shares:					
Basic weighted average number of shares	144,922	5	-	-	-
Diluted weighted average number of shares	144,922	5	*-	*-	*-

* - information not meaningful due to reverse splits.

	Year Ended December 31,				
	2017	2016	2015	2014	2013
Selected Balance Sheet Data:					
Total cash	$11	$52	$20	$45	$7,581
Vessels, net	2,009	2,122	10,305	62,310	71,834
Total assets	2,545	2,931	18,718	64,253	87,632
Long-term debt, including current portion	17,598	17,598	17,598	17,598	59,687
Total shareholders' equity	(38,207)	(33,593)	(16,760)	25,004	12,793

B. Capitalization and Indebtedness

Not required.

C. Reasons for the Offer and Use of Proceeds

Not required.

D. Risk Factors

The common shares of our company are considered speculative. Investing in our common shares involves a high degree of risk and uncertainty. You should carefully consider the following risks and uncertainties in addition to other information in this annual report in evaluating our company and our business before purchasing our common shares. Our business, operating or financial condition could be harmed due to any of the following risks.

Risk Factors Relating to FreeSeas

At December 31, 2017, FreeSeas' current liabilities exceeded its current assets, which could impair its ability to successfully operate its business and could have material adverse effects on its revenues, cash flows and profitability and its ability to comply with its debt covenants and pay its debt service and other obligations.

As a result of the historically low charter rates for drybulk vessels which have been affecting the Company for over seven years, and the resulting material adverse impact on the Company's results from operations, the accompanying consolidated financial statements have been prepared on a going concern basis. The Company has incurred net losses of $7,121, $20,511 and $52,949 during the years ended December 31, 2017, 2016 and 2015, respectively. The Company's cash flow projections for 2018, indicate that cash on hand will not be sufficient to cover debt repayments scheduled as of December 31, 2017 and operating expenses and capital expenditure requirements for at least twelve months from the balance sheet date. As of December 31, 2017 and 2016, the Company had working capital deficits of $40,216 and $35,715, respectively. All of the above raises substantial doubt regarding the Company's ability to continue as a going concern. Management plans to continue to provide for its capital requirements by issuing additional equity securities and debt in addition to executing their business plan. The Company's ability to continue as a going concern is dependent upon its ability to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal course of business operations when they come due and to generate profitable operations in the future.

On February 22, 2014, the Company and certain of its subsidiaries entered into terms with the National Bank of Greece ("NBG") for settlement of its obligations arising from the loan agreement with NBG. Pursuant to the terms, NBG agreed to accept a cash payment of $22,000 no later than December 31, 2014, in full and final settlement of all of the Company's obligations to NBG and NBG would forgive the remaining outstanding balance of approximately $4,700. On September 17, 2014, the Company made a payment of $2,700 to reduce outstanding indebtedness with NBG. On September 24, 2014, the Company sold the M/V Free Impala, a 1997-built, 24,111 dwt Handysize drybulk carrier for a gross sale price of $3,600 and the vessel was delivered to her new owners. Subsequently, the amount of $3,300 had been used to reduce outstanding indebtedness with NBG, which had a mortgage on the vessel. The agreed settlement of the Company's obligations, arising from the loan agreement with NBG mentioned above, was not realized and negotiations have resumed for a new agreement. On June 18, 2015, the Company received from NBG a reservation of rights letter stating that the Bank may take any actions and may exercise all of their rights and remedies referred in the security documents. In December 2017, the Company received notification from NBG that the Company has not paid the aggregate amount of $25,788 constituting repayment installments, accrued loan and default interest due on December 15, 2017.

If the Company is not able to reach a new agreement with NBG its standalone lender, this could lead to the acceleration of the outstanding debt under its debt agreement. The Company's failure to satisfy its covenants under its debt agreement and any consequent acceleration of its outstanding indebtedness would have a material adverse effect on the Company's business operations, financial condition and liquidity.

Generally accepted accounting principles require that long-term debt be classified as a current liability when a covenant violation gives the lender the right to call the debt at the balance sheet date, absent a waiver. As a result of the actual breach existing under the Company's credit facility with NBG acceleration of such debt by its lender could result. Accordingly, as of December 31, 2017, the Company is required to reclassify its long-term debt as current liability on its consolidated balance sheet since the Company has not received waiver in respect to the breach discussed above.

The Company is currently exploring several alternatives aiming to manage its working capital requirements and other commitments, including offerings of securities through structured financing agreements, disposition of certain vessels in its current fleet and additional reductions in operating and other costs.

The consolidated financial statements as of December 31, 2017, were prepared assuming that the Company would continue as a going concern despite its significant losses and working capital deficit. Accordingly, the financial statements did not include any adjustments relating to the recoverability and classification of recorded asset amounts, the amounts and classification of liabilities, or any other adjustments that might result in the event the Company is unable to continue as a going concern, except for the classification of all debt, as current.

We received a report from our independent registered public accounting firm with an explanatory paragraph for the year ended December 31, 2017 with respect to our ability to continue as a going concern. The existence of such a report may adversely affect our stock price and our ability to raise capital. There is no assurance that we will not receive a similar report for our year ending December 31, 2018.

In their report dated May 14, 2018, our independent registered public accounting firm expressed substantial doubt about our ability to continue as a going concern as we have incurred recurring operating losses, have a working capital deficiency, have failed to meet scheduled payment obligations under our loan facilities and have not complied with certain covenants included in our loan agreements with banks. Furthermore, if we were forced to liquidate our assets, the amount realized could be substantially lower than the carrying value of these assets. Our ability to continue as a going concern is subject to our ability to obtain necessary funding from outside sources, including obtaining additional funding from the sale of our securities, obtaining loans from various financial institutions or lenders where possible and restructuring outstanding debt obligations that are currently in default. Our continued net operating losses increase the difficulty in meeting such goals and there can be no assurances that such methods will prove successful.

We have been in breach of certain loan covenants contained in our loan agreement with NBG. If we are not successful in obtaining a waiver with respect to covenants breached, our lender may declare an event of default and accelerate our outstanding indebtedness under the agreement, which would impair our ability to continue to conduct our business, which raises substantial doubt about our ability to continue as a going concern.

Our loan agreement requires that we comply with certain financial and other covenants. As a result of the drop in our drybulk asset values, we were not in compliance with the NBG facility covenants relating to vessel values as of December 31, 2017. In addition, we were in breach of interest cover ratios, leverage and minimum liquidity covenants with the NBG facility not previously waived. A violation of these covenants constitutes an event of default under our credit facility, which would, unless waived by our lender, provide our lender with the right to require us to post additional collateral, increase our interest payments and/or pay down our indebtedness to a level where we are in compliance with our loan covenants. Furthermore, our lender may accelerate our indebtedness and foreclose its liens on our vessels, in which case our vessels may be auctioned or otherwise transferred which would impair our ability to continue to conduct our business. As a result of these breaches, our total indebtedness is presented within current liabilities in the December 31, 2017 consolidated balance sheet.

If the Company is not able to reach an agreement with the NBG or if the Company is unable to comply with any such restructured loan terms agreed upon, this could lead to the acceleration of the outstanding debt under its debt agreements. The Company’s failure to satisfy its covenants under its debt agreement, and any consequent acceleration of its outstanding indebtedness would have a material adverse effect on the Company’s business operations, financial condition and liquidity.

Our loan agreements contain covenants that may limit our liquidity and corporate activities.

If the drybulk market remains depressed or further declines, we may require further waivers and/or covenant amendments to our loan agreements relating to our compliance with certain covenants for certain periods of time. The waivers and/or covenant amendments may impose additional operating and financial restrictions on us and modify the terms of our existing loan agreements. Any such waivers or amendments, if needed, could contain such additional restrictions and might not be granted at all.

Our loan agreements require that we maintain certain financial and other covenants. The low drybulk charter rates and drybulk vessel values have previously affected, and may in the future affect, our ability to comply with these covenants. A violation of these covenants constitutes an event of default under our credit facilities and would provide our lenders with various remedies, including the right to require us to post additional collateral, enhance our equity and liquidity, withhold payment of dividends, increase our interest payments, pay down our indebtedness to a level where we are in compliance with our loan covenants, sell vessels in our fleet, or reclassify our indebtedness as current liabilities. Our lenders could also accelerate our indebtedness and foreclose their liens on our vessels. The exercise of any of these remedies could materially adversely impair our ability to continue to conduct our business. Moreover, our lenders may require the payment of additional fees, require prepayment of a portion of our indebtedness to them, accelerate the amortization schedule for our indebtedness and increase the interest rates they charge us on our outstanding indebtedness.

As a result of our loan covenants, our lenders have imposed operating and financial restrictions on us. These restrictions may limit our ability to:

- incur additional indebtedness;
- create liens on our assets;
- sell capital stock of our subsidiaries;
- make investments;
- engage in mergers or acquisitions;
- pay dividends;
- make capital expenditures;
- change the management of our vessels or terminate or materially amend our management agreements; and
- sell our vessels.

We depend upon a few significant customers for a large part of our revenues. The loss of one or more of these customers could adversely affect our financial performance.

We have historically derived a significant part of our revenue from a small number of charterers. During the year ended December 31, 2017, there were no charterers individually that accounted for more than 10% of the Company's voyage revenues. During the same period in 2016, we derived approximately 97% of our gross revenues from two charterers. If we do remain dependent, in large part, on a small number of charterers, if one or more of our charterers is unable to perform under one or more charters with us, if we are not able to find appropriate replacement charterers, or if a charterer exercises certain rights to terminate its charter, we could suffer a loss of revenues that could materially adversely affect our business, financial condition and results of operations.

The international drybulk shipping industry is highly competitive, and we may not be able to compete successfully for charters with new entrants or established companies with greater resources.

We employ our vessels in a highly competitive market that is capital intensive and highly fragmented. Competition arises primarily from other vessel owners, some of which have substantially greater resources than we do. Competition for the transportation of drybulk cargo by sea is intense and depends on price, customer relationships, operating expertise, professional reputation and size, age, location and condition of the vessel. Due in part to the highly fragmented market, additional competitors with greater resources could enter the drybulk shipping industry and operate larger fleets through consolidations or acquisitions and may be able to offer lower charter rates than we are able to offer, which could have a material adverse effect on our fleet utilization and, accordingly, our profitability.

We currently rely on our Managers to manage and charter our fleet.

We currently have no employees and contract (a) the management of our fleet, including crewing, maintenance and repair, through Free Bulkers S.A. ("Free Bulkers") and OpenSeas Maritime S.A. ("OpenSeas Maritime") and (b) all of our financial, accounting, including our financial reporting and internal controls, and other back-office services, through Prodigy Inc. (collectively, our "Managers"). We rely on our Managers to provide the technical management of our fleet and to attract charterers and charter brokers. The loss of its services or failure to perform its obligations could reduce our revenues and net income and adversely affect our operations and business if we are not able to contract with other companies to provide these services or take over these aspects of our business directly. FreeSeas has no control over our Managers. Our Managers are not liable to us for any losses or damages, if any, that may result from their management of our fleet unless the same shall have resulted from willful misconduct or gross negligence of our Managers or any person to whom performance of the management services has been delegated by our Managers. Pursuant to their agreements with us, our Managers' liability for such acts, except in certain limited circumstances, may not exceed ten times the annual management fee payable by the applicable subsidiary to our Managers. Although we may have rights against our Managers, if our Managers default on their obligations to us, we may have no recourse against our Managers. Further, we will need approval from our lenders if we intend to replace our Managers as our fleet managers.

We and two of our executive officers have affiliations with our Managers that could create conflicts of interest detrimental to us.

Our Chairman, Chief Executive Officer and President, Ion G. Varouxakis, is also the controlling shareholder and officer of Free Bulkers and is also the controlling shareholder of OpenSeas Maritime and Mr. Dimitris Filippas, our Chief Financial Officer is officer of OpenSeas Maritime These dual responsibilities of our officers and the relationships between the companies could create conflicts of interest between our Managers and us. Each of our operating subsidiaries has a nonexclusive management agreement with one of our Managers. Although our Managers currently each serves as manager for vessels owned or operated by us under bareboat charters, our Managers are not restricted from entering into management agreements with other competing shipping companies. Our Managers could also allocate charter and/or vessel purchase and sale opportunities to others. There can be no assurance that our Managers would resolve any conflicts of interest in a manner beneficial to us.

Management and service fees are payable to our Managers, regardless of our profitability, which could have a material adverse effect on our business, financial condition and results of operations.

The management and service fees due from us to our Managers are payable whether or not our vessels are employed, and regardless of our profitability. We have no ability to require our Managers to reduce the management fees and service fees if our profitability decreases, which could have a material adverse effect on our business, financial condition and results of operations.

Our Managers are a privately held companies, and there is little or no publicly available information about them.

The ability of our Managers to continue providing services for our benefit will depend in part on their own financial strength. Circumstances beyond our control could impair our Managers' financial strength. Because our Managers are privately held, it is unlikely that information about their financial strength would become public or available to us prior to any default by our Managers under the management agreement. As a result, an investor in us might have little advance warning of problems that affect our Managers, even though those problems could have a material adverse effect on us.

As part of their services to us, our Managers must continue to upgrade their operational, accounting and financial systems, and add more staff. If our Managers cannot upgrade these systems or recruit suitable additional employees, their services to us and, therefore, our performance may suffer.

Our current operating, internal control, accounting and financial systems are provided by our Managers and may not be adequate if our Managers' efforts to improve those systems may be ineffective. If our Managers cannot continue to upgrade their operational and financial systems effectively or recruit suitable employees, their services to us and, therefore, our performance may suffer and our ability to expand our business further will be restricted.

We and our Managers may be unable to attract and retain key executive officers with experience in the shipping industry, which may reduce the effectiveness of our management and lower our results of operations.

Our success depends to a significant extent upon the abilities and efforts of our and our Managers' executive officers. The loss of any of these individuals could adversely affect our business prospects and financial condition. Our success will depend on retaining these key members of our and our Managers' management team. Difficulty in retaining our executive officers, and difficulty in our Managers retaining their executive officers, could adversely affect our results of operations and ability to pay dividends. We do not maintain “key man” life insurance on any of our officers.

We intend to continue to charter most of our vessels in the spot market, and as a result, we will be exposed to the cyclicality and volatility of the spot charter market.

Since we intend to continue to charter our vessels in the spot market, we will be exposed to the cyclicality and volatility of the spot charter market, and we may not have long term, fixed time charter rates to mitigate the adverse effects of downturns in the spot market. We cannot assure you that we will be able to successfully charter our vessels in the future at rates sufficient to allow us to meet our obligations. The supply of and demand for shipping capacity strongly influences freight rates. Because the factors affecting the supply and demand for vessels are outside of our control and are unpredictable, the nature, timing, direction and degree of changes in industry conditions are also unpredictable.

Factors that influence demand for drybulk vessel capacity include:

- demand for and production of drybulk products;
- global and regional economic and political conditions including developments in international trade, fluctuations in industrial and agricultural production and armed conflicts;
- the distance drybulk cargo is to be moved by sea;
- environmental and other regulatory developments; and
- changes in seaborne and other transportation patterns.

The factors that influence the supply of drybulk vessel capacity include:

- the number of new building deliveries;
- port and canal congestion;
- the scrapping rate of older vessels;
- vessel casualties; and
- the number of vessels that are out of service, i.e., laid-up, drydocked, awaiting repairs or otherwise not available for hire.

In addition to the prevailing and anticipated freight rates, factors that affect the rate of new building, scrapping and laying-up include new building prices, availability of financing for dry-bulk vessel acquisition and building, secondhand vessel values in relation to scrap prices, costs of bunkers and other operating costs, costs associated with classification society surveys, normal maintenance and insurance coverage, the efficiency and age profile of the existing fleet in the market and government and industry regulation of maritime transportation practices, particularly environmental protection laws and regulations. These factors influencing the supply of and demand for shipping capacity are outside of our control, and we may not be able to correctly assess the nature, timing and degree of changes in industry conditions.

We anticipate that the future demand for our drybulk carriers will be dependent upon economic growth in the world's major industrialized economies, as well as emerging economies including in particular China, Japan and India, seasonal and regional changes in demand, changes in the capacity of the global drybulk carrier fleet and the sources and supply of drybulk cargo to be transported by sea. The capacity of the global drybulk carrier fleet seems likely to increase, and we can provide no assurance as to the timing or extent of future economic growth. Adverse economic, political, social or other developments could have a material adverse effect on our business, results of operations, cash flows and financial condition. Should the drybulk market strengthen significantly in the future, we may enter into medium to long term employment contracts for some or all of our vessels.

We intend to employ our vessels predominantly in the spot market with charters that typically last one to two months.

When our charters in the spot market end, we may not be able to replace them promptly, and any replacement charters could be at lower charter rates, which may materially, adversely affect our earnings and results of operations.

We will generally attempt to recharter our vessels at favorable rates with reputable charterers. All of our vessels currently operate in the spot market. If the drybulk shipping market is in a period of depression when our vessels' charters expire, it is likely that we may be forced to re-charter them at reduced rates, if such charters are available at all. In the event charter rates fall below our costs to operate a vessel or for any other strategic or operational matter, we may determine not to recharter a vessel until such time as the charter rates increase or such strategic or operational matter ceases to exist. We cannot assure you that we will be able to obtain new charters at comparable or higher rates or with comparable charterers, that we will be able to obtain new charters at all or that we may decide not to charter a vessel at all. The charterers under our charters have no obligation to renew or extend the charters. We will generally attempt to recharter our vessels at favorable rates with reputable charterers as our charters expire. Failure to obtain replacement charters at rates comparable to our existing charters and our decision not to charter vessels will reduce or eliminate our revenue and will adversely affect our ability to service our debt. Further, we may have to incur lay-up expenses or reposition our vessels without cargo or compensation to deliver them to future charterers or to move vessels to areas where we believe that future employment may be more likely or advantageous. Laying up expenses and reactivating expenses would increase our vessel operating expenses. Repositioning our vessels would increase our vessel operating costs. If any of the foregoing events were to occur, our revenues, net income and earnings may be materially adversely affected.

Further declines in charter rates and other market deterioration could cause us to incur impairment charges.

We evaluate the recoverable amounts of our vessels to determine if events have occurred that would require an impairment of their carrying amounts. The recoverable amount of vessels is reviewed based on events and changes in circumstances that would indicate that the carrying amount of the assets might not be recovered. The review for potential impairment indicators and future undiscounted net operating cash flows related to the vessels is complex and requires us to make various estimates including future charter rates and earnings from the vessels which have been historically volatile.

When our estimate of future undiscounted net operating cash flows for any vessel is lower than the vessel's carrying value, the carrying value is written down, by recording a charge to operations, to the vessel's fair market value if the fair market value is lower than the vessel's carrying value. The carrying values of our vessels may not represent their fair market value because the market prices of secondhand vessels tend to fluctuate with changes in charter rates and the cost of new buildings. Any impairment charges incurred as a result of declines in charter rates could have a material adverse effect on our business, results of operations, cash flows and financial condition. As of December 31, 2017, the Company did not perform an impairment assessment of its long-lived asset M/V Free Neptune, since the impairment charge of $4,286 recorded last year reduced the vessel's carrying value below her scrap value of $2,756 as of December 31, 2017.

Our charterers may terminate or default on their charters, which could adversely affect our results of operations and cash flow.

The ability of each of our charterers to perform its obligations under a charter will depend on a number of factors that are beyond our control. These factors may include general economic conditions, the condition of the drybulk shipping industry, the charter rates received for specific types of vessels, hedging arrangements, the ability of charterers to obtain letters of credit from its customers, cash reserves, cash flow considerations and various operating expenses. Many of these factors impact the financial viability of our charterers. Charterers may not pay or may attempt to renegotiate charter rates. Should a charterer fail to honor its obligations under its agreement with us, it may be difficult for us to secure substitute employment for the affected vessel, and any new charter arrangements we secure in the spot market or on a time charter may be at lower rates.

We lose a charterer or the benefits of a charter if a charterer fails to make charter payments because of its financial inability, disagreements with us or otherwise, terminates the charter because we fail to deliver the vessel within the time specified in the charter, the vessel is lost or damaged beyond repair, there are serious deficiencies in the vessel or prolonged periods of off-hire, default under the charter or the vessel has been subject to seizure for more than a specified number of days.

If our charterers fail to meet their obligations to us, we would experience material adverse effects on our revenues, cash flows and profitability and our ability to comply with our debt covenants and pay our debt service and other obligations. The actual or perceived credit quality of our charterers, and any defaults by them, may materially affect our ability to obtain the additional debt financing that we will require to acquire additional vessels or may significantly increase our costs of obtaining such financing. Our inability to obtain additional financing at all, or at a higher than anticipated cost, may materially impair our ability to implement our business strategy.

Charter rates are subject to seasonal fluctuations, which may adversely affect our operating results.

Our fleet consists of Handysize and Handymax drybulk carriers that operate in markets that have historically exhibited seasonal variations in demand and, as a result, in charter rates. This seasonality may result in quarter-to-quarter volatility in our operating results. The energy markets primarily affect the demand for coal, with increases during hot summer periods when air conditioning and refrigeration require more electricity and towards the end of the calendar year in anticipation of the forthcoming winter period. Grain shipments are driven by the harvest within a climate zone. Because three of the five largest grain producers (the United States, Canada and the European Union) are located in the northern hemisphere and the other two (Argentina and Australia) are located in the southern hemisphere, harvests occur throughout the year and grains require drybulk shipping accordingly. As a result of these and other factors, the drybulk shipping industry is typically stronger in the fall and winter months. Therefore, we expect our revenues from our drybulk carriers to be typically weaker during the fiscal quarters ending June 30 and September 30 and, conversely, we expect our revenues from our drybulk carriers to be typically stronger in fiscal quarters ending December 31 and March 31. Seasonality in the drybulk industry could materially affect our operating results.

The aging of our fleet may result in increased operating costs in the future, which could adversely affect our ability to operate our vessels profitably.

The majority of our vessels were acquired second-hand, and we estimate their useful lives to be 28 years from their date of delivery from the yard, depending on various market factors and management’s ability to comply with government and industry regulatory requirements. As of December 31, 2017, the age of the vessel we operated was 21.6 years. Part of our business strategy includes the continued acquisition of second hand vessels when we find attractive opportunities.

In general, expenditures necessary for maintaining a vessel in good operating condition increase as a vessel ages. Second hand vessels may also develop unexpected mechanical and operational problems despite adherence to regular survey schedules and proper maintenance. Cargo insurance rates also tend to increase with a vessel's age, and older vessels tend to be less fuel-efficient than newer vessels. While the difference in fuel consumption is factored into the freight rates that our older vessels earn, if the cost of bunker fuels were to increase significantly, it could disproportionately affect our vessels and significantly lower our profits. In addition, changes in governmental regulations, safety or other equipment standards may require:

- expenditures for alterations to existing equipment;
- the addition of new equipment; or
- restrictions on the type of cargo a vessel may transport.

We cannot give assurances that future market conditions will justify such expenditures or enable us to operate our vessels profitably during the remainder of their economic lives.

Although we inspect the secondhand vessels that we acquire prior to purchase, this inspection does not provide us with the same knowledge about a vessel's condition and the cost of any required (or anticipated) repairs that we would have had if this vessel had been built for and operated exclusively by us. Generally, we do not receive the benefit of warranties on secondhand vessels.

Unless we set aside reserves or are able to borrow funds for vessel replacement, at the end of a vessel's useful life our revenue will decline, which would adversely affect our business, results of operations and financial condition.

Unless we maintain reserves or are able to borrow or raise funds for vessel replacement, we may be unable to replace the vessels in our fleet upon the expiration of their useful lives, which we expect to be 28 years from their date of delivery from the yard. Our cash flows and income are dependent on the revenues earned by the chartering of our vessels to customers. If we are unable to replace the vessels in our fleet upon the expiration of their useful lives, our business, results of operations, financial condition and ability to pay dividends will be materially and adversely affected. Any reserves set aside for vessel replacement may not be available for dividends.

If any of our vessels fail to maintain their class certification and/or fail any annual survey, intermediate survey, dry-docking or special survey, that vessel would be unable to carry cargo, thereby reducing our revenues and profitability and violating certain loan covenants of our third-party indebtedness.

The hull and machinery of every commercial vessel must be classed by a classification society authorized by its country of registry. The classification society certifies that a vessel is safe and seaworthy in accordance with the applicable rules and regulations of the country of registry of the vessel and the Safety of Life at Sea Convention, or SOLAS.

A vessel must undergo annual surveys, intermediate surveys, dry-dockings and special surveys. In lieu of a special survey, a vessel's machinery may be on a continuous survey cycle, under which the machinery would be surveyed periodically over a five-year period. Our vessels are on special survey cycles for hull inspection and continuous survey cycles for machinery inspection. Every vessel is also required to be dry-docked every two to three years for inspection of the underwater parts of such vessel.

If any vessel does not maintain its class and/or fails any annual survey, intermediate survey, dry-docking or special survey, the vessel will be unable to carry cargo between ports and will be unemployable and uninsurable, thereby reducing our revenues and profitability. That could also cause us to be in violation of certain covenants in our loan agreements. In addition, the cost of maintaining our vessels' classifications may be substantial at times and could result in reduced revenues.

Our vessels may suffer damage and we may face unexpected dry-docking costs, which could affect our cash flow and financial condition.

If our vessels suffer damage, they may need to be repaired at a dry-docking facility, resulting in vessel downtime and vessel off-hire. The costs of dry-dock repairs are unpredictable and can be substantial. We may have to pay dry-docking costs that our insurance does not cover. The inactivity of these vessels while they are being repaired and repositioned, as well as the actual cost of these repairs, would decrease our earnings. In addition, space at dry-docking facilities is sometimes limited and not all dry-docking facilities are conveniently located. We may be unable to find space at a suitable dry-docking facility or we may be forced to move to a dry-docking facility that is not conveniently located to our vessels' positions. The loss of earnings while our vessels are forced to wait for space or to relocate to dry-docking facilities that are farther away from the routes on which our vessels trade would also decrease our earnings.

Our growth depends on the growth in demand for and the shipping of drybulk cargoes.

Our growth strategy focuses on the drybulk shipping sector. Accordingly, our growth depends on growth in world and regional demand for and the shipping of drybulk cargoes, which could be negatively affected by a number of factors, such as declines in prices for drybulk cargoes or general political and economic conditions.

8

Reduced demand for and the shipping of drybulk cargoes would have a material adverse effect on our future growth and could harm our business, results of operations and financial condition. In particular, Asian Pacific economies and India have been the main driving force behind the past increase in seaborne drybulk trade and the demand for drybulk carriers. The negative change in economic conditions in any Asian Pacific country, but particularly in China or Japan, as well as India, may have a material adverse effect on our business, financial condition and results of operations, as well as our future prospects, by further reducing demand and resultant charter rates.

If we fail to manage our growth properly, we may not be able to successfully expand our market share.

We will continue exploring expansion opportunities as our financial resources permit. Our growth will depend on:

- locating and acquiring suitable vessels;
- placing new building orders and taking delivery of vessels;
- identifying and consummating acquisitions or joint ventures;
- integrating any acquired vessel successfully with our existing operations;
- enhancing our customer base;
- managing our expansion; and
- obtaining the required financing.

If our financial resources permit, we could face risks in connection with growth by acquisition, such as undisclosed liabilities and obligations and difficulty experienced in obtaining additional qualified personnel, managing relationships with customers and suppliers, and integrating newly acquired operations into existing infrastructures.

We cannot give any assurance that we will be successful in executing our growth plans or that we will not incur significant expenses and losses in connection with the execution of those growth plans.

Our ability to successfully implement our business plan depends on our ability to obtain additional financing, which may affect the value of your investment in us.

We plan to continue to explore expansion opportunities. We will require substantial additional financing to fund any acquisitions of additional vessels and to implement our business plan. We cannot be certain that sufficient financing will be available on terms that are acceptable to us or at all. If we cannot raise the financing we need in a timely manner and on acceptable terms, we may not be able to acquire the vessels necessary to implement our business plans and consequently you may lose some or all of your investment in us.

While we expect that a significant portion of the financing resources needed to acquire vessels, if any, will be through long-term debt financing, we may raise additional funds through offerings of securities and other structured financing agreements. New equity investors may dilute the percentage of the ownership interest of our existing shareholders. Sales or the possibility of sales of substantial amounts of shares of our common stock in the public markets could adversely affect the market price of our common stock.

The market values of our vessels have declined and may further decrease, and we may incur losses when we sell vessels or we may be required to write down their carrying value, which may adversely affect our earnings and our ability to implement our fleet renewal program.

The market values of our vessels will fluctuate depending on general economic and market conditions affecting the shipping industry and prevailing charter hire rates, competition from other shipping companies and other modes of transportation, the types, sizes and ages of our vessels, applicable governmental regulations and the cost of new buildings.

If a determination is made that a vessel's future useful life is limited or its future earnings capacity is reduced, it could result in an impairment of its carrying amount on our financial statements that would result in a charge against our earnings and the reduction of our shareholders' equity. As of December 31, 2017, the Company did not perform an impairment assessment of its long-lived asset M/V Free Neptune, since the impairment charge of $4,286 recorded last year reduced the vessel's carrying value below her scrap value of $2,756 as of December 31, 2017.If for any reason we sell our vessels at a time when prices have fallen, the sale price may be less than the vessels' carrying amount on our financial statements, and we would incur a loss and a reduction in earnings. On September 26, 2016, the Company sold to unrelated third parties the M/V Free Maverick, a 1998-built, 23,994 dwt Handysize drybulk carrier for a gross sale price of $1,925. As a result of the sale the Company recognized a loss of $277 for the year ended December 31, 2016 in the accompanying consolidated statement of operations.

We have incurred secured debt under loan agreements for all of our vessels. The market value of our vessels is based, in part, on charter rates and the stability of charter rates over a period of time. As a result of global economic conditions, volatility in charter rates, generally declining charter rates, and other factors, we have recently experienced a decrease in the market value of our vessels. Due to the decline of the market value of our fleet, we were not in compliance with certain covenants of our existing loan agreements that relate to maintenance of asset values and, as a result, we may not be able to refinance our debt or obtain additional financing. There can be no assurances that charter rates will stabilize or increase, that the market value of our vessels will stabilize or increase or that we will regain compliance with the financial covenants in our loan agreements or that our lenders will agree to waivers or forbearances.

If we fail to sell our vessels at prices acceptable to us, it could have a material adverse effect on our competitiveness and business operations.

Maritime claimants could arrest our vessels, which could interrupt our cash flow.

Crew members, suppliers of goods and services to a vessel, shippers of cargo and other parties may be entitled to a maritime lien against a vessel for unsatisfied debts, claims or damages. In many jurisdictions, a maritime lien holder, such as our lenders, may enforce its lien by arresting a vessel through foreclosure proceedings. The arresting or attachment of one or more of our vessels could interrupt our cash flow and require us to pay large sums of funds to have the arrest lifted.

In addition, in some jurisdictions, such as South Africa, under the "associated vessel" theory of liability, a claimant may arrest both the vessel which is subject to the claimant's maritime lien and any "associated" vessel, which is any vessel owned or controlled by the same owner or managed by the same manager. Claimants could try to assert "associated vessel" liability against one of our vessels for claims relating to another of our vessels or a vessel managed by our Manager.

The smuggling of drugs or other contraband onto our vessels may lead to governmental claims against us.

We expect that our vessels will call in ports in South America and other areas where smugglers are known to attempt to hide drugs and other contraband on vessels, with or without the knowledge of crew members. To the extent our vessels are found with contraband, whether inside or attached to the hull of our vessel and whether with or without the knowledge of any of our crew, we may face governmental or other regulatory claims which could have an adverse effect on our business, results of operations, cash flows and financial condition.

Rising fuel prices may adversely affect our profits.

Upon redelivery of vessels at the end of a period time or trip time charter, we may be obligated to repurchase bunkers on board at prevailing market prices, which could be materially higher than fuel prices at the inception of the charter period. In addition, although we rarely deploy our vessels on voyage charters, fuel is a significant, if not the largest, expense that we would incur with respect to vessels operating on voyage charter. As a result, an increase in the price of fuel may adversely affect our profitability. The price and supply of fuel is volatile and fluctuates based on events outside our control, including geopolitical developments, supply and demand for oil and gas, actions by OPEC and other oil and gas producers, war and unrest in oil producing countries and regions, regional production patterns and environmental concerns and regulations.

We are subject to regulation and liability under environmental laws and the failure to comply with these regulations may subject us to increased liability, may adversely affect our insurance coverage and may result in a denial of access to, or detention in, certain ports. This could require significant expenditures and reduce our cash flows and net income.

Our business and the operation of our vessels are materially affected by government regulation in the form of international conventions and national, state and local laws and regulations in force in the jurisdictions in which the vessels operate, as well as in the country or countries of their registration, including those governing the management and disposal of hazardous substances and wastes, the cleanup of oil spills and other contamination, air emissions, and water discharges and ballast water management. We are also required by various governmental and quasi-governmental agencies to obtain certain permits, licenses and certificates with respect to our operations. Because such conventions, laws, regulations and permit requirements are often revised, or the required additional measures for compliance are still under development, we cannot predict the ultimate cost of complying with such conventions, laws, regulations or permit requirements, or the impact thereof on the resale prices or useful lives of our vessels. Additional conventions, laws and regulations may be adopted which could limit our ability to do business or increase the cost of our doing business and which may materially adversely affect our business, financial condition and results of operations.

10

Environmental requirements can also affect the resale prices or useful lives of our vessels or require reductions in cargo capacity, ship modifications or operational changes or restrictions. Failure to comply with these requirements could lead to decreased availability of or more costly insurance coverage for environmental matters or result in the denial of access to certain jurisdictional waters or ports, or detention in certain ports. Under local, national and foreign laws, as well as international treaties and conventions, we could incur material liabilities, including cleanup obligations and claims for natural resource, personal injury and property damages in the event that there is a release of petroleum or other hazardous materials from our vessels or otherwise in connection with our operations. The 2010 explosion of the Deepwater Horizon and the subsequent release of oil into the Gulf of Mexico or similar events may result in further regulation of the shipping industry, including modifications to statutory liability schemes.

The operation of our vessels is affected by the requirements set forth in the International Safety Management, or ISM Code. The failure of a shipowner or bareboat charterer to comply with the ISM Code may subject such party to increased liability, may decrease available insurance coverage for the affected vessels, and/or may result in a denial of access to, or detention in, certain ports.

The European Union is currently considering proposals to further regulate vessel operations. Individual countries in the European Union may also have additional environmental and safety requirements. It is difficult to predict what legislation or regulation, if any, may be adopted by the European Union or any other country or authority.

The International Maritime Organization or other regulatory bodies may adopt additional regulations in the future that could adversely affect the useful lives of our vessels as well as our ability to generate income from them or resell them at attractive prices.

The United States Oil Pollution Act of 1990, or OPA, established an extensive regulatory and liability regime for the protection and clean-up of the environment from oil spills. Under OPA, vessel owners, operators and bareboat charterers are “responsible parties” and are jointly, severally and strictly liable (unless the spill results solely from the act or omission of a third party, an act of God or an act of war) for all containment and clean-up costs and other damages arising from discharges or threatened discharges of oil from their vessels, including bunkers (fuel).

Violations of, or liabilities under, environmental or other applicable laws and regulations can result in substantial penalties, fines and other sanctions, including, in certain instances, seizure or detention of our vessels. Events of this nature could have a material adverse effect on our business, financial condition and results of operations.

Technological innovation related to existing or new vessels could reduce the competitiveness of our older vessels and therefore the value of such vessels in the chartering and secondhand resale markets.

The charter hire rates and the value and operational life of a vessel are determined by a number of factors, including the vessel's efficiency, operational flexibility and physical life. Efficiency includes speed, fuel economy and the ability to load and discharge cargo quickly. Flexibility includes the ability to enter harbors, utilize related docking facilities and pass through canals and straits. The length of a vessel's physical life is related to its original design and construction, its maintenance and the impact of the stress of operations. If new drybulk carriers are built that are more efficient or more flexible or have longer physical lives than our older vessels, competition from these more technologically advanced vessels could adversely affect the competitiveness of our older vessels, and, in turn, the amount of charter hire payments we receive for our older vessels once their initial charters expire, and the resale value of our older vessels could significantly decrease.

Our vessels are exposed to inherent operational risks that may not be adequately covered by our insurance.

The operation of any vessel includes risks such as mechanical failure, collision, fire, contact with fixed or floating objects, cargo or property loss or damage and business interruption due to political circumstances in foreign countries, piracy, terrorist attacks, armed hostilities and labor strikes. With a drybulk carrier, the cargo itself and its interaction with the ship can be a risk factor. By their nature, drybulk cargoes are often heavy, dense, easily shifted, and react badly to water exposure. In addition, drybulk carriers are often subjected to battering treatment during unloading operations with grabs, jackhammers (to pry encrusted cargoes out of the hold), and small bulldozers. This treatment may cause damage to the vessel. Vessels damaged due to treatment during unloading procedures may be more susceptible to breach to the sea. Hull breaches in drybulk carriers may lead to the flooding of the vessels' holds. If a drybulk carrier suffers flooding in its forward holds, the bulk cargo may become so dense and waterlogged that its pressure may buckle the vessel's bulkheads leading to the loss of a vessel. If we are unable to adequately maintain our vessels we may be unable to prevent these events. Any of these circumstances or events could negatively impact our business, financial condition and results of operations.

Further, such occurrences could result in death or injury to persons, loss of property or environmental damage, delays in the delivery of cargo, loss of revenues from or termination of charter contracts, governmental fines, penalties or restrictions on conducting business, higher insurance rates and damage to our reputation and customer relationships generally. In the past, political conflicts have also resulted in attacks on vessels, mining of waterways and other efforts to disrupt international shipping, particularly in the Arabian Gulf region. Acts of terrorism and piracy have also affected vessels trading in regions such as the South China Sea and the Gulf of Aden and Indian Ocean off the coast of Somalia and Kenya. If these attacks and other disruptions result in areas where our vessels are deployed being characterized by insurers as "war risk" zones or Joint War Committee "war, strikes, terrorism and related perils" listed areas, as the Gulf of Aden currently is, premiums payable for such coverage could increase significantly and such insurance coverage may be more difficult or impossible to obtain. In addition, there is always the possibility of a marine disaster, including oil spills and other environmental damage. Although our vessels carry a relatively small amount of the oil used for fuel ("bunkers"), a spill of oil from one of our vessels or losses as a result of fire or explosion could be catastrophic under certain circumstances.

We may not be adequately insured against all risks, and our insurers may not pay particular claims. With respect to war risks insurance, which we usually obtain for certain of our vessels making port calls in designated war zone areas, such insurance may not be obtained prior to one of our vessels entering into an actual war zone, which could result in that vessel not being insured. Even if our insurance coverage is adequate to cover our losses, we may not be able to timely obtain a replacement vessel in the event of a loss. Under the terms of our credit facilities, we will be subject to restrictions on the use of any proceeds we may receive from claims under our insurance policies. Furthermore, in the future, we may not be able to maintain or obtain adequate insurance coverage at reasonable rates for our fleet. We may also be subject to calls, or premiums, in amounts based not only on our own claim records but also the claim records of all other members of the protection and indemnity associations through which we receive indemnity insurance coverage for tort liability. Our insurance policies also contain deductibles, limitations and exclusions which, although we believe are standard in the shipping industry, may nevertheless increase our costs in the event of a claim or decrease any recovery in the event of a loss. If the damages from a catastrophic oil spill or other marine disaster exceeded our insurance coverage, the payment of those damages could have a material adverse effect on our business and could possibly result in our insolvency.

In addition, we may not carry loss of hire insurance. Loss of hire insurance covers the loss of revenue during extended vessel off-hire periods, such as those that occur during an unscheduled drydocking due to damage to the vessel from accidents. Accordingly, any loss of a vessel or any extended period of vessel off-hire, due to an accident or otherwise, could have a material adverse effect on our business, financial condition and results of operations.

We may be subject to increased premium payments because we obtain some of our insurance through protection and indemnity associations.

We may be subject to increased premium payments, or calls, in amounts based not only on our and our Manager's claim records but also the claim records of other members of the protection and indemnity associations through which we receive insurance coverage for tort liability, including pollution-related liability. Our protection and indemnity associations may not have enough resources to cover claims made against them. Our payment of these calls could result in significant expense to us, which could have a material adverse effect on our business, results of operations, cash flows and financial condition.

Our operations expose us to global political risks, such as wars and political instability that may interfere with the operation of our vessels causing a decrease in revenues from such vessels.

We are an international company and primarily conduct our operations outside the United States. Changing economic, political and governmental conditions in the countries where we are engaged in business or where our vessels are registered will affect us. In the past, political conflicts, particularly in the Middle East, resulted in attacks on vessels, mining of waterways and other efforts to disrupt shipping in the area. In addition, future political and governmental instability, revolutions and wars in regions where our vessels trade could affect our trade patterns and adversely affect our operations by causing delays in shipping on certain routes or making shipping impossible on such routes, thereby causing a decrease in revenues.

During a period of war or emergency, a government could requisition for title or seize our vessels. Requisition for title occurs when a government takes control of a vessel and becomes the owner. A government could also requisition our vessels for hire, when a government takes control of a vessel and effectively becomes the charterer at dictated charter rates. Government requisition of one or more of our vessels could reduce our revenues and net income.

Because our seafaring employees are covered by collective bargaining agreements, failure of industry groups to renew those agreements may disrupt our operations and adversely affect our earnings.

All of the seafarers employed on the vessels in our fleet are covered by collective bargaining agreements that set basic standards. We cannot assure you that these agreements will prevent labor interruptions. Any labor interruptions could disrupt our operations and harm our financial performance.

Crew costs are a significant expense for us under our charters. Recently, the limited supply of and increased demand for well-qualified crew, due to the increase in the size of the global shipping fleet, has created upward pressure on crewing costs, which we generally bear under our period time and spot charters. Increases in crew costs may adversely affect our profitability.

Increases in interest rates would reduce funds available to purchase vessels and service debt.

We have purchased, and may purchase in the future, vessels with loans that provide for periodic interest payments based on indices that fluctuate with changes in market interest rates. If interest rates increase significantly, it would increase our costs of financing our acquisition of vessels, which could decrease the number of additional vessels that we could acquire and adversely affect our financial condition and results of operations and may adversely affect our ability to service debt.

Because we generate all of our revenues in U.S. dollars but will incur a portion of our expenses in other currencies, exchange rate fluctuations could have an adverse impact on our results of operations.

We generate all of our revenues in U.S. dollars, but we expect that portions of our future expenses will be incurred in currencies other than the U.S. dollar. This difference could lead to fluctuations in our net income due to changes in the value of the dollar relative to the other currencies, in particular the Euro. Expenses incurred in foreign currencies against which the dollar falls in value can increase, decreasing net income. For the year ended December 31, 2017 and 2016, the fluctuation in the value of the dollar against foreign currencies did not have a material impact on us.

We may have to pay tax on United States source income, which would reduce our earnings.

Under the laws of the countries of the Company and its subsidiaries incorporation and/or vessels' registration, the Company is not subject to tax on international shipping income; however, they are subject to registration and tonnage taxes, which have been included in Vessel operating expenses in the accompanying consolidated statement of operations. Pursuant to the Internal Revenue Code of the United States (the "Code"), U.S. source income from the international operations of ships is generally exempt from U.S. tax if the company operating the ships meets both of the following requirements, (a) the Company is organized in a foreign country that grants an equivalent exemption to corporations organized in the United States, and (b) either (i) more than 50% of the value of the Company's stock is owned, directly or indirectly, by individuals who are "residents" of the Company's country of organization or of another foreign country that grants an "equivalent exemption" to corporations organized in the United States (the "50% Ownership Test") or (ii) the Company's stock is "primarily and regularly traded on an established securities market" in its country of organization, in another country that grants an "equivalent exemption" to United States corporations, or in the United States (the "Publicly-Traded Test").

To complete the exemption process, the Company's shipowning subsidiaries must file a U.S. tax return, state the basis of their exemption and obtain and retain documentation attesting to the basis of their exemptions. The Company's subsidiaries completed the filing process for 2017 on or prior to the applicable tax filing deadline. All the Company's ship-operating subsidiaries currently satisfy the Publicly-Traded Test based on the trading volume and the widely-held ownership of the Company's shares, but no assurance can be given that this will remain so in the future, since continued compliance with this rule is subject to factors outside the Company's control. Based on its U.S. source Shipping Income for 2015, 2016 and 2017, the Company would be subject to U.S. federal income tax of approximately $5, $nil and $nil, respectively, in the absence of an exemption under Section 883.

U.S. tax authorities could treat us as a "passive foreign investment company," which could have adverse U.S. federal income tax consequences to U.S. holders.

A foreign corporation will be treated as a "passive foreign investment company," or PFIC, for U.S. federal income tax purposes if either (1) at least 75% of its gross income for any taxable year consists of certain types of "passive income" or (2) at least 50% of the average value of the corporation's assets produce or are held for the production of those types of "passive income." For purposes of these tests, "passive income" includes dividends, interest, and gains from the sale or exchange of investment property and rents and royalties other than rents and royalties which are received from unrelated parties in connection with the active conduct of a trade or business. For purposes of these tests, income derived from the performance of services does not constitute "passive income." U.S. shareholders of a PFIC are subject to a disadvantageous U.S. federal income tax regime with respect to the income derived by the PFIC, the distributions they receive from the PFIC and the gain, if any, they derive from the sale or other disposition of their shares in the PFIC.

Based on our currently anticipated operations, we do not believe that we will be a PFIC with respect to any taxable year. In this regard, we intend to treat the gross income we derive or are deemed to derive from our time chartering activities as services income, rather than rental income. Accordingly, we believe that our time chartering activities does not constitute "passive income," and the assets that we own and operate in connection with the production of that income do not constitute passive assets.

There is, however, no direct legal authority under the PFIC rules addressing our proposed method of operation, and a federal court decision has characterized income received from vessel time charters as rental rather than services income for U.S. tax purposes. Accordingly, no assurance can be given that the U.S. Internal Revenue Service, or IRS, or a court of law will accept our position, and there is a risk that the IRS or a court of law could determine that we are a PFIC. Moreover, no assurance can be given that we would not constitute a PFIC for any future taxable year if there were to be changes in the nature and extent of our operations.

If the IRS were to find that we are or have been a PFIC for any taxable year, our U.S. shareholders will face adverse U.S. tax consequences. Under the PFIC rules, unless those shareholders make an election available under the Code (which election could itself have adverse consequences for such shareholders), such shareholders would be liable to pay United States federal income tax at the then prevailing income tax rates on ordinary income plus interest upon excess distributions and upon any gain from the disposition of our common stock, as if the excess distribution or gain had been recognized ratably over the shareholder's holding period of our common stock.

Risk Factors Relating to the Drybulk Shipping Industry

The international drybulk shipping industry is cyclical and volatile and charter rates have decreased significantly and may further decrease in the future, which may adversely affect our earnings, vessel values and results of operations.

The drybulk shipping industry is cyclical with volatility in charter hire rates and profitability. The degree of charter hire rate volatility among different types of drybulk vessels has varied widely. Since the middle of the third quarter of 2008, charter hire rates for drybulk vessels have decreased substantially, they may remain volatile for the foreseeable future and could continue to decline further. Additionally, charter rates have been particularly volatile. As a result, our charter rates could further decline significantly, resulting in a loss and a reduction in earnings.

We anticipate that the future demand for our drybulk vessels will be dependent upon existing conditions in the world's economies, seasonal and regional changes in demand, changes in the number of drybulk vessels being ordered and constructed, particularly if there is an oversupply of vessels, changes in the capacity of the global drybulk fleet and the sources and supply of drybulk cargo to be transported by sea. Adverse economic, political, social or other developments could have a further material adverse effect on drybulk shipping in general and on our business and operating results in particular.

Our ability to re-charter our drybulk vessels upon the expiration or termination of their current time charters, the charter rates payable under any renewal or replacement charters will depend upon, among other things, the current state of the drybulk shipping market. If the drybulk shipping market is in a period of depression when our vessels' charters expire, it is likely that we may be forced to re-charter them at reduced rates, including rates whereby we incur a loss, which may reduce our earnings or make our earnings volatile.

In addition, because the market value of our vessels may fluctuate significantly, we may incur losses when we sell vessels, which may adversely affect our earnings. If we sell vessels at a time when vessel prices have fallen and before we have recorded an impairment adjustment to our financial statements, the sale may be at less than the vessel's carrying amount on our financial statements, resulting in a loss and a reduction in earnings.

The drybulk carrier charter market remains significantly below its high in the middle of 2008 and the average rates achieved in the six prior years, which has and may continue to adversely affect our revenues, earnings and profitability and our ability to comply with our loan covenants and repay our indebtedness.

The drybulk shipping industry is cyclical with attendant volatility in charter hire rates and profitability. The degree of charter hire rate volatility among different types of drybulk vessels has varied widely; however, the continued downturn in the drybulk charter market has severely affected the entire drybulk shipping industry and charter hire rates for drybulk vessels have declined significantly from historically high levels. The Baltic Dry Index (the "BDI"), which is published daily by the Baltic Exchange Limited, a London-based membership organization that provides daily shipping market information to the global investing community, is a daily average of charter rates in selected shipping routes measured on a time charter and voyage basis covering Handysize, Supramax, Panamax and Capesize drybulk carriers. The BDI has long been viewed as the main benchmark to monitor the movements of the drybulk vessel charter market and the performance of the entire drybulk shipping market. The BDI declined 94% in 2008 from a peak of 11,793 in May 2008 to a low of 663 in December 2008 and remained volatile during 2009, ranging from a low of 772 in January 2009 to a high of 4,661 in November 2009. The BDI continued its volatility in 2014, 2015 and 2016. In 2016, the BDI reached a high of 1,257 and a low of 290. During 2017, the BDI has remained volatile, ranging from a low of 685 on February 14, 2017 to a high of 1,338 on March 29, 2017. Market participants confidence remains at a high level despite: (i) recent fears over a trade war between the U.S. and China and (ii) regulatory concerns regarding the most pragmatic post-2020 bunker solution, since demand is improving and oversupply is easing. The BDI ended the first quarter of 2018 at 1,055 points, i.e. 23% lower from where it ended in 2017. The most recent fall is attributed mainly to the latest escalation of U.S.-China trade war threats.

The decline and volatility in charter rates has been due to various factors, including the lack of trade financing for purchases of commodities carried by sea, which had resulted in a significant decline in cargo shipments. The decline and volatility in charter rates in the drybulk market also affects the value of our drybulk vessels, which follows the trends of drybulk charter rates, and earnings on our charters, and similarly, affects our cash flows, our ability to repay our indebtedness and compliance with the covenants contained in our loan agreements.

An economic slowdown in the Asia Pacific region could exacerbate the effect of recent slowdowns in the economies of the European Union and may have a material adverse effect on our business, financial condition and results of operations.

We anticipate a significant number of the port calls made by our vessels will continue to involve the loading or discharging of drybulk commodities in ports in the Asia Pacific region. As a result, any negative changes in economic conditions in any Asia Pacific country, particularly in China, may exacerbate the effect of recent slowdowns in the economies of the European Union and may have a material adverse effect on our business, financial condition and results of operations, as well as our future prospects. Before the global economic financial crisis that began in 2008, China had one of the world’s fastest growing economies in terms of gross domestic product (“GDP”) which had a significant impact on shipping demand. A decrease in the level of China’s export of goods or an increase in trade protectionism could have a material adverse impact on our charterers’ business and, in turn, could cause a material adverse effect on our earnings, financial condition and cash flows.

Changes in the economic and political environment in China and policies adopted by the government to regulate its economy may have a material adverse effect on our business, financial condition and results of operations.

The Chinese economy differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development, or OECD, in such respects as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, rate of inflation and balance of payments position. Since 1978, increasing emphasis has been placed on the utilization of market forces in the development of the Chinese economy. There is an increasing level of freedom and autonomy in areas such as allocation of resources, production, pricing and management and a gradual shift in emphasis to a “market economy” and enterprise reform. Although limited price reforms were undertaken, with the result that prices for certain commodities are principally determined by market forces, many of the reforms are experimental and may be subject to change or abolition. We cannot assure you that the Chinese government will continue to pursue a policy of economic reform. The level of imports to and exports from China could be adversely affected by changes to these economic reforms, as well as by changes in political, economic and social conditions or other relevant policies of the Chinese government, such as changes in laws, regulations or export and import restrictions, all of which could, adversely affect our business, financial condition and operating results.

Risks involved with operating ocean-going vessels could affect our business and reputation, which may reduce our revenues.

The operation of an ocean-going vessel has inherent risks. These risks include the possibility of:

- crew strikes and/or boycotts;
- marine disaster;
- piracy;
- environmental accidents;
- cargo and property losses or damage; and
- business interruptions caused by mechanical failure, human error, war, terrorism, political action in various countries, labor strikes or adverse weather conditions.

The involvement of any of our vessels in an environmental disaster may harm our reputation as a safe and reliable vessel operator. Any of these circumstances or events could increase our costs or lower our revenues.

The M/V Free Goddess was hijacked by Somali pirates on February 7, 2012 while transiting the Indian Ocean eastbound. On October 11, 2012, we announced that all 21 crew members of the M/V *Free Goddess* were reported safe and well after the vessel's release by the pirates. At the time of the hijacking the vessel was on time charter in laden condition. Since the release from the pirates, the ex M/V Free Goddess, renamed to M/V Figaro, has been laying at the port of Salalah, Oman, undertaking repairs funded mostly by insurers. The repairs of the vessel were completed, and notice of readiness was tendered to her Charterers for the resumption of the voyage. The Charterers repudiated the Charter and we accepted Charterers' repudiation and terminated the fixture. Cargo interests commenced proceedings before the local Omani Courts under the Bills of Lading for delivery of the cargo in Oman, which were rejected at the first instance and were appealed by Cargo interests. The appeal by Cargo interests was rejected by the Court. Concurrently with the above proceedings, Cargo interests have obtained favorable arbitration decisions and a UK High Court order against the former owner Adventure Five S.A. to deliver the cargo at the port of Salalah, Oman. Griffin Underwriting, The Kidnap and Ransom insurers of the M/V Free Goddess, have commenced action before the High Court in the UK against Adventure Five, Free Bulkers and our CEO alleging damages. Those proceedings have been frozen by mutual agreement between the parties pending the conclusion of the ongoing settlement negotiations. The Company is no longer the Bareboat Charterers of the M/V Figaro. On September 30, 2017, the bareboat hire agreement in connection with the M/V Figaro was terminated. Subsequent to the termination of the hire, the vessel was sold to unrelated third parties.

An oversupply of drybulk vessel capacity may lead to reductions in charter rates and profitability.

An over-supply of drybulk carrier capacity may result in a reduction of charter hire rates. Because the factors affecting the supply and demand for vessels are outside of our control and are unpredictable, the nature, timing, direction and degree of changes in industry conditions are also unpredictable.

Factors that influence demand for vessel capacity include:

- supply and demand for energy resources, commodities, semi-finished and finished consumer and industrial products;
- changes in the exploration or production of energy resources, commodities, semi-finished and finished consumer and industrial products;
- the location of regional and global exploration, production and manufacturing facilities;
- the location of consuming regions for energy resources, commodities, semi-finished and finished consumer and industrial products;
- the globalization of production and manufacturing; global and regional economic and political conditions, including armed conflicts, terrorist activities, embargoes and strikes;

- developments in international trade;
- changes in seaborne and other transportation patterns, including the distance cargo is transported by sea;
- environmental and other regulatory developments;
- currency exchange rates; and weather.

The factors that influence the supply of vessel capacity include:

- the number of new building deliveries;
- port and canal congestion;
- the scrapping rate of older vessels;
- vessel casualties; and
- the number of vessels that are out of service.

16

We anticipate that the future demand for our drybulk carriers will be dependent upon continued economic growth in the world's economies, including China and India, seasonal and regional changes in demand, changes in the capacity of the global drybulk carrier fleet and the sources and supply of drybulk cargoes to be transported by sea. The capacity of the global drybulk carrier fleet seems likely to increase and economic growth may not continue. Adverse economic, political, social or other developments could have a material adverse effect on our business and operating results.

Increased inspection procedures and tighter import and export controls could increase costs and disrupt our business.

International shipping is subject to various security and customs inspection and related procedures in countries of origin and destination. Inspection procedures can result in the seizure of the contents of our vessels, delays in the loading, offloading or delivery and the levying of customs duties, fines or other penalties against us.

Since the terrorist attacks of September 11, 2001, there has been a variety of limitations intended to enhance vessel security.

Regulations by the U.S. Coast Guard ("USCG") and rules pursuant to the International Convention for the Safety of Life at Sea have imposed increased compliance costs on vessel owners and charterers. These costs include certification costs imposed by relevant agencies and bonding costs under U.S. Customs and Border Protection, as well as potential delays in transit due to increased security procedures regulating the entry into harbors or the discharge of cargo.

It is possible that changes to inspection procedures could impose additional financial and legal obligations on us. Furthermore, changes to inspection procedures could also impose additional costs and obligations on our customers and may, in certain cases, render the shipment of certain types of cargo uneconomical or impractical. Any such changes or developments may have a material adverse effect on our business, results of operations, cash flows, financial condition and ability to pay dividends.

Risks Related to Our Common Stock

The market price of our common stock has been and may in the future be subject to significant fluctuations.

The market price of our common stock has been and may in the future be subject to significant fluctuations as a result of many factors, some of which are beyond our control. Among the factors that have in the past and could in the future affect our stock price are:

- quarterly variations in our results of operations;
- our lenders' willingness to extend our loan covenant waivers, if necessary;
- changes in market valuations of similar companies and stock market price and volume fluctuations generally;
- changes in earnings estimates or publication of research reports by analysts;
- speculation in the press or investment community about our business or the shipping industry generally;
- strategic actions by us or our competitors such as acquisitions or restructurings;
- the thin trading market for our common stock, which makes it somewhat illiquid;
- the current ineligibility of our common stock to be the subject of margin loans because of its low current market price;
- regulatory developments;
- additions or departures of key personnel;
- general market conditions; and
- domestic and international economic, market and currency factors unrelated to our performance.

The stock markets in general, and the markets for drybulk shipping and shipping stocks in particular, have experienced extreme volatility that has sometimes been unrelated to the operating performance of individual companies. These broad market fluctuations may adversely affect the trading price of our common stock.

We have convertible securities outstanding, which if fully exercised, could require us to issue a significant number of shares of our common stock and result in substantial dilution to existing shareholders and cause the market price of our common stock to decline.

As of April 19, 2018, we had 4,034,678 shares of common stock issued and outstanding, convertible notes outstanding that may be converted into an estimated 69,840,531 shares of common stock at current market prices, outstanding warrants to purchase 0.0000002909 shares of our common stock that could result in our issuance of 1,172,263,654 shares of common stock based upon the exchange formula contained therein at current market prices and 8,160 shares of Series D Convertible Preferred Stock (the “Series D Preferred Stock”) outstanding. The conversion or exercise of our outstanding convertible securities could result in substantial dilution to our existing holders, and the sales of such material amounts of our common stock issued upon conversion or exercise could cause the market price for our common stock to decline.

If we are unable to obtain additional funding our business operations will be harmed and if we do obtain additional financing our then existing shareholders may suffer substantial dilution.

In order to fund further growth of our fleet, we may have to incur additional indebtedness and/or sell additional equity securities. Future issuances of our common stock, directly or indirectly through convertible or exchangeable securities, options, warrants or rights and will generally dilute the ownership interests of holders of our existing common stock. Additional series or classes of preferred shares, if issued, will generally have a preference on dividend payments, which could prohibit or otherwise reduce our ability to pay dividends to holders of our existing preferred stock. Any additional debt we incur will be senior in all respects to our common stock, could contain financial and operating covenants with which we must comply and will include acceleration provisions upon defaults thereunder, including our failure to make any debt service payments, and possibly under other debt. Because our decision to issue additional equity securities or incur additional debt in the future will depend on a variety of factors, including market conditions and other matters that are beyond our control, we cannot predict or estimate the timing, amount or form of our capital raising activities in the future. Future sales or other issuances of a substantial number of shares of common stock or other securities in the public market or otherwise, or the perception that these sales could occur, may depress the market price for our common stock. These sales or issuances could also impair our ability to raise additional capital through the sale of our equity securities in the future.

The continuously adjustable conversion price feature of our convertible notes and warrants may encourage investors to make short sales in our common stock, which could have a depressive effect on the price of our common stock.

Our convertible notes are convertible into shares of our common stock at a 35%-54% discount to the trading price of the common stock prior to the conversion. Our warrants are exercisable on a cashless basis pursuant to an exchange formula that is based on the difference between the black-scholes value of the warrant when issued and our current market price. The significant downward pressure on the price of the common stock as the investors convert/exercise and sell material amounts of common stock could encourage short sales by investors. This could place further downward pressure on the price of the common stock. The investors could sell common stock into the market in anticipation of covering the short sale by converting/exercising their securities, which could cause the further downward pressure on the stock price. In addition, not only the sale of shares issued upon conversion or exercise of the convertible note or warrants, but also the mere perception that these sales could occur, may adversely affect the market price of the common stock.

There is no guarantee of a continuing and liquid public market for you to resell our common shares.

On March 2, 2016, the Company received notice from the Listing Qualifications Staff (the “Staff”) of The NASDAQ Stock Market LLC (“NASDAQ”) indicating that unless the Company timely requests a hearing before the NASDAQ Listing Qualifications Panel (the “Panel”), its securities would be subject to delisting from The NASDAQ Capital Market based upon its non-compliance with the minimum bid price requirement, as set forth in NASDAQ Listing Rule 5550(a)(2), and concerns raised by the Staff, pursuant to the Staff’s discretionary authority under NASDAQ Listing Rule 5101, regarding the Company’s ability to remedy the bid price deficiency in light of dilution that may occur from financing transactions. The Company requested a hearing before the Panel, at which hearing it presented its plan to regain and sustain compliance with the bid price requirement and otherwise address the Staff’s concerns in connection therewith.

On April 21, 2016, the Company was notified by NASDAQ that its pending appeal before the Panel had been denied, and that trading in the Company's common stock will be suspended on NASDAQ effective with the open of business on Monday, April 25, 2016. The Company was approved for trading on the OTCQB® Venture Market, operated by OTC Markets Group Inc., and its common stock began trading on OTCQB effective April 25, 2016 under the trading symbol "FREEF." Effective June 16, 2017, as a result of our failure to timely file our annual report on Form 20-F, our common stock was removed from the OTCQB and began trading on the OTC Pink market. We cannot assure you that an active and liquid public market for our common shares will continue and you may not be able to sell your shares of our common stock in the future at the price that you paid for them, or at all.

Our common stock is subject to the "penny stock" rules of the SEC and the trading market in our securities is limited, which makes transactions in our stock cumbersome and may reduce the value of an investment in our stock.

The SEC has adopted Rule 15g-9 which establishes the definition of a "penny stock," for the purposes relevant to us, as any equity security that has a market price of less than $5.00 per share or with an exercise price of less than $5.00 per share, subject to certain exceptions. For any transaction involving a penny stock, unless exempt, the rules require:

- that a broker or dealer approve a person's account for transactions in penny stocks; and
- the broker or dealer receive from the investor a written agreement to the transaction, setting forth the identity and quantity of the penny stock to be purchased.

In order to approve a person's account for transactions in penny stocks, the broker or dealer must:

- obtain financial information and investment experience objectives of the person; and
- make a reasonable determination that the transactions in penny stocks are suitable for that person and the person has sufficient knowledge and experience in financial matters to be capable of evaluating the risks of transactions in penny stocks.

The broker or dealer must also deliver, prior to any transaction in a penny stock, a disclosure schedule prescribed by the SEC relating to the penny stock market, which, in highlight form:

- sets forth the basis on which the broker or dealer made the suitability determination; and that the broker or dealer received a signed, written agreement from the investor prior to the transaction.

Generally, brokers may be less willing to execute transactions in securities subject to the “penny stock” rules. This may make it more difficult for investors to dispose of our common stock and cause a decline in the market value of our stock.

Disclosure also has to be made about the risks of investing in penny stocks in both public offerings and in secondary trading and about the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and the rights and remedies available to an investor in cases of fraud in penny stock transactions. Finally, monthly statements have to be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks.

FINRA sales practice requirements may also limit a shareholder’s ability to buy and sell our stock.

In addition to the “penny stock” rules described above, FINRA has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer’s financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. The FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

Future sales or issuances of our stock could cause the market price of our common stock to decline.

Issuance of a substantial number of shares of our common stock in public or private offerings, or in payment of obligations due, or the perception that these issuances could occur, may depress the market price for our common stock. These issuances could also impair our ability to raise additional capital through the sale of our equity securities in the future. We may issue additional shares of our common stock in the future and our shareholders may elect to sell large numbers of shares held by them from time to time. Also, we may need to raise additional capital to achieve our business plans.

Because the Republic of the Marshall Islands, where we are incorporated, does not have a well-developed body of corporate law, shareholders may have fewer rights and protections than under typical United States law, such as Delaware, and shareholders may have difficulty in protecting their interest with regard to actions taken by our Board of Directors.

Our corporate affairs are governed by amended and restated articles of incorporation and by-laws and by the Marshall Islands Business Corporations Act, or BCA. The provisions of the BCA resemble provisions of the corporation laws of a number of states in the United States. However, there have been few judicial cases in the Republic of the Marshall Islands interpreting the BCA. The rights and fiduciary responsibilities of directors under the law of the Republic of the Marshall Islands are not as clearly established as the rights and fiduciary responsibilities of directors under statutes or judicial precedent in existence in certain U.S. jurisdictions. Shareholder rights may differ as well. For example, under Marshall Islands law, a copy of the notice of any meeting of the shareholders must be given not less than 15 days before the meeting, whereas in Delaware such notice must be given not less than 10 days before the meeting. Therefore, if immediate shareholder action is required, a meeting may not be able to be convened as quickly as it can be convened under Delaware law. Also, under Marshall Islands law, any action required to be taken by a meeting of shareholders may only be taken without a meeting if consent is in writing and is signed by all of the shareholders entitled to vote, whereas under Delaware law action may be taken by consent if approved by the number of shareholders that would be required to approve such action at a meeting. Therefore, under Marshall Islands law, it may be more difficult for a company to take certain actions without a meeting even if a majority of the shareholders approve of such action. While the BCA does specifically incorporate the non-statutory law, or judicial case law, of the State of Delaware and other states with substantially similar legislative provisions, public shareholders may have more difficulty in protecting their interests in the face of actions by the management, directors or controlling shareholders than would shareholders of a corporation incorporated in a U.S. jurisdiction.

It may not be possible for investors to enforce U.S. judgments against us.

We, and all our subsidiaries, are or will be incorporated in jurisdictions outside the U.S. and substantially all of our assets and those of our subsidiaries and will be located outside the U.S. In addition, most of our directors and officers are or will be non-residents of the U.S., and all or a substantial portion of the assets of these non-residents are or will be located outside the U.S. As a result, it may be difficult or impossible for U.S. investors to serve process within the U.S. upon us, our subsidiaries, or our directors and officers, or to enforce a judgment against us for civil liabilities in U.S. courts. In addition, you should not assume that courts in the countries in which we or our subsidiaries are incorporated or where our or the assets of our subsidiaries are located would enforce judgments of U.S. courts obtained in actions against us or our subsidiaries based upon the civil liability provisions of applicable U.S. federal and state securities laws or would enforce, in original actions, liabilities against us or our subsidiaries based on those laws.

We can issue shares of preferred stock without shareholder approval, which could adversely affect the rights of common shareholders.

Our articles of incorporation permit us to establish the rights, privileges, preferences and restrictions, including voting rights, of future series of our preferred stock and to issue such stock without approval from our stockholders. The rights of holders of our common stock may suffer as a result of the rights granted to holders of preferred stock that we may issue in the future. In addition, we could issue preferred stock to prevent a change in control of our company, depriving common shareholders of an opportunity to sell their stock at a price in excess of the prevailing market price.

Our stockholder rights plan may discourage a takeover.

In January 2009, our Board of Directors authorized shares of Series A Participating Preferred Stock in connection with its adoption of a stockholder rights plan, under which we issued rights to purchase Series A Preferred Stock to holders of our common stock. Upon certain triggering events, each Right entitles the registered holder to purchase from us one one-thousandth of a share of Preferred Stock at an exercise price of approximately $4 billion, subject to adjustment. Our stockholder rights plan may generally discourage a merger or tender offer involving our securities that is not approved by our Board of Directors by increasing the cost of effecting any such transaction and, accordingly, could have an adverse impact on stockholders who might want to vote in favor of such merger or participate in such tender offer. Our stockholder rights plan expires in January 2019.

Provisions in our organizational documents, our management agreement and under Marshall Islands corporate law could make it difficult for our shareholders to replace or remove our current Board of Directors or have the effect of discouraging, delaying or preventing a merger or acquisition, which could adversely affect the market price of our common stock.

Several provisions of our amended and restated articles of incorporation and by-laws, and certain provisions of the Marshall Islands corporate law, could make it difficult for our shareholders to change the composition of our Board of Directors in any one year, preventing them from changing the composition of management. In addition, these provisions may discourage, delay or prevent a merger or acquisition that shareholders may consider favorable. These provisions include:

- authorizing our Board of Directors to issue “blank check” preferred stock without shareholder approval;
- providing for a classified Board of Directors with staggered, three year terms;

prohibiting cumulative voting in the election of directors;

authorizing the removal of directors only for cause and only upon the affirmative vote of the holders of a two-thirds majority of the outstanding shares of our common shares, voting as a single class, entitled to vote for the directors;

limiting the persons who may call special meetings of shareholders;

establishing advance notice requirements for election to our Board of Directors or proposing matters that can be acted on by shareholders at shareholder meetings; and

limiting our ability to enter into business combination transactions with certain shareholders.

Pursuant to the terms of our management agreement, our Manager is entitled to a termination fee if such agreement is terminated upon a “change of control,” which term includes, but is not limited to, the election of a director not recommended by the then-current Board of Directors, any person or entity or group of affiliated persons or entities that becomes a beneficial owner of 15% or more of our voting securities, a merger of FreeSeas where less than a majority of the shares of the resulting entity are held by the FreeSeas shareholders or the sale of all or substantially all of FreeSeas’ assets. The termination fee as of December 31, 2017 would have been $28,198. In addition, we have implemented a shareholder rights plan pursuant to which the holders of our common stock receive one right to purchase one one-thousandth of a share of our Series A Participating Preferred Stock at an exercise price of approximately $4 billion per share, subject to adjustment. The rights become exercisable upon the occurrence of certain change in control events. These provisions and our shareholder rights plan could substantially impede the ability of public shareholders to benefit from a change in control and, as a result, may adversely affect the market price of our common shares and your ability to realize any potential change of control premium.

Item 4. Information on the Company

Our Organization and Corporate Structure

We were incorporated on April 23, 2004 under the name “Adventure Holdings S.A.” pursuant to the laws of the Republic of the Marshall Islands to serve as the parent holding company of our ship-owning entities. On April 27, 2005, we changed our name to “FreeSeas Inc.”

We became a public reporting company on December 15, 2005, when we completed a merger with Trinity Partners Acquisition Company Inc., or Trinity, a blank check company formed to serve as a vehicle to complete a business combination with an operating business, in which we were the surviving corporation. At the time of the merger we owned three drybulk carriers. We currently own one Handysize drybulk carrier and operate two Handysize drybulk carriers.

Our common stock currently trades on the OTC Pink market under the trading symbol “FREEF”.

Our principal executive offices are located at 20, Amerikis Street., 10671, Athens, Greece and our telephone number is 011-30-210-729-7015.

Capital Expenditures and Divestitures

During the last three fiscal years, our capital expenditures and divestitures were as follows:

- On May 20, 2015, the M/V *Free Hero*, 1995-built, 24,318 dwt Handysize drybulk carrier and the M/V *Free Goddess*, 1995-built, 22,051 dwt Handysize drybulk carrier, have been sold for a gross sale price of $5,500 each, and the Company’s subsidiaries have entered into long-term bareboat agreements for such vessels with purchase options at a daily hire rate of $1,100 per vessel. The vessels have been renamed to M/V *Fiorello* and M/V *Figaro*, respectively;

- On June 15, 2016, the bareboat hire agreement in connection with the M/V *Fiorello* was terminated. Subsequent to the termination of the hire, the vessel was sold for a gross sale price of $1,490 with the sale proceeds being applied towards obligations to the bareboat Owners of the vessel and trade creditors;

- On September 26, 2016, the Company sold to unrelated third parties the M/V *Free Maverick*, a 1998-built, 23,994 dwt Handysize drybulk carrier for a gross sale price of $1,925. As a result of the sale the Company recognized a loss of $277;

- On September 30, 2017, the bareboat hire agreement in connection with the M/V *Figaro* was terminated. Subsequent to the termination of the hire, the vessel was sold to unrelated third parties. The Company realized the amount of $1,924 as gain on settlement of liability.

Our Fleet

We are an international drybulk shipping company incorporated under the laws of the Republic of the Marshall Islands with principal executive offices in Athens, Greece. As of December 31, 2017, the Company operated one Handysize drybulk carrier. Our vessel carries a variety of drybulk commodities, including iron ore, grain and coal, which are referred to as “major bulks,” as well as bauxite, phosphate, fertilizers, steel products, cement, sugar and rice, or “minor bulks.” As of April 20, 2018, the dwt of the vessel we operate is 30,838 dwt and the age of the vessel is 21.6 years.

Our investment and operational focus has been in the Handysize sector, which is generally defined as less than 40,000 dwt of carrying capacity and the Handymax sector which is generally defined as between 40,000 dwt and 60,000 dwt. Handysize and Handymax vessels are, we believe, more versatile in the types of cargoes that they can carry and trade routes they can follow, and offer less volatile returns than larger vessel classes. We believe this segment also offers better demand and supply demographics than other drybulk asset classes. Due to the very adverse charter rate environment of the latest shipping cycle values of larger vessels have dropped to levels that constitute buying opportunities.

We have contracted the management of our vessels to our Managers, entities beneficially owned by Ion G. Varouxakis, our Chairman, President and Chief Executive Officer. In addition, Mr. Dimitris Filippas, our Chief Financial Officer, is an officer of one of our Managers. Our Managers provide technical management of our fleet, commercial management of our fleet, financial reporting and accounting services and office space. While the Managers are responsible for finding and arranging charters for our vessels, the final decision to charter our vessels remains with us.

The following table details the vessel we operate as of April 20, 2018:

Vessel Name	Type	Built	Dwt	Employment
M/V Free Neptune	Handysize	1996	30,838	Lay-up

21

Competitive Strengths

We believe that we possess a number of strengths that provide us with a competitive advantage in the drybulk shipping industry, including:

Experienced management team. We have benefited from the expertise of our executive officers, including that of Ion G. Varouxakis, our Chairman, President and Chief Executive Officer, and that of our Managers' personnel, which consists of seasoned shipping professionals with long-standing experience in the industry. We believe that our management team has a proven track record of strong performance throughout a challenging economic climate, as we have actively and decisively renewed our fleet while reducing operating costs without sacrificing quality or safety in the process.

Experienced in managing older vessels. We have solid experience in managing older vessels and have very good relationships with third party suppliers, shipyards and contractors who can accommodate urgent needs for vessels that are older and may require urgent and competitively priced repairs. We have also forged over the years a relationship of trust with insurers and classification societies who are willing to provide their services at competitive rates, and accommodate bespoke requirements suitable to older vessels. The lower capital requirement for the acquisition of older vessels in conjunction with our ability to keep their maintenance cost at competitive levels provides us with unique investment opportunities.

Business Strategy

Our primary objectives are to profitably grow our business and maximize value to our shareholders by pursuing the following strategies:

Expanding into larger asset classes (Supramax and/or Panamax). The recent market downturn has particularly affected the value of larger asset classes creating the potential for relatively greater capital appreciation and operational leverage as the market recovers. We shall also consider pursuing investments in larger asset classes in order to take advantage of all available opportunities as they arise.

Build on our experience in operating older vessels. Our experience in managing older vessels provides us with the flexibility to make investments in older vessels, a segment where little or no financing is available from traditional capital sources, and often superior return on capital can be achieved compared to high capital modern vessels.

Build upon our strategic relationships. We intend to continue to build upon our extensive experience and relationships with ship brokers, financial institutions, industrial partners and commodity traders. We use these relationships to identify chartering and acquisition opportunities and gain access to sources of additional financing, industry contacts and market intelligence. In addition, our relationships and experience with insurers and technical service providers, spares suppliers and repair shipyards position us optimally for the competitive operation of a versatile fleet with heavy employment commitments and demanding technical requirements.

Vessel Employment

We intend to employ predominantly our vessels in the spot market with charters that typically last one to two months.

A trip time charter is a short-term time charter for a voyage between load port(s) and discharge port(s) under which the charterer pays fixed daily hire rate on a semi-monthly basis for use of the vessel. A period time charter is charter for a vessel for a fixed period of time at a set daily rate. Under trip time charters and time charters, the charterer pays voyage expenses. Under all three types of charters, the vessel owners pay for vessel operating expenses, which include crew costs, provisions, deck and engine stores, lubricating oil, insurance, maintenance and repairs. The vessel owners are also responsible for each vessel's dry-docking and intermediate and special survey costs. Lastly, vessels can be chartered under "bareboat" contracts whereby the charterer is responsible for the vessel's maintenance and operations, as well as all voyage expenses.

Vessels operating on period time charter provide more predictable cash flows, but can yield lower profit margins than vessels operating in the spot market during periods characterized by favorable market conditions. Vessels operating in the spot market generate revenues that are less predictable but may enable us to increase profit margins during periods of increasing drybulk charter rates. However, we would then be exposed to the risk of declining drybulk charter rates, which may be higher or lower than the rates at which we chartered our vessels. We are constantly evaluating opportunities for period time charters, but only expect to enter into additional period time charters if we can obtain contract terms that satisfy our criteria.

Although we have not previously done so, we may from time to time utilize forward freight agreements that enable us to enter into contractual obligations to sell the spot charter forward and thereby reduce our exposure to a potential deterioration of the charter market.

Customers

During 2017, there were no charterers that individually accounted for more than 10% of the Company's voyage revenues. During 2016, we derived approximately 97% of our gross revenues from two charterers. We believe that our customer base is composed of established charterers.

Management of Operations and Fleet

Pursuant to our amended and restated services agreement with our Managers, our operations are executed and supervised by our Manager, based on the strategy devised by the board of directors and subject to the approval of our board of directors as described below. We pay a monthly fee of $50 (on the basis that the $/Euro exchange rate is 1.35 or lower; if on the last business day of each month the $/Euro exchange rate exceeds 1.35 then the service fee payable will be adjusted for the following month in question, so that the amount payable in dollars will be the equivalent in Euro based on 1.35 $/Euro exchange rate) as compensation for services related to accounting, financial reporting, implementation of Sarbanes-Oxley internal control over financial reporting procedures and general administrative and management services plus expenses. The Manager is entitled to a termination fee if the agreement is terminated upon a "change of control" as defined in its services agreement. The termination fee as of December 31, 2017 would be approximately $28,198.

Our Managers, provide us with the following services:

General Administration. Our Managers provide us with general administrative, office and support services necessary for our operations and our fleet, including technical and clerical personnel, communication, accounting, and data processing services.

Financial Accounting Services. Our Managers maintain our books, records and accounts and provides all services as are necessary for the preparation and maintenance of the our accounting records in accordance with U.S. GAAP, preparing and filing financial statements with the SEC in accordance with applicable financial reporting requirements, and developing, implementing, monitoring and assessing our internal controls;

Sale and Purchase of Vessels. Our Managers advise our board of directors when opportunities arise to purchase, including through new buildings, or to sell any vessels. All decisions to purchase or sell vessels require the approval of our board of directors. Any purchases or sales of vessels approved by our board of directors are arranged and completed by our Managers. This involves the appointment of superintendents to inspect and take delivery of vessels and to monitor compliance with the terms and conditions of the purchase contracts.

We also contract the technical management of our vessels to our Managers, Free Bulkers and OpenSeas Maritime Free Bulkers has a separate management contract with one of our ship-owning subsidiaries and provides a wide range of services on a fixed fee per vessel basis, as described below. OpenSeas Maritime has a management contract with another of our subsidiaries relating to a vessel bareboat chartered. These services include vessel operations, maintenance, regulatory compliance, crewing, supervising dry-docking and repairs, arranging insurance for vessels, vessel supplying, advising on the purchase and sale of vessels, and performing certain accounting and other administrative services, including financial reporting and internal controls requirements. Pursuant to our amended management agreement with our Managers, we pay our Managers a monthly technical management fee of $19 (on the basis that the dollar/Euro exchange rate is 1.30 or lower; if on the first business day of each month the dollar/Euro exchange rate exceeds 1.30 then the management fee payable will be increased for the month in question, so that the amount payable in dollars will be the equivalent in Euro based on 1.30 dollar/Euro exchange rate) plus a fee of $400 per day for superintendent attendance and other direct expenses.

We also pay our Managers a fee equal to 1.25% of the gross freight or hire from the employment of FreeSeas' owned and bareboat chartered vessels and a 1% commission on the gross purchase price of any new vessel acquired or the gross sale price of any vessel sold by FreeSeas with the assistance of our Managers.

Our Managers currently manage the vessels owned and bareboat chartered.

We believe that we pay our Managers industry-standard fees for these services.

Crewing and Employees

We currently have no employees, our Managers are responsible for employing all of the executive officers and staff to execute and supervise the operations. In addition, our Managers are responsible for recruiting, either directly or through a crewing agent, the senior officers and all other crew members for our vessels.

Long-Term Debt

Please see “Item 5. Operating and Financial Review and Prospects – Long-Term Debt” for a description of our credit facility with NBG, our current non-compliance with our obligations and covenants under the facility agreement, and the status of our efforts to reach a settlement with the Bank.

Charter Hire Rates

Charter hire rates fluctuate by varying degrees among drybulk carrier size categories. The volume and pattern of trade in a small number of commodities (major bulks) affect demand for larger vessels. Therefore, charter rates and vessel values of larger vessels often show greater volatility. Conversely, trade in a greater number of commodities (minor bulks) drives demand for smaller drybulk carriers. Accordingly, charter rates and vessel values for those vessels are subject to less volatility.

Charter hire rates paid for drybulk carriers are primarily a function of the underlying balance between vessel supply and demand, although at times other factors may play a role. Furthermore, the pattern seen in charter rates is broadly mirrored across the different charter types and the different drybulk carrier categories. However, because demand for larger drybulk vessels is affected by the volume and pattern of trade in a relatively small number of commodities, charter hire rates (and vessel values) of larger ships tend to be more volatile than those for smaller vessels.

In the time charter market, rates vary depending on the length of the charter period and vessel specific factors such as age, speed and fuel consumption.

In the voyage charter market, rates are influenced by cargo size, commodity, port dues and canal transit fees, as well as commencement and termination regions. In general, a larger cargo size is quoted at a lower rate per ton than a smaller cargo size. Routes with costly ports or canals generally command higher rates than routes with low port dues and no canals to transit. Voyages with a load port within a region that includes ports where vessels usually discharge cargo or a discharge port within a region with ports where vessels load cargo also are generally quoted at lower rates, because such voyages generally increase vessel utilization by reducing the unloaded portion (or ballast leg) that is included in the calculation of the return charter to a loading area.

Within the drybulk shipping industry, the charter hire rate references most likely to be monitored are the freight rate indices issued by the Baltic Exchange. These references are based on actual charter hire rates under charters entered into by market participants as well as daily assessments provided to the Baltic Exchange by a panel of major shipbrokers.

Property

We had entered into an agreement with Free Bulkers, pursuant to which we had agreed to pay Free Bulkers 65% of the rents due from Free Bulkers to the lessor of rented office space and 65% of the apportioned common expenses and maintenance expenses. In June 2017, we relocated our offices to 6, Loukianou Street, 10675, Athens, Greece. We entered into an agreement pursuant to which we agreed to pay our Manager, Prodigy Inc., 50% of the rents due from Prodigy Inc. to the lessor for use of office space by the Company and 50% of the apportioned common expenses and maintenance expenses. In December 2017, we relocated our offices to 20, Amerikis Street, 10671, Athens, Greece. We have entered into an agreement pursuant to which we agreed to pay our Manager, Prodigy Inc., 50% of the rents due from Prodigy Inc. to the lessor for use of office space by the Company and 50% of the apportioned common expenses and maintenance expenses.

Competition

We operate in markets that are highly competitive and based primarily on supply and demand. We compete for charters on the basis of price, vessel location, size, age and condition of the vessel, as well as on our reputation. There are many drybulk shipping companies which are publicly traded on the U.S. stock markets, such as DryShips Inc. and Diana Shipping Inc., which are significantly larger than we are and have substantially more capital, more and larger vessels, personnel, revenue and profits and which are in competition with us. There is no assurance that we can successfully compete with such companies for charters or other business.

Our Managers arrange our charters (whether spot charters, period time charters, bareboat charters or pools) through the use of brokers, who negotiate the terms of the charters based on market conditions. We compete with other owners of drybulk carriers in the, Handysize and Handymax sectors. Charters for our vessels are negotiated by our Managers utilizing a worldwide network of shipbrokers. These shipbrokers advise our Managers on a continuous basis of the availability of cargo for any particular vessel. There may be several shipbrokers involved in any one charter. The negotiation for a charter typically begins prior to the completion of the previous charter in order to avoid any idle time. The terms of the charter are based on industry standards.

24

Seasonality

Coal, iron ore and grains, which are the major bulks of the drybulk shipping industry, are somewhat seasonal in nature. The energy markets primarily affect the demand for coal, with increases during hot summer periods when air conditioning and refrigeration require more electricity and towards the end of the calendar year in anticipation of the forthcoming winter period. The demand for iron ore tends to decline in the summer months because many of the major steel users, such as automobile makers, reduce their level of production significantly during the summer holidays. Grains are completely seasonal as they are driven by the harvest within a climate zone. Because three of the five largest grain producers (the United States of America, Canada and the European Union) are located in the northern hemisphere and the other two (Argentina and Australia) are located in the southern hemisphere, harvests occur throughout the year and grains required drybulk shipping accordingly.

Environmental and Other Regulations

Government regulation and laws significantly affects the ownership and operation of our vessels. The vessels are subject to international conventions and treaties, national, state and local laws and regulations in force in the countries in which our vessels may operate or are registered, including those governing the management and disposal of hazardous substances and wastes, the cleanup of oil spills and other contamination, air emissions, and water discharges and ballast water management.

A variety of governmental and private entities subject our vessels to both scheduled and unscheduled inspections. These entities include the local port authorities (United States Coast Guard, harbor master or equivalent), classification societies, flag state administration (country of registry) and charterers. Certain of these entities require us to obtain permits, licenses, financial assurances and certificates for the operation of our vessels. Failure to maintain necessary permits or approvals could require us to incur substantial costs or result in the temporary suspension of operation of one or more of our vessels.

We believe that the heightened level of environmental and quality concerns among insurance underwriters, regulators and charterers is leading to greater inspection and safety requirements on all vessels and may accelerate the scrapping of older vessels throughout the industry. Increasing environmental concerns have created a demand for vessels that conform to the stricter environmental standards. We are required to maintain operating standards for all of our vessels that will emphasize operational safety, quality maintenance, continuous training of its officers and crews and compliance with U.S. and international regulations. We believe that the operation of our vessels is in substantial compliance with applicable environmental laws and regulations; however, because such laws and regulations are frequently changed and may impose increasingly stricter requirements, such future requirements may limit our ability to do business, increase our operating costs, force the early retirement of our vessels, and/or affect their resale value, all of which could have a material adverse effect on our financial condition and results of operations.

International Maritime Organization

The International Maritime Organization, or IMO, the United Nations agency for maritime safety and the prevention of pollution by ships, has adopted the International Convention for the Prevention of Marine Pollution, 1973, as modified by the related Protocol of 1978, or the MARPOL Convention, which has been updated through various amendments. The MARPOL Convention establishes environmental standards relating to oil leakage or spilling, garbage management, sewage, air emissions, handling and disposal of noxious liquids and handling of harmful substances in packaged forms. The IMO adopted regulations that set forth pollution prevention requirements applicable to drybulk carriers. These regulations have been adopted by over 150 nations, including many of the jurisdictions in which our vessels operate.

In September 1997, the IMO adopted Annex VI to the International Convention for the Prevention of Pollution from Ships to address air pollution from vessels. Annex VI, which came into effect on May 19, 2005, set limits on sulfur oxide (“SOx”) and NOx emissions from vessels and prohibited deliberate emissions of ozone depleting substances, such as chlorofluorocarbons. Annex VI also included a global cap on the sulfur content of fuel oil and allowed for special areas to be established with more stringent controls on sulfur emissions. Annex VI has been ratified by some, but not all IMO member states, including the Marshall Islands. Pursuant to a Marine Notice issued by the Marshall Islands Maritime Administrator as revised in March 2005, vessels flagged by the Marshall Islands that are subject to Annex VI must, if built before the effective date, obtain an International Air Pollution Prevention Certificate evidencing compliance with Annex VI by the first dry docking after May 19, 2005, but no later than May 19, 2008. All vessels subject to Annex VI and built after May 19, 2005 must also have this Certificate. We have obtained International Air Pollution Prevention certificates for all of our vessels. Amendments to Annex VI regarding particulate matter, NOx and SOx emission standards entered into force in July 2010. The amendments provide for a progressive reduction in SOx emissions from ships, with the global sulfur cap reduced initially to 3.50% (from the current 4.50%), effective from 1 January 2012; then progressively to 0.50%, effective from 1 January 2020, subject to a feasibility review to be completed no later than 2018. The Annex VI amendments also establish tiers of stringent NOx emissions standards for new marine engines, depending on their dates of installation. The United States ratified the amendments, and all vessels subject to Annex VI must comply with the amended requirements when entering U.S. ports or operating in U.S. waters. Additionally, more stringent emission standards apply in coastal areas designated by MEPC as Emission Control Areas (ECAs). The North American ECA, which includes the area extending 200 nautical miles from the Atlantic/Gulf and Pacific Coasts of the United States and Canada, the Hawaiian Islands, and the French territories of St. Pierre and Miquelon, has been enforceable since August 1, 2012. Fuel used by vessels operating in the ECA cannot exceed a 1.0% sulfur content, dropping to a 0.1% sulfur content in 2015. NOx after-treatment requirements will apply in 2016. The U.S. Caribbean ECA, which includes the waters of Puerto Rico and the Virgin Islands, became enforceable on January 1, 2014. We may incur costs to install control equipment on our engines in order to comply with the new requirements. Other ECAs may be designated, and the jurisdictions in which our vessels operate may adopt more stringent emission standards independent of IMO.

The operation of our vessels is also affected by the requirements set forth in the IMO’s Management Code for the Safe Operation of Ships and Pollution Prevention, or the ISM Code. The ISM Code requires shipowners and bareboat charterers to develop and maintain an extensive “Safety Management System” that includes the adoption of a safety and environmental protection policy setting forth instructions and procedures for safe operation and describing procedures for dealing with emergencies. The failure of a shipowner or management company to comply with the ISM Code may subject such party to increased liability, may decrease available insurance coverage for the affected vessels, and may result in a denial of access to, or detention in, certain ports. Currently, each of our vessels is ISM Code-certified. However, there can be no assurance that such certification will be maintained indefinitely.

Additional or new conventions, laws and regulations may also be adopted that could adversely affect our ability to operate our vessels.

The U.S. Oil Pollution Act of 1990

The United States Oil Pollution Act of 1990, or OPA, established an extensive regulatory and liability regime for the protection and clean-up of the environment from oil spills. OPA affects all owners and operators whose vessels trade in the United States, its territories and possessions or whose vessels operate in waters of the United States, which includes the United States' territorial sea and its 200 nautical mile exclusive economic zone. The United States has also enacted the Comprehensive Environmental Response, Compensation and Liability Act, or CERCLA, which applies to the discharge of hazardous substances other than oil, whether on land or at sea. Both OPA and CERCLA affect our operations.

Under OPA, vessel owners, operators, charterers and management companies are "responsible parties" and are jointly, severally and strictly liable (unless the spill results solely from the act or omission of a third party, an act of God or an act of war) for all containment and removal costs and other damages arising from discharges or threatened discharges of oil from their vessels, including bunkers (fuel). Effective July 31, 2009, the U.S. Coast Guard adjusted the limits of OPA liability for drybulk vessels to the greater of $1,000 per gross ton or $854,400 and established a procedure for adjusting the limits for inflation every three years. CERCLA contains a liability scheme that is similar to that under the OPA, and liability under CERCLA is limited to the greater of $300 per gross ton or $5 million for vessels carrying a hazardous substance as cargo and the greater of $300 per gross ton or $0.5 million for any other vessel. These limits of liability do not apply if an incident was directly caused by violation of applicable U.S. federal safety, construction or operating regulations or by a responsible party's gross negligence or willful misconduct, or if the responsible party fails or refuses to report the incident or to cooperate and assist in connection with oil removal activities. In response to the 2010 oil spill in the Gulf of Mexico resulting from the explosion of the *Deepwater Horizon* drilling rig, bills have been introduced in the U.S. Congress to increase the limits of OPA liability for all vessels.

OPA requires owners and operators of vessels to establish and maintain with the United States Coast Guard evidence of financial responsibility sufficient to meet their potential liabilities under OPA. Under the regulations, vessel owners and operators may evidence their financial responsibility by showing proof of insurance, surety bond, self-insurance, or guaranty. Upon satisfactory demonstration of financial responsibility, a Certificate of Financial Responsibility, or COFR, is issued by the United States Coast Guard. This certificate must be carried aboard the vessel to comply with these financial responsibility regulations. We have complied with these financial responsibility regulations by obtaining and carrying COFRs for each of our vessels that operate in U.S. waters. Currently none of our vessels operate in U.S. waters. We may incur additional costs to obtain COFRs for vessels, if required, and to comply with increased limits of liability in the future.

OPA specifically permits individual states to impose their own liability regimes with regard to oil pollution incidents occurring within their boundaries, and some states have enacted legislation providing for unlimited liability for oil spills. In some cases, states, which have enacted such legislation, have not yet issued implementing regulations defining vessels owners' responsibilities under these laws. We currently comply, and intend to continue to comply in the future, with all applicable state regulations in the ports where our vessels call. We currently maintain pollution liability coverage as part of our protection and indemnity insurance for each of our vessels in the amount of $1 billion per incident. If the damages from a catastrophic pollution liability incident exceed our insurance coverage, the payment of those damages may materially decrease our net income.

26

The United States Clean Water Act

The United States Clean Water Act, or CWA, prohibits the discharge of oil or hazardous substances in navigable waters and imposes strict liability in the form of penalties for any unauthorized discharges. The CWA also imposes substantial liability for the costs of removal, remediation and damages and complements the remedies available under the OPA and CERCLA. Under U.S. Environmental Protection Agency, or EPA, regulations we are required to obtain a CWA permit regulating and authorizing any discharges of ballast water or other wastewaters incidental to our normal vessel operations if we operate within the three-mile territorial waters or inland waters of the United States. The permit, which EPA has designated as the Vessel General Permit for Discharges Incidental to the Normal Operation of Vessels, or VGP, incorporated the then-current U.S. Coast Guard requirements for ballast water management, as well as supplemental ballast water requirements and limits for 26 other specific discharges. Regulated vessels cannot operate in U.S. waters unless they are covered by the VGP. To do so, vessel owners must submit a Notice of Intent, or NOI, at least 30 days before the vessel operates in U.S. waters. To comply with the VGP vessel owners and operators may have to install equipment on their vessels to treat ballast water before it is discharged or implement port facility disposal arrangements or procedures at potentially substantial cost. The VGP also requires states to certify the permit, and certain states have imposed more stringent discharge standards as a condition of their certification. Many of the VGP requirements have already been addressed in our vessels' current ISM Code SMS Plan. We have submitted NOIs for all of our vessels that operate in U.S. waters. As part of a settlement of a lawsuit challenging the VGP, EPA has proposed a new VGP with numerical restrictions on organisms in ballast water discharges. The new VGP is now in effect by EPA and it is monitored onboard by the USCG. Our ships are in full compliance with the VGP regulations.

Other Environmental Initiatives

The EU has also adopted legislation that: requires member states to impose criminal sanctions for certain pollution events, such as the unauthorized discharge of tank washings. The European Parliament recently endorsed a European Commission proposal to criminalize certain pollution discharges from ships. If the proposal becomes formal EU law, it will affect the operation of vessels and the liability of owners for oil and other pollutional discharges. It is difficult to predict what legislation, if any, may be promulgated by the European Union or any other country or authority.

The Paris Memorandum of Understanding on Port State Control (Paris MoU) to which 27 nations are party adopted the "New Inspection Regime" (NIR) to replace the existing Port State Control system, effective January 1, 2011. The NIR is a significant departure from the previous system, as it is a risk based targeting mechanism that will reward quality vessels with a smaller inspection burden and subject high-risk ships to more in-depth and frequent inspections. The inspection record of a vessel, its age and type, the Voluntary IMO Member State Audit Scheme, and the performance of the flag State and recognized organizations are used to develop the risk profile of a vessel.

The U.S. National Invasive Species Act, or NISA, was enacted in 1996 in response to growing reports of harmful organisms being released into U.S. ports through ballast water taken on by ships in foreign ports. Under NISA, the USCG adopted regulations in July 2004 imposing mandatory ballast water management practices for all vessels equipped with ballast water tanks entering U.S. waters. These requirements can be met by performing mid-ocean ballast exchange, by retaining ballast water on board the ship, or by using environmentally sound alternative ballast water management methods approved by the USCG. (However, mid-ocean ballast exchange is mandatory for ships heading to the Great Lakes or Hudson Bay, or vessels engaged in the foreign export of Alaskan North Slope crude oil.) Mid-ocean ballast exchange is the primary method for compliance with the USCG regulations, since holding ballast water can prevent ships from performing cargo operations upon arrival in the United States, and alternative methods are still under development. Vessels that are unable to conduct mid-ocean ballast exchange due to voyage or safety concerns may discharge minimum amounts of ballast water (in areas other than the Great Lakes and the Hudson River), provided that they comply with record keeping requirements and document the reasons they could not follow the required ballast water management requirements. On March 23, 2012 the USCG adopted ballast water discharge standards that set maximum acceptable discharge limits for living organisms and established standards for ballast water management systems. The regulations became effective on June 21, 2012 and will be phased in between January 1, 2014 and January 1, 2016 for existing vessels, depending on the size of their ballast water tanks and their next drydocking date. Although the USCG ballast water management requirements are consistent with the requirements in EPA's proposed VGP, the USCG intends to review the practicability of implementing even more stringent ballast water discharge standards and publish the results of that review no later than January 1, 2016. In the past absence of federal standards, states enacted legislation or regulations to address invasive species through ballast water and hull cleaning management and permitting requirements. Michigan's ballast water management legislation was upheld by the Sixth Circuit Court of Appeals and California enacted legislation extending its ballast water management program to regulate the management of "hull fouling" organisms attached to vessels and adopted regulations limiting the number of organisms in ballast water discharges. Other states may proceed with the enactment of requirements similar to those of California and Michigan or the adoption of requirements that are more stringent than the EPA and USCG requirements. We could incur additional costs to comply with the new VGP and additional USCG or state ballast water management requirements.

At the international level, the IMO adopted the International Convention for the Control and Management of Ships' Ballast Water and Sediments, or the BWM Convention, in February 2004. The Convention's implementing regulations call for a phased introduction of mandatory ballast water exchange requirements, to be replaced in time with mandatory concentration limits. The BWM Convention will not enter into force until 12 months after it has been adopted by 30 states, the combined merchant fleets of which represent not less than 35% of the gross tonnage of the world's merchant shipping. The Convention has not yet entered into force because a sufficient number of states have failed to adopt it. However, in March 2010, MEPC passed a resolution urging the ratification of the Convention and calling upon those countries that have already ratified it to encourage the installation of ballast water management systems.

If the mid-ocean ballast exchange is made mandatory throughout the United States or at the international level, or if water treatment requirements or options are instituted, the cost of compliance could increase for ocean carriers. Although we do not believe that the costs of compliance with a mandatory mid-ocean ballast exchange would be material, it is difficult to predict the overall impact of such a requirement on our business.

Greenhouse Gas Regulation

The 2005 Kyoto Protocol to the United Nations Framework Convention on Climate Change required adopting countries to implement national programs to reduce emissions of certain greenhouse gases, but emissions from international shipping are not subject to the soon to expire Kyoto Protocol. International negotiations regarding a successor to the Kyoto Protocol are on-going. The IMO's MEPC adopted two new sets of mandatory requirements to address greenhouse gas emissions from vessels at its July 2011 meeting. The EEDI establishes a minimum energy efficiency level per capacity mile and will be applicable to new vessels. The Ship Energy Efficiency Management Plan will be applicable to currently operating vessels of 400 metric tons and above. These requirements entered into force in January 2013 and could cause us to incur additional compliance costs. The IMO is also considering the development of market based mechanisms to reduce greenhouse gas emissions from vessels, as well as sustainable development goals for marine transportation, but it is impossible to predict the likelihood that such measures might be adopted or their potential impacts on our operations at this time. The EU is considering measures including an expansion of the existing EU emissions trading scheme to greenhouse gas emissions from marine vessels, The U.S. EPA Administrator issued a finding that greenhouse gases threaten the public health and safety and has adopted regulations relating to the control of greenhouse gas emissions from certain mobile and stationary sources. Although the EPA findings and regulations do not extend to vessels and vessel engines, the EPA is separately considering a petition from the California Attorney General and environmental groups to regulate greenhouse gas emissions from ocean-going vessels under the CAA. Any passage of climate control legislation or other regulatory initiatives by the IMO, the EU or individual countries in which we operate or any international treaty adopted to succeed the Kyoto Protocol could require us to make significant financial expenditures or otherwise limit our operations that we cannot predict with certainty at this time.

Vessel Security Regulation

Since the terrorist attacks of September 11, 2001, there have been a variety of initiatives intended to enhance vessel security. On November 25, 2002, the Maritime Transportation Security Act of 2002, or MTSA, came into effect. To implement certain portions of the MTSA, in July 2003, the United States Coast Guard issued regulations requiring the implementation of certain security requirements aboard vessels operating in waters subject to the jurisdiction of the United States of America. Similarly, in December 2002, amendments to SOLAS created a new chapter of the convention dealing specifically with maritime security. The new chapter went into effect in July 2004, and imposes various detailed security obligations on vessels and port authorities, most of which are contained in the newly created ISPS Code.

Among the various requirements are:

- on-board installation of automatic information systems, to enhance vessel-to-vessel and vessel-to-shore communications;
- on-board installation of ship security alert systems;
- the development of vessel security plans; and
- compliance with flag state security certification requirements.

The United States Coast Guard regulations, intended to align with international maritime security standards, exempt non-U.S. vessels from MTSA vessel security measures provided such vessels have on board, by July 1, 2004, a valid International Ship Security Certificate that attests to the vessel's compliance with SOLAS security requirements and the ISPS Code. Our vessels are in compliance with the various security measures addressed by the MTSA, SOLAS and the ISPS Code. We do not believe these additional requirements will have a material financial impact on our operations.

Inspection by Classification Societies

The hull and machinery of every commercial vessel must be classed by a classification society authorized by its country of registry. The classification society certifies that a vessel is safe and seaworthy in accordance with the applicable rules and regulations of the country of registry of the vessel and SOLAS.

A vessel must undergo annual surveys, intermediate surveys, dry-dockings and special surveys. In lieu of a special survey, a vessel's machinery may be on a continuous survey cycle, under which the machinery would be surveyed periodically over a five-year period. Our vessels are on special survey cycles for hull inspection and continuous survey cycles for machinery inspection. Every vessel is also required to be dry-docked every two to three years for inspection of the underwater parts of such vessel. If any vessel does not maintain its class and/or fails any annual survey, intermediate survey, dry-docking or special survey, the vessel will be unable to carry cargo between ports and will be unemployable and uninsurable. That could cause us to be in violation of certain covenants in our loan agreements.

At an owner's application, the surveys required for class renewal may be split according to an agreed schedule to extend over the entire period of class. This process is referred to as continuous class renewal.

All areas subject to survey as defined by the classification society are required to be surveyed at least once per class period, unless shorter intervals between surveys are prescribed elsewhere. The period between two subsequent surveys of each area must not exceed five years.

Most insurance underwriters make it a condition for insurance coverage and lending that a vessel be certified as "in class" by a classification society which is a member of the International Association of Classification Societies. Our vessels are certified as being "in class" by their respective classification societies all of which are members of the International Association of Classification Societies.

The table below lists the next dry-docking and special surveys scheduled for the vessel, to the extent such dates are known as of the date of this annual report:

Vessel	Next Intermediate Dry-docking	Next Special Survey Dry-docking
M/V *Free Neptune*	Third quarter 2017*	Second quarter 2019

*The M/V *Free Neptune* has not passed her previous intermediate drydocking since it is in lay-up condition.

ISM and ISPS certifications have been awarded to all of our vessels and to the Managers by either the vessel's flag country or a member of the International Association of Classification Societies

Risk of Loss and Liability Insurance

General

The operation of any cargo vessel includes risks such as mechanical failure, physical damage, collision, property loss, cargo loss or damage and business interruption due to political circumstances in foreign countries, hostilities and labor strikes. In addition, there is always an inherent possibility of marine disaster, including oil spills and other environmental mishaps, and the liabilities arising from owning and operating vessels in international trade. OPA, which imposes virtually unlimited liability upon owners, operators and bareboat charterers of any vessel trading in the exclusive economic zone of the United States of America for certain oil pollution accidents in the United States of America, has made liability insurance more expensive for ship owners and operators trading in the United States of America market. While we believe that our present insurance coverage is adequate, not all risks can be insured, and there can be no guarantee that any specific claim will be paid, or that we will always be able to obtain adequate insurance coverage at reasonable rates.

Hull and Machinery Insurance

We have obtained marine hull and machinery and war risk insurance, which include the risk of actual or constructive total loss, for all of our vessels. The vessels are each covered up to at least their fair market values or such higher amounts as may be required to meet the requirements of any outstanding indebtedness on a particular vessel, with deductibles in amounts of approximately $250.

Protection and Indemnity Insurance

Protection and indemnity insurance is provided by mutual protection and indemnity associations, or P&I associations, which covers our third-party liabilities in connection with our shipping activities. This includes third-party liability and other related expenses of injury or death of crew, passengers and other third parties, loss or damage to cargo, claims arising from collisions with other vessels, damage to other third-party property, pollution arising from oil or other substances, and salvage, towing and other related costs, including wreck removal. Protection and indemnity insurance is a form of mutual indemnity insurance, extended by protection and indemnity mutual associations, or "clubs."

Our current protection and indemnity insurance coverage for pollution is $1 billion per vessel per incident. The 14 P&I associations that comprise the International Group insure approximately 90% of the world's commercial tonnage and have entered into a pooling agreement to reinsure each association's liabilities. Each P&I association has capped its exposure to this pooling agreement at $5.4 billion. As a member of a P&I association, which is a member of the International Group, we are subject to calls payable to the associations based on its claim records as well as the claim records of all other members of the individual associations and members of the pool of P&I associations comprising the International Group.

Loss of Hire Insurance

With the exception of kidnap and ransom insurance and its loss of hire extension (described below), we have not obtained loss of hire insurance for any of our vessels. Loss of hire insurance generally provides coverage against loss of charter hire that result from the loss of use of a vessel. We will review annually whether obtaining and/or maintaining this insurance is cost effective. Our ability to obtain loss of hire insurance is subject to market conditions and general availability.

Kidnap and Ransom

We have kidnap and ransom insurance on a case by case basis, generally when one of our vessels is transitioning in an area where acts of piracy are known to take place. Kidnap and ransom insurance generally provides coverage of ransom paid, including interest if ransom money are through financing products and including delivery expense of ransom, fees of negotiators and crisis management personnel and the cost of reinstatement of replacement crew. The loss of hire extension covers the insured for any hire lost during seizure for a certain number of days that have been agreed on at the inception of the coverage, typically either 90, 120 or 180 days.

Procedures in the Event of an Insured Event

Marine casualties are an inherent risk in the shipping industry. If one of our vessels undergoes a marine casualty, we intend to take prompt action in consultation with the appropriate insurers, as described above, to ascertain the extent of any damage to our vessel, its cargo, the crew, the vessel's ability to complete its charter and any environmental impact and the appropriate steps to try to mitigate the impact of the casualty on our financial condition and results of operations.

Legal Proceedings

We are not and have not been involved in any legal proceedings that have, or have had, a significant effect on our business, financial position, results of operations or liquidity, nor are we aware of any proceedings that are pending or threatened that may have significant effect on our business, financial position, results of operations or liquidity. From time to time, we may be subject to legal proceedings and claims in the ordinary course of business, principally personal injury and property casualty claims. We expect that these claims would be covered by insurance, subject to customary deductibles. Those claims, even if lacking in merit, could result in the expenditure of significant financial and managerial resources.

Exchange Controls

Under Marshall Islands law, there are currently no restrictions on the export or import of capital, including foreign exchange controls or restrictions that affect the remittance of dividends, interest or other payments to non-resident holders of our common stock.

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

The following management's discussion and analysis should be read in conjunction with our historical consolidated financial statements and accompanying notes included elsewhere in this report. This discussion contains forward-looking statements that reflect our current views with respect to future events and financial performance. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of various factors, such as those set forth in the section entitled "Risk Factors" and elsewhere in this report.

The historical consolidated financial results of FreeSeas described below are presented, unless otherwise stated, in thousands of United States dollars.

Overview

We are an international drybulk shipping company incorporated under the laws of the Republic of the Marshall Islands with principal executive offices in Athens, Greece. The Company currently operates one Handysize drybulk carrier. Our vessel carries a variety of drybulk commodities, including iron ore, grain and coal, which are referred to as "major bulks," as well as bauxite, phosphate, fertilizers, steel products, cement, sugar and rice, or "minor bulks." As of April 19, 2018, the dwt of the vessel we operate is 30,838 dwt and the age of the vessels is 21.6 years.

Our investment and operational focus has been in the Handysize sector, which is generally defined as less than 40,000 dwt of carrying capacity and the Handymax sector which is generally defined as between 40,000 dwt and 60,000 dwt. Handysize and Handymax vessels are, we believe, more versatile in the types of cargoes that they can carry and trade routes they can follow, and offer less volatile returns than larger vessel classes. We believe this segment also offers better demand and supply demographics than other drybulk asset classes. Due to the very adverse charter rate environment of the latest shipping cycle values of larger vessels have dropped to levels that constitute buying opportunities.

Recent Developments

- Effective February 6, 2018, the Company effectuated a five thousand-to-one reverse stock split of its issued and outstanding common stock.

- On February 14, 2018, the Company sold to M. DALAKOS - I. FASSOLIS - N. THEOFANOPOULOS & PARTNERS LAW FIRM, a non-U.S. creditor, a $92.6 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which matures a year from issuance and accrues interest at the rate of 8% per annum. The note holder is subject to the restrictions of Regulation S promulgated under the 1933 Act and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lower of (i) $0.00065 and (ii) 75% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the holder in cash, for 127.5% of any outstanding principal and interest remaining on the note.

- On February 16, 2018, the Company sold to GENEVA ROTH REMARK HOLDINGS, INC., a $53 12% interest bearing convertible note due in nine months subject to the restrictions of Rule 144 promulgated under the 1933 Act. One hundred eighty days following the date of this note, the holder has the right to convert all or any part of the outstanding and unpaid principal amount and accrued interest of the note into Company's common stock, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the 58% of the average of the lowest three trading prices of the Company's common stock on any trading day during the ten trading days prior to the conversion. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 115% of principal plus interest (during days 1-30) to 140% of principal plus interest (during days 151-180).

- On March 1, 2018, the Company sold to MARINE PLUS S.A., a non-U.S. creditor, a $148 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which matures a year from issuance and accrues interest at the rate of 8% per annum. The note holder is subject to the restrictions of Regulation S promulgated under the 1933 Act and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the investor in cash, for 127.5% of any outstanding principal and interest remaining on the note.

- On April 17, 2018, upon full conversion of the $93 convertible promissory note to Jabro Funding Corp. plus accrued interest, the Company has issued an aggregate 1,455,083 shares of common stock to the note holder.

Employment and Charter Rates

Our Fleet

The following table details the vessel we operate in our fleet as of April 20, 2018:

Vessel Name	Type	Built	Dwt	Employment
M/V Free Neptune	Handysize	1996	30,838	Lay-up

31

Acquisition of Vessels

From time to time, as opportunities arise and depending on the availability of financing, we intend to acquire additional secondhand drybulk carriers. When a vessel is acquired free of charter, we enter into a new charter contract. The shipping industry uses income days (also referred to as “voyage” or “operating” days) to measure the number of days in a period during which vessels actually generate revenues.

Consistent with shipping industry practice, we treat the acquisition of a vessel (whether acquired with or without a charter) as the acquisition of an asset rather than a business. When we acquire a vessel, we conduct, also consistent with shipping industry practice, an inspection of the physical condition of the vessel, unless practical considerations do not allow such an inspection. We also examine the vessel’s classification society records. We do not obtain any historical operating data for the vessel from the seller. We do not consider that information material to our decision on acquiring the vessel.

Prior to the delivery of a purchased vessel, the seller typically removes from the vessel all records and log books, including past financial records and accounts related to the vessel. Upon the change in ownership, the technical management agreement between the seller’s technical manager and the seller is automatically terminated and the vessel’s trading certificates are revoked by its flag state, in the event the buyer determines to change the vessel’s flag state.

When a vessel has been under a voyage charter, the seller delivers the vessel free of charter to the buyer. When a vessel is under time charter and the buyer wishes to assume that charter, the buyer cannot acquire the vessel without the charterer’s consent and an agreement between the buyer and the charterer for the buyer to assume the charter. The purchase of a vessel does not in itself transfer the charter because the charter is a separate service agreement between the former vessel owner and the charterer.

When we acquire a vessel and want to assume or renegotiate a related time charter, we must take the following steps:

Obtain the charterer’s consent to us as the new owner;

Obtain the charterer’s consent to a new technical manager;

Obtain the charterer’s consent to a new flag for the vessel, if applicable;

Arrange for a new crew for the vessel;

Replace all hired equipment on board the vessel, such as gas cylinders and communication equipment;

Negotiate and enter into new insurance contracts for the vessel through our own insurance brokers;

Register the vessel under a flag state and perform the related inspections in order to obtain new trading certificates from the flag state, if we change the flag state;

Implement a new planned maintenance program for the vessel; and

Ensure that the new technical manager obtains new certificates of compliance with the safety and vessel security regulations of the flag state.

Business Components and Activities

Our business comprises the following primary components:

- Employment and operation of our drybulk carriers; and
- Management of the financial, general and administrative elements involved in the ownership and operation of our drybulk vessels.

The employment and operation of our vessels involve the following activities:

- Vessel maintenance and repair;
- Planning and undergoing dry-docking, special surveys and other major repairs;
- Organizing and undergoing regular classification society surveys;
- Crew selection and training;
- Vessel spares and stores supply;
- Vessel bunkering;
- Contingency response planning;
- Onboard safety procedures auditing;
- Accounting;
- Vessel insurance arrangements;
- Vessel chartering;
- Vessel hire management; and
- Vessel performance monitoring.

Our Fleet-Illustrative Comparison of Possible Excess of Carrying Value over Estimated Charter-Free Market Value of Certain Vessels

In “-Critical Accounting Policies-Impairment of Long Lived Assets,” we discuss our policy for impairing the carrying values of our vessels. Historically, the market values of vessels have experienced volatility, which from time to time may be substantial. As a result, the charter-free market value, or basic market value, of certain of our vessels may have declined below those vessels’ carrying value, even though we would not impair those vessels’ carrying value under our accounting impairment policy, due to our belief that future undiscounted cash flows expected to be earned by such vessels over their operating lives would exceed such vessels’ carrying amounts. As of December 31, 2017, the Company did not perform an impairment assessment of its long-lived asset M/V *Free Neptune*, since the impairment charge of $4,286 recorded last year reduced the vessel’s carrying value below her scrap value of $2,756 as of December 31, 2017.

Drybulk Vessels	DWT	**Year Built**	**Date of Acquisition**	**Purchase Price (in million USD)**	**Carrying Value as of 12/31/2017 (in million USD)**	**Fair Market Value as of 12/31/2017 (in million USD)**	**Carrying Value as of 12/31/2016 (in million USD)**	**Fair Market Value as of 12/31/2016 (in million USD)**
Free Neptune	30,838	1996	08/25/09	$ 11.0	$ 2.0	$ 2.0	$ 2.1	$ 2.1

33

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. GAAP. The preparation of those financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses and related disclosure at the date of our financial statements. Actual results may differ from these estimates under different assumptions and conditions. Critical accounting policies are those that reflect significant judgments of uncertainties and potentially result in materially different results under different assumptions and conditions. We have described below what we believe are our most critical accounting policies, because they generally involve a comparatively higher degree of judgment in their application. For a description of all our significant accounting policies, see Note 2 to our consolidated financial statements.

Impairment of Long-lived Assets: The Company follows the guidance under ASC 360, “Property, Plant and Equipment,” which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The standard requires that, long-lived assets and certain identifiable intangibles held and used or disposed of by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. When the estimate of undiscounted cash flows, excluding interest charges, expected to be generated by the use of the asset is less than its carrying amount, the Company should evaluate the asset for an impairment loss. Measurement of the impairment loss is based on the fair value of the asset which is determined based on management estimates and assumptions and by making use of available market data. The fair values are determined through Level 2 inputs of the fair value hierarchy as defined in ASC 820 “Fair value measurements and disclosures” and are derived principally from or by corroborated or observable market data. Inputs, considered by management in determining the fair value, include independent broker’s valuations, FFA indices, average charter hire rates and other market observable data that allow value to be determined. The Company evaluates the carrying amounts and periods over which long-lived assets are depreciated to determine if events have occurred which would require modification to their carrying values or useful lives. In evaluating useful lives and carrying values of long-lived assets, management reviews certain indicators of potential impairment, such as future undiscounted net operating cash flows, vessel sales and purchases, business plans and overall market conditions. In performing the recoverability tests the Company determines future undiscounted net operating cash flows for each vessel and compares it to the vessel’s carrying value. The future undiscounted net operating cash flows are determined by considering the Company’s alternative courses of action, estimated vessel’s utilization, its scrap value, the charter revenues from existing time charters for the fixed fleet days and an estimated daily time charter equivalent for the unfixed days over the remaining estimated useful life of the vessel, net of vessel operating expenses adjusted for inflation, and cost of scheduled major maintenance. When the Company’s estimate of future undiscounted net operating cash flows for any vessel is lower than the vessel’s carrying value, the carrying value is written down, by recording a charge to operations, to the vessel’s fair market value.

As of December 31, 2017, the Company performed an impairment assessment of its long-lived asset M/V Free Neptune by comparing the undiscounted net operating cash flows for the vessel to its respective carrying value. The significant factors and assumptions the Company used in each future undiscounted net operating cash flow analysis included, among others, operating revenues, commissions, off-hire days, dry-docking costs, operating expenses and management fee estimates. Revenue assumptions were based on contracted time charter rates up to the end of life of the current contract of each vessel as well as the ten-year historical average time charter rates for the remaining life of the vessel after the completion of the current contracts. In addition, the Company used an annual operating expenses escalation factor and an estimate of off hire days. All estimates used and assumptions made were in accordance with the Company's internal budgets and historical experience of the shipping industry. As of December 31, 2017, the Company did not perform an impairment assessment of its long-lived asset M/V Free Neptune, since the impairment charge of $4,286 recorded last year reduced the vessel's carrying value below her scrap value of $2,756 as of December 31, 2017.

Vessels' Depreciation: The cost of the Company's vessels is depreciated on a straight-line basis over the vessels' remaining economic useful lives from the acquisition date, after considering the estimated residual value (vessel's residual value is equal to the product of its lightweight tonnage and estimated scrap rate). Effective April 1, 2009, and following management's reassessment of the useful lives of the Company's assets, the fleets useful life was increased from 27 to 28 years since the date of initial delivery from the shipyard. Management's estimate was based on the current vessels' operating condition, as well as the conditions prevailing in the market for the same type of vessels.

Accounting for Special Survey and Dry-docking Costs: Effective as of January 1, 2014, the Company changed the deferral method of accounting for special survey and dry-docking costs whereby actual costs incurred were deferred and amortized over periods of five and two and a half years, respectively. The Company now follows the direct expense method of accounting for special survey and dry-docking costs whereby costs are expensed in the period incurred for the vessels.

Accounting for Revenue and Expenses: Revenue is recorded when services are rendered, the Company has a signed charter agreement or other evidence of an arrangement, the price is fixed or determinable, and collection is reasonably assured. A voyage charter involves the carriage of a specific amount and type of cargo from specific load port(s) to specific discharge port(s), subject to various cargo handling terms, in return for payment of an agreed upon freight rate per ton of cargo. A time charter involves placing a vessel at the charterers' disposal for a period of time during which the charterer uses the vessel in return for the payment of a specified daily hire rate. Short period charters for less than three months are referred to as spot charters. Time charters extending three months to a year are generally referred to as medium term charters. All other time charters are considered long term. Voyage revenues for the transportation of cargo are recognized ratably over the estimated relative transit time of each voyage. A voyage is deemed to commence when a vessel is available for loading of its next fixed cargo and is deemed to end upon the completion of the discharge of the current cargo. Revenues from time chartering of vessels are accounted for as operating leases and are thus recognized on a straight-line basis as the average revenue over the rental periods of such charter agreements, as service is provided. Voyage expenses, primarily consisting of port, canal and bunker expenses that are unique to a particular charter, are paid for by the charterer under time charter arrangements or by the Company under voyage charter arrangements, except for commissions, which are always paid for by the Company, regardless of charter type. All voyage and vessel operating expenses are expensed as incurred, except for commissions. Commissions are deferred over the related voyage charter period to the extent revenue has been deferred since commissions are earned as the Company's revenues are earned. Probable losses on voyages in progress are provided for in full at the time such losses can be estimated.

Important Measures for Analyzing Results of Operations

We believe that the important measures for analyzing trends in the results of our operations consist of the following:

Ownership days. We define ownership days as the total number of calendar days in a period during which each vessel in the fleet was owned by us, including days of vessels in lay-up. Ownership days are an indicator of the size of the fleet over a period and affect both the amount of revenues earned and the amount of expenses that we incur during that period.

Available days. We define available days as the number of ownership days less the aggregate number of days that our vessels are off-hire due to major repairs, dry-dockings or special or intermediate surveys or days of vessels in lay-up. The shipping industry uses available days to measure the number of ownership days in a period during which vessels are actually capable of generating revenues.

Operating days. We define operating days as the number of available days in a period less the aggregate number of days that vessels are off-hire due to any reason, including unforeseen circumstances. The shipping industry uses operating days to measure the aggregate number of days in a period during which vessels could actually generate revenues.

Fleet utilization. We calculate fleet utilization by dividing the number of operating days during a period by the number of available days during that period. The shipping industry uses fleet utilization to measure a company's efficiency properly operating its vessels and minimizing the amount of days that its vessels are off-hire for any unforeseen reason.

Off-hire. The period a vessel is unable to perform the services for which it is required under a charter. Off-hire periods typically include days spent undergoing repairs and dry-docking, whether or not scheduled.

Time charter. A time charter is a contract for the use of a vessel for a specific period of time during which the charterer pays substantially all of the voyage expenses, including port costs, canal charges and bunkers expenses. The vessel owner pays the vessel operating expenses, which include crew wages, insurance, technical maintenance costs, spares, stores and supplies and commissions on gross voyage revenues. Time charter rates are usually fixed during the term of the charter. Prevailing time charter rates do fluctuate on a seasonal and year-to-year basis and may be substantially higher or lower from a prior time charter agreement when the subject vessel is seeking to renew the time charter agreement with the existing charterer or enter into a new time charter agreement with another charterer. Fluctuations in time charter rates are influenced by changes in spot charter rates.

Voyage charter. A voyage charter is an agreement to charter the vessel for an agreed per-ton amount of freight from specified loading port(s) to specified discharge port(s). In contrast to a time charter, the vessel owner is required to pay substantially all of the voyage expenses, including port costs, canal charges and bunkers expenses, in addition to the vessel operating expenses.

Time charter equivalent (TCE). The time charter equivalent, or TCE, equals voyage revenues minus voyage expenses divided by the number of operating days during the relevant time period, including the trip to the loading port. TCE is a non-GAAP, standard seaborne transportation industry performance measure used primarily to compare period-to-period changes in a seaborne transportation company’s performance despite changes in the mix of charter types (i.e., spot charters, time charters and bareboat charters) under which the vessels may be employed during a specific period.

35

Adjusted EBITDA represents net earnings before taxes, depreciation and amortization, (gain)/loss on derivative instruments, stock-based compensation expense, vessel impairment loss, loss on commitment and contingency, contractual derivative obligation, interest and finance cost net, gain on debt extinguishment, provision and write-offs of insurance claims and bad debts, gain on settlement of payable, loss on settlement of liability through stock issuance and dry-docking costs. Effective as of January 1, 2014, the Company follows the direct expense method of accounting for special survey and dry-docking costs whereby such costs are expensed in the period incurred and not amortized until the next dry-docking. Under the laws of the Marshall Islands, we are not subject to tax on international shipping income. However, we are subject to registration and tonnage taxes, which have been included in vessel operating expenses. Accordingly, no adjustment for taxes has been made for purposes of calculating Adjusted EBITDA. Adjusted EBITDA is a non-GAAP measure and does not represent and should not be considered as an alternative to net income or cash flow from operations, as determined by U.S. GAAP, and our calculation of Adjusted EBITDA may not be comparable to that reported by other companies. The shipping industry is capital intensive and may involve significant financing costs. The Company uses Adjusted EBITDA because it presents useful information to management regarding the Company's ability to service and/or incur indebtedness by excluding items that we do not believe are indicative of our core operating performance, and therefore is an alternative measure of our performance. The Company also believes that Adjusted EBITDA is useful to investors because it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. Adjusted EBITDA has limitations as an analytical tool, however, and should not be considered in isolation or as a substitute for analysis of the Company's results as reported under U.S. GAAP. Some of these limitations are: (i) Adjusted EBITDA does not reflect changes in, or cash requirements for, working capital needs; and (ii) although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such capital expenditures.

Revenues

Our revenues were driven primarily by the number of vessels we operate, the number of operating days during which our vessels generate revenues, and the amount of daily charter hire that our vessels earn under charters. These, in turn, are affected by a number of factors, including the following:

- The nature and duration of our charters;
- The amount of time that we spent repositioning its vessels;
- The amount of time that our vessels spent in dry-dock undergoing repairs;
- Maintenance and upgrade work;
- The age, condition and specifications of our vessels;
- The levels of supply and demand in the drybulk carrier transportation market; and
- Other factors affecting charter rates for drybulk carriers under voyage charters.

A voyage charter is generally a contract to carry a specific cargo from a load port to a discharge port for an agreed-upon total amount. Under voyage charters, voyage expenses such as port, canal and fuel costs are paid by the vessel owner. A trip time charter is a short-term time charter for a voyage between load port(s) and discharge port(s) under which the charterer pays fixed daily hire rate on a semi-monthly basis for use of the vessel. A period time charter is charter for a vessel for a fixed period of time at a set daily rate. Under trip time charters and time charters, the charterer pays voyage expenses. Under all three types of charters, the vessel owners pay for vessel operating expenses, which include crew costs, provisions, deck and engine stores, lubricating oil, insurance, maintenance and repairs. The vessel owners are also responsible for each vessel's dry-docking and intermediate and special survey costs.

Vessels operating on period time charters provide more predictable cash flows, but can yield lower profit margins than vessels operating in the spot charter market for single trips during periods characterized by favorable market conditions.

Vessels operating in the spot charter market generate revenues that are less predictable, but can yield increased profit margins during periods of improvements in drybulk rates. Spot charters also expose vessel owners to the risk of declining drybulk rates and rising fuel costs. Our vessel was laid up during the year ended December 31, 2017.

A standard maritime industry performance measure is the TCE. TCE rates are defined as our time charter revenues less voyage expenses during a period divided by the number of our operating days during the period, which is consistent with industry standards. Voyage expenses include port charges, bunker (fuel oil and diesel oil) expenses, canal charges and commissions. Our average TCE rate for financial year 2015, 2016 and 2017 was $649, $(1,163) and $nil, respectively.

Vessel Operating Expenses

Vessel operating expenses include crew wages and related costs, the cost of insurance, expenses relating to repairs and maintenance, the costs of spares and consumable stores, tonnage taxes and other miscellaneous expenses. Vessel operating expenses generally represent costs of a fixed nature.

Principal Factors Affecting Our Business

The principal factors that affected our financial position, results of operations and cash flows include the following:

- Number of vessels owned and operated;
- Charter market rates and periods of charter hire;
- Vessel operating expenses and direct voyage costs, which are incurred in both U.S. dollars and other currencies, primarily Euros;
- Management fees and service fees;
- Depreciation and amortization expenses, which are a function of vessel cost, any significant post-acquisition improvements, estimated useful lives, estimated residual scrap values, and fluctuations in the carrying value of our vessels, as well as, drydocking and special survey costs;
- Financing costs related to indebtedness associated with the vessels; and
- Fluctuations in foreign exchange rates.

Performance Indicators

(All amounts in tables in thousands of U.S. dollars except for fleet data and average daily results)

The following performance measures were derived from our audited consolidated financial statements for the year ended December 31, 2017, 2016 and 2015 included elsewhere in this report. The historical data included below is not necessarily indicative of our future performance.

	For the year ended December 31,		
	2017	2016	2015
Adjusted EBITDA (1)	$ (4,066)	$ (5,877)	$ (9,408)
Fleet Data:			
Average number of vessels (2)	1.0	1.7	3.0
Ownership days (3)	365	635	1,088
Available days (4)	-	182	480
Operating days (5)	-	104	462
Fleet utilization (6)	0 %	57.1 %	96.3 %
Average Daily Results:			
Average TCE rate (7)	$ nil	$ (1,163)	$ 649
Vessel operating expenses (8)	$ 3,145	$ 3,438	$ 4,565
Management fees (9)	$ 1,090	$ 1,106	$ 983
General and administrative expenses(10)	$ 4,233	$ 4,477	$ 3,083
Total vessel operating expenses (11)	$ 4,235	$ 4,543	$ 5,548

(1) Adjusted EBITDA represents net earnings before taxes, depreciation and amortization, (gain)/loss on derivative instruments, stock-based compensation expense, vessel impairment loss, loss on commitment and contingency, contractual derivative obligation, interest and finance cost net, gain on debt extinguishment, provision and write-offs of insurance claims and bad debts, gain on settlement of payable, loss on settlement of liability through stock issuance, loss on note issuance, loss on derivative liability, gain on settlement of liability and dry-docking costs. Effective as of January 1, 2014, the Company follows the direct expense method of accounting for special survey and dry-docking costs whereby such costs are expensed in the period incurred and not amortized until the next dry-docking. Under the laws of the Marshall Islands, we are not subject to tax on international shipping income. However, we are subject to registration and tonnage taxes, which have been included in vessel operating expenses. Accordingly, no adjustment for taxes has been made for purposes of calculating Adjusted EBITDA. Adjusted EBITDA is a non-GAAP measure and does not represent and should not be considered as an alternative to net income or cash flow from operations, as determined by U.S. GAAP, and our calculation of Adjusted EBITDA may not be comparable to that reported by other companies. The shipping industry is capital intensive and may involve significant financing costs. The Company uses Adjusted EBITDA because it presents useful information to management regarding the Company's ability to service and/or incur indebtedness by excluding items that we do not believe are indicative of our core operating performance, and therefore is an alternative measure of our performance. The Company also believes that Adjusted EBITDA is useful to investors because it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. Adjusted EBITDA has limitations as an analytical tool, however, and should not be considered in isolation or as a substitute for analysis of the Company's results as reported under U.S. GAAP. Some of these limitations are: (i) Adjusted EBITDA does not reflect changes in, or cash requirements for, working capital needs; and (ii) although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such capital expenditures.

	For the year ended December 31,		
	2017	2016	2015
Net loss	$(7,121)	$(20,511)	$(52,949)
Depreciation and amortization	113	1,939	3,585
Stock-based compensation charge	—	206	898
Vessel impairment loss	—	4,286	18,891
Loss on derivative instruments	—	—	—
Interest and finance cost, net of interest income	3,031	3,632	5,027
Loss on sale of vessels	—	277	7,620
Loss on commitment and contingency	—	—	2,000
Contractual derivative obligation	—	5,442	3,300
Loss due to capital lease write-off	—	—	3,058
Provision and write-offs of insurance claims and bad debts	—	(1,185)	(525)
Gain / (loss) on settlement of payable	—	37	(313)
Loss on note issuance	344	—	—
Loss on derivative liability	1,491	—	—
Gain on settlement of liability	(1,924)	—	—
Adjusted EBITDA	$(4,066)	$(5,877)	$(9,408)

(2)

Average number of vessels is the number of vessels that constituted our fleet for the relevant period, as measured by the sum of the number of days each vessel was a part of our fleet during the period divided by the number of calendar days in the period.

(3) Ownership days are the total number of days in a period during which the vessels in our fleet have been owned by us, including days of vessels in lay-up. Ownership days are an indicator of the size of our fleet over a period and affect both the amount of revenues and the amount of expenses that we record during a period.

38

(4) Available days are the number of ownership days less the aggregate number of days that our vessels are off-hire due to major repairs, dry dockings or special or intermediate surveys or days of vessels in lay-up. The shipping industry uses available days to measure the number of ownership days in a period during which vessels are actually capable of generating revenues.

(5) Operating days are the number of available days less the aggregate number of days that our vessels are off-hire due to any reason, including unforeseen circumstances. The shipping industry uses operating days to measure the aggregate number of days in a period during which vessels could actually generate revenues.

(6) We calculate fleet utilization by dividing the number of our fleet's operating days during a period by the number of available days during the period. The shipping industry uses fleet utilization to measure a company's efficiency in properly operating its vessels and minimizing the amount of days that its vessels are off-hire for any unforeseen reasons.

(7) TCE is a non-GAAP measure of the average daily revenue performance of a vessel on a per voyage basis. Our method of calculating TCE is consistent with industry standards and is determined by dividing operating revenues (net of voyage expenses and commissions) by operating days for the relevant time period. Voyage expenses primarily consist of port, canal and fuel costs that are unique to a particular voyage, which would otherwise be paid by the charterer under a time charter contract. TCE is a standard shipping industry performance measure used primarily to compare period-to-period changes in a shipping company's performance despite changes in the mix of charter types (i.e., spot charters, time charters and bareboat charters) under which the vessels may be employed between the periods:

	For the year ended December 31,		
	2017	2016	2015
Operating revenues	$ —	$ 506	$ 2,304
Voyage expenses and commissions	$ (727)	$ (627)	$ (2,004)
Net operating revenues	$ (727)	$ (121)	$ 300
Operating days	0	104	462
Time charter equivalent daily rate	$ **nil**	$ (1,163)	$ 649

(8) Average daily vessel operating expenses, which includes crew costs, provisions, deck and engine stores, lubricating oil, insurance, maintenance and repairs, is calculated by dividing vessel operating expenses by ownership days for the relevant time periods:

	For the year ended December 31,		
	2017	2016	2015
Vessel operating expenses (excluding dry-docking costs)	$ 1,148	$ 2,183	$ 4,967
Ownership days	365	635	1,088
Daily vessel operating expense	$ 3,145	$ 3,438	$ 4,565

(9) Daily management fees are calculated by dividing total management fees (excluding stock-based compensation charge and gain on shares issued to the Manager) paid on ships owned by ownership days for the relevant time period.

(10) Average daily general and administrative expenses are calculated by dividing general and administrative expenses (excluding stock-based compensation charge and gain on shares issued to the Manager) by ownership days for the relevant period.

(11) Total vessel operating expenses, or TVOE, is a measurement of our total expenses associated with operating our vessels. TVOE is the sum of vessel operating expenses and management fees. Daily TVOE is calculated by dividing TVOE by fleet ownership days for the relevant time period.

Results of Operations

Year Ended December 31, 2017 as Compared to Year Ended December 31, 2016

REVENUES - Operating revenues for the year ended December 31, 2017 were $nil compared to $506 for the year ended December 31, 2016. The decrease of $506 is mainly attributable to the fact that the only vessel owned and operated by the Company was laid up.

VOYAGE EXPENSES AND COMMISSIONS - Voyage expenses, which include bunkers, cargo expenses, port expenses, port agency fees, tugs, extra insurance and various expenses, were $727 for the year ended December 31, 2017, as compared to $609 for the year ended December 31, 2016. The variance in voyage expenses reflects mainly the increased replenishment of bunkers to the owners' account during the year ended December 31, 2017. For year ended December 31, 2017, commissions charged amounted to $nil, as compared to $18 for the year ended December 31, 2016. The decrease in commissions is due to nil operating revenues for the year ended December 31, 2017 compared to year ended December 31, 2016. The commission fees represent commissions paid to the Managers and unaffiliated third parties relating to vessels chartered during the relevant periods.

OPERATING EXPENSES - Vessel operating expenses, which include dry-docking costs, crew cost, provisions, deck and engine stores, lubricating oil, insurance, maintenance and repairs, totaled $1,148 in the year ended December 31, 2017, as compared to $2,183 in the year ended December 31, 2016. The decrease in operating expenses was due to the fact that only one vessel was owned and operated in our fleet, during the year ended December 31, 2017, as compared to 1.7 during the year ended December 31, 2016, resulting in the reduction of ownership days of our fleet to 365 days compared to 635 days in the same period of 2016.

DEPRECIATION AND AMORTIZATION - For the year ended December 31, 2017, depreciation expense was at $113 as compared to $1,939 in the year ended December 31, 2016. The decrease was due to the decrease of the average number of vessels owned referred in the “REVENUES” paragraph above.

MANAGEMENT FEES - Management fees for the year ended December 31, 2017 totaled $398 as compared to $702 in the year ended December 31, 2016. The $304 decrease in management fees reflects the reduction of the number of vessels managed in our fleet.

GENERAL AND ADMINISTRATIVE EXPENSES - General and administrative expenses, which include, among other things, legal, audit, audit-related expenses, travel expenses, communications expenses, stock-based compensation charges and services fees and expenses charged by the Manager, totaled $1,545 for the year ended December 31, 2017 as compared to $3,049 for the year ended December 31, 2016. The decrease reflected the successful efforts of the Company to reduce the overhead expenses.

PROVISION AND WRITE-OFFS OF INSURANCE CLAIMS AND BAD DEBTS - There was no corresponding amount in 2017.

LOSS ON COMMITMENT AND CONTINGENCY - There was no corresponding amount in 2017 or 2016.

CONTRACTUAL DERIVATIVE OBLIGATION - There was no corresponding amount in 2017.

LOSS ON SALE OF VESSELS - There was no corresponding amount in 2017.

VESSELS IMPAIRMENT CHARGE - There was no corresponding amount in 2017.

FINANCING COSTS - Financing costs amounted to $3,031 and $3,632 for the years ended December 31, 2017 and 2016, respectively. The decrease of the interest and financing costs incurred for the year ended December 31, 2017 as compared to the same period in 2016 was attributed to less amount of convertible debt net discount expensed for the year ended December 31, 2017.

NET LOSS - Net loss for the year ended December 31, 2017 was $7,121 as compared to net loss of $20,511 for the year ended December 31, 2016. The decrease of $13,390 for the year ended December 31, 2017 was mainly due to the following one-off charges recorded in the year ended December 2016: (a) the impairment charge of $4,286 for the M/V Free Neptune recorded as of December 31, 2016 and (b) the contractual derivative obligation of $5,442 recorded as of December 31, 2016.

Year Ended December 31, 2016 as Compared to Year Ended December 31, 2015

REVENUES - Operating revenues for the year ended December 31, 2016 were $506 compared to $2,304 for the year ended December 31, 2015. The decrease of $1,798 is mainly attributable to the fact that the average number of vessels owned was 1.7 for the year ended December 31, 2016 compared to 3 for the year ended December 31, 2015. In addition, the charter rates during the year ended December 31, 2016 were substantially lower than 2015, which negatively affected our revenues.

VOYAGE EXPENSES AND COMMISSIONS - Voyage expenses, which include bunkers, cargo expenses, port expenses, port agency fees, tugs, extra insurance and various expenses, were $609 for the year ended December 31, 2016, as compared to $1,831 for the year ended December 31, 2015. The variance in voyage expenses reflects mainly the decreased replenishment of bunkers to the owners' account during the year ended December 31, 2016. For year ended December 31, 2016, commissions charged amounted to $18, as compared to $174 for the year ended December 31, 2015. The decrease in commissions is due to the decrease of operating revenues for the year ended December 31, 2016 compared to year ended December 31, 2015. The commission fees represent commissions paid to the Managers, other affiliated companies associated with family members of our CEO, and unaffiliated third parties relating to vessels chartered during the relevant periods.

OPERATING EXPENSES - Vessel operating expenses, which include dry-docking costs, crew cost, provisions, deck and engine stores, lubricating oil, insurance, maintenance and repairs, totaled $2,183 in the year ended December 31, 2016, as compared to $4,967 in the year ended December 31, 2015. The decrease in operating expenses was due to the fact that fewer vessels were owned in our fleet, 1.7 during the year ended December 31, 2016, as compared to 3 during the year ended December 31, 2015, resulting in the reduction of ownership days of our fleet to 635 days compared to 1,088 days in the same period of 2015.

DEPRECIATION AND AMORTIZATION - For the year ended December 31, 2016, depreciation expense was at $1,939 as compared to $3,585 in the year ended December 31, 2015. The decrease was due to the decrease of the average number of vessels owned referred in the "REVENUES" paragraph above.

MANAGEMENT FEES - Management fees for the year ended December 31, 2016 totaled $702 as compared to $1,070 in the year ended December 31, 2015. The $368 decrease in management fees reflects the reduction of the number of vessels managed in our fleet.

GENERAL AND ADMINISTRATIVE EXPENSES - General and administrative expenses, which include, among other things, legal, audit, audit-related expenses, travel expenses, communications expenses, stock-based compensation charges and services fees and expenses charged by the Manager, totaled $3,049 for the year ended December 31, 2016 as compared to $4,252 for the year ended December 31, 2015. The decrease reflected the successful efforts of the Company to reduce the overhead expenses.

PROVISION AND WRITE-OFFS OF INSURANCE CLAIMS AND BAD DEBTS - For the years ended December 31, 2016 and 2015, the amounts were $1,185 and $525 respectively, which reflected the reversed provision and write-off of various long outstanding accounts receivable.

LOSS ON COMMITMENT AND CONTINGENCY - There was no corresponding amount in 2016. The Company, as of December 31, 2015, has recognized a contingency loss of $2,000 on the repurchase commitment by writing-off $2,000 on the Options Advance Payment.

CONTRACTUAL DERIVATIVE OBLIGATION - The Company, as of December 31, 2016, recognized, as a contractual derivative obligation, an expense of $5,442 being the remaining balance of the put-option price of $3,500 for the vessel Figaro, plus $1,490 being the sale price of M/V Fiorello and $452 due under its bareboat charter terms as of the date of its termination June 15, 2016.

LOSS ON SALE OF VESSELS - For the year ended December 31, 2016, as a result of the sale of M/V Free Maverick, the Company recognized a loss of $277 in the accompanying consolidated statements of operations. There was no corresponding amount in 2015.

FINANCING COSTS - Financing costs amounted to $3,632 and $5,026 for the years ended December 31, 2016 and 2015, respectively. The decrease of the interest and financing costs incurred for the year ended December 31, 2016 as compared to the same period in 2015 was attributed to less amount of convertible debt net discount expensed for the year ended December 31, 2016.

NET LOSS - Net loss for the year ended December 31, 2016 was $20,511 as compared to net loss of $52,949 for the year ended December 31, 2015. The decrease of $32,438 for the year ended December 31, 2016 was mainly due to the following one-off charges recorded in the year ended December 2015: (a) the loss due to capital lease write-off of $3,058 recorded in the year ended December 31, 2015; (b) the impairment charge of $18,891 for the M/V Free Maverick recorded as of December 31, 2015; (c) the loss on commitment and contingency of $2,000 recorded as of December 31,2015; (d) the contractual derivative obligation of $3,000 recorded as of December 31, 2015 and (e) the loss of $7,620 on sale of M/V Free Hero and M/V Free Goddess recorded as of December 31, 2015.

Liquidity and Capital Resources

The Company has historically financed its capital requirements from sales of equity or equity-linked securities, operating cash flows and long-term borrowings. As of December 31, 2017, its bank borrowing with NBG its standalone lender, totaled $17,598. The Company has primarily used its funds for capital expenditures to maintain its fleet, comply with international shipping standards and environmental laws and regulations, and fund working capital requirements.

As a result of the historically low charter rates for drybulk vessels, which have affected the Company for over six years, and the resulting material adverse impact on the Company's results from operations, the accompanying consolidated financial statements have been prepared on a going concern basis. The Company has incurred net losses of $7,121, $20,511 and $52,949 during the years ended December 31, 2017, 2016 and 2015, respectively. The Company's cash flow projections for 2018, indicate that cash on hand will not be sufficient to cover debt repayments scheduled as of December 31, 2017 and operating expenses and capital expenditure requirements for at least twelve months from the balance sheet date. As of December 31, 2017 and 2016, the Company had working capital deficits of $40,216 and $35,715, respectively. All of the above raises substantial doubt regarding the Company's ability to continue as a going concern. Management plans to continue to provide for its capital requirements by issuing additional equity securities and debt in addition to executing their business plan. The Company's ability to continue as a going concern is dependent upon its ability to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal course of business operations when they come due and to generate profitable operations in the future.

On February 22, 2014, the Company and certain of its subsidiaries entered into terms with NBG for settlement of its obligations arising from the loan agreement with NBG. Pursuant to the terms, NBG agreed to accept a cash payment of $22,000 no later than December 31, 2014, in full and final settlement of all of the Company's obligations to NBG and NBG would forgive the remaining outstanding balance of approximately $4,700. On September 17, 2014 the Company made a payment of $2,700 to reduce outstanding indebtedness with NBG. On September 24, 2014, the Company sold the M/V Free Impala, a 1997-built, 24,111 dwt Handysize drybulk carrier for a gross sale price of $3,600 and the vessel was delivered to her new owners. Subsequently, the amount of $3,300 had been used to reduce outstanding indebtedness with NBG, which had a mortgage on the vessel. The agreed settlement of the Company's obligations, arising from the loan agreement with NBG mentioned above, was not realized and negotiations have resumed for a new agreement. On June 18, 2015, the Company received from NBG a reservation of rights letter stating that the Bank may take any actions and may exercise all of their rights and remedies referred in the security documents. In December 2017, the Company received notification from NBG that the Company has not paid the aggregate amount of $25,788 constituting repayment installments, accrued loan and default interest due on December 15, 2017.

If the Company is not able to reach an agreement with NBG, this could lead to the acceleration of the outstanding debt under its debt agreement. The Company's failure to satisfy its covenants under its debt agreement and any consequent acceleration of its outstanding indebtedness would have a material adverse effect on the Company's business operations, financial condition and liquidity.

Generally accepted accounting principles require that long-term debt be classified as a current liability when a covenant violation gives the lender the right to call the debt at the balance sheet date, absent a waiver. As a result of the actual breach existing under the Company's credit facility with NBG acceleration of such debt by its lender could result. Accordingly, as of December 31, 2017, the Company is required to reclassify its long-term debt as current liability on its consolidated balance sheet since the Company has not received waiver in respect to the breach discussed above.

The Company is currently exploring several alternatives aiming to manage its working capital requirements and other commitments, including offerings of securities through structured financing agreements, disposition of certain vessels in its current fleet and additional reductions in operating and other costs.

Cash Flows

Year Ended December 31, 2017 as Compared to Year Ended December 31, 2016

OPERATING ACTIVITIES - Net cash used in operating activities decreased by $8,048 to $825 for the year ended December 31, 2017, as compared to $8,873 for the year ended December 31, 2016. The decrease reflected the lesser number of vessels owned and in operation during the year ended December 31, 2017.

FINANCING ACTIVITIES - Net cash provided by financing activities for the year ended December 31, 2017 was $784, as compared to $7,233 for the year ended December 31, 2016. The decrease reflects the lesser number of proceeds from convertible notes the Company sold during the year ended December 31, 2017.

INVESTING ACTIVITIES - Net cash provided by investing activities for the year ended December 31, 2017 was $nil, as compared to $1,672 for the year ended December 31, 2016. The decrease reflects that no sales of vessels occurred in the year ended December 31, 2017 compared to two vessels sold in the year ended December 31, 2016.

Year Ended December 31, 2016 as Compared to Year Ended December 31, 2015

OPERATING ACTIVITIES - Net cash used in operating activities decreased by $1,092 to $8,873 for the year ended December 31, 2016, as compared to $9,965 for the year ended December 31, 2015. The decrease reflected the lower number of vessels owned and in operation during the year ended December 31, 2016.

FINANCING ACTIVITIES - Net cash provided by financing activities for the year ended December 31, 2016 was $7,233, as compared to $6,489 for the year ended December 31, 2015. The increase reflects the cash provided as by the proceeds of convertible notes the Company sold during the year ended December 31, 2016.

INVESTING ACTIVITIES - Net cash provided by investing activities for the year ended December 31, 2016 was $1,672, as compared to $3,451 for the year ended December 31, 2015. The decrease reflects the sale of only one vessel compared to two vessels in the year ended December 31, 2015.

Bank Loan - current portion

As of December 31, 2017, the Company’s bank debt is as follows:

	NBG
December 31, 2016	$17,598
Additions	$-
Payments	$-
December 31, 2017	$17,598

Lender	Vessel	Remaining Repayment Terms
National Bank of Greece	*M/V Free Neptune*	The loan matured on December 16, 2016 and remains outstanding as set forth above.

The vessel indicated in the above table is pledged as collateral for the respective loan.

The Company’s credit facility with NBG bears interest at LIBOR plus a margin of 4%, and is secured by mortgage on the financed vessel (M/V *Free Neptune*) and assignments of vessel’s earnings and insurance coverage proceeds. It also includes affirmative and negative financial covenants of the borrower, including maintenance of operating accounts, average cash balances to be maintained with the lending bank and minimum ratios for the fair value of the collateral vessel compared to the outstanding loan balance. The borrower is restricted under its respective loan agreement from incurring additional indebtedness, changing the vessel’s flag without the lender’s consent or distributing earnings.

The weighted average interest rate for the year ended December 31, 2017 and 2016 was 4% and 4%, respectively. Interest expense incurred under the above loan agreements amounted to $1,935, $1,467 and $1,237 for the years ended December 31, 2017, 2016 and 2015, respectively, and is included in “Interest and Finance Costs” in the accompanying consolidated statements of operations.

NBG Facility

On February 22, 2014, the Company and certain of its subsidiaries entered into terms with NBG for settlement of its obligations arising from the loan agreement with NBG. Pursuant to the terms, NBG agreed to accept a cash payment of $22,000 no later than December 31, 2014, in full and final settlement of all of the Company's obligations to NBG and NBG would forgive the remaining outstanding balance of approximately $4,700. On September 17, 2014, the Company made a payment of $2,700 to reduce outstanding indebtedness with NBG. On September 24, 2014, the Company sold the M/V Free Impala, a 1997-built, 24,111 dwt Handysize drybulk carrier for a gross sale price of $3,600 and the vessel was delivered to her new owners. Subsequently, the amount of $3,300 had been used to reduce outstanding indebtedness with NBG, which had a mortgage on the vessel. The agreed settlement of the Company's obligations, arising from the loan agreement with NBG mentioned above, was not realized and negotiations have resumed for a new agreement. On June 18, 2015, the Company received from NBG a reservation of rights letter stating that the Bank may take any actions and may exercise all of their rights and remedies referred in the security documents. In December 2017, the Company received notification from NBG that the Company has not paid the aggregate amount of $25,788 constituting repayment installments, accrued loan and default interest due on December 15, 2017. The Company is in negotiations with NBG to find an amicable solution for final settlement of all of its obligations to NBG.

Loan Covenants

As of December 31, 2016 and December 31, 2017, the Company was in breach of certain of its financial covenants for its loan agreement with NBG, including the loan-to-value ratio, interest cover ratio, minimum liquidity requirements and leverage ratio. Thus, in accordance with guidance related to classification of obligations that are callable by the creditor, the Company has classified all of the related long-term debt amounting to $17,598 as current at December 31, 2017.

NBG loan agreement:

Average corporate liquidity: the Company is required to maintain an average corporate liquidity of at least $3,000;

Leverage ratio: the corporate guarantor's leverage ratio shall not at any time exceed 55%;

Ratio of EBITDA to net interest expense shall not be less than 3; and

Value to loan ratio: the fair market value of the financed vessels shall be at least (a) 115% for the period July 1, 2010 to June 30, 2011 and (b) 125% thereafter.

The covenants described above are tested annually on December 31st.

Off-Balance Sheet Arrangements

As of December 31, 2017, we did not have any off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC.

Summary of Contractual Obligations

The following table summarizes our contractual committed obligations and their maturity dates as of December 31, 2017:

(Dollars in thousands)	Payments Due by Period Total	**Less than 1 year**	**2-year**	**3-year**	**4-year**	**5-year**	**More than 5 years**
	(U.S. dollars in thousands)						
Services fees to the Manager*	3,000	600	600	600	600	600	They will be renewed each anniversary date
Management fees to the Managers	1,595	228	228	228	228	228	455
Total obligations	$4,595	$ 828	$828	$828	$828	$828	$455

*As of June 1, 2017, the services fees were reduced to $50 per month from $136.

44

Item 6. Directors, Senior Management and Employees

A. Directors and Senior Management

The following sets forth the names of the members of our board of directors and our senior management. Generally, each member of the board of directors serves for a three-year term. Additionally, the directors are divided among three classes, so the term of office of a certain number of directors expires each year. Consequently, the number of directors who stand for re-election each year may vary. Our executive officers are appointed by, and serve at the pleasure of, the board of directors. The primary business address of each of our executive officers and directors is 20, Amerikis Street., 106 71, Athens, Greece.

Name	**Age**	**Position**	**Term Expires**
Ion G. Varouxakis	47	Chairman of the Board of Directors, Chief Executive Officer and President	2020
Dimitris Filippas	41	Chief Financial Officer, Treasurer and Director	2018
Argyro Fonia	44	Director	2019

Ion G. Varouxakis is one of our founders and is the Chairman of our Board of Directors. He also serves as our President and Chief Executive Officer. In 2003, Mr. Varouxakis founded Free Bulkers, the beginning of a single-vessel, self-financed entrepreneurial venture that led to FreeSeas' founding and NASDAQ listing in 2005. Prior to founding Free Bulkers, Mr. Varouxakis held since 1997 management positions in private shipping companies operating in the drybulk sector. Mr. Varouxakis holds a candidature degree in law from the Catholic University of Saint Louis in Brussels and a Bachelor of Science degree in economics from the London School of Economics and Political Science. Mr. Varouxakis is a member of the Hellenic Committee of the Korean Register of Shipping, a member of the Hellenic and Black Sea Committee of Bureau Veritas and an officer of the reserves of the Hellenic Army.

Dimitris K. Filippas became our Deputy Chief Financial Officer in November 2013 and joined the Board of Directors in February 2017. He became our Chief Financial Officer in October 2017. Mr. Filippas has been the Finance Manager for Free Bulkers since 2007. Mr. Filippas has substantial experience in the ship finance field. He holds a BSc in Banking and International Finance from Cass Business School and a Master's Degree in Shipping Business and Finance with Distinction from LGU.

Argyro Fonia was appointed to the Board in October 2017. Ms. Fonia has been the chief accounting officer for Free Bulkers, one of the Company's managers, since September 2013. Ms. Fonia has substantial experience in the accounting field. She has been working as chief accountant in various shipping companies during the last ten years. She holds a BA in Economics and an MSc in Financial Management from East London University.

B. Compensation

Director Compensation

The total gross cash compensation paid for each of the years ended December 31, 2016 and 2017 to our directors was $nil. Starting from the fourth quarter in 2015, we have reduced the fee we pay to each of our non-executive directors to $3 per quarter, except that if the U.S. Dollar/Euro exchange rate exceeds 1.35 on the last business day of each quarter, then the amount of the directors' fees payable for that quarter will be increased so that the amount payable in U.S. Dollars will be the equivalent in Euros based on a 1.35 U.S. Dollar/Euro exchange rate. Our directors received shares of common stock in addition to directors' fees in 2013.

Management Compensation

The Company currently does not pay any cash compensation to the Company's executive officers, including our President and Chief Executive Officer and our Chief Financial Officer. Instead, the Company has entered into restated new services agreements with one of the Managers, pursuant to which the Company pays the Manager a monthly fee of $50 for services related to accounting, financial reporting, implementation of Sarbanes-Oxley internal controls procedures, and general administrative and management services, including the services of the Company's President and Chief Executive Officer and Chief Financial Officer, plus expenses.

Compensation Discussion and Analysis

As described above, we do not directly retain the services of our President and Chief Executive Officer and our Chief Financial Officer. Instead, their services are provided pursuant to the terms of a new services agreement with one of the Managers. Pursuant to the terms of this services agreement, we pay the Manager a monthly fee of $50 (on the basis that the dollar/Euro exchange rate is 1.35 or lower; if on the last business day of each month the dollar/Euro exchange rate exceeds 1.35 then the service fee payable will be adjusted for the following month in question, so that the amount payable in dollars will be the equivalent in Euro based on 1.35 dollar/Euro exchange rate) as compensation for services related to accounting, financial reporting, implementation of Sarbanes-Oxley internal controls procedures, and general administrative and management services, plus expenses. The Managers are also entitled to a termination fee if the agreements are terminated upon a "change of control" as defined in the services agreements. See "Certain Relationships and Related Transactions—Manager."

In determining the amount to be paid to the Managers under the services agreement, our Board of Directors considers the costs incurred and expected to be incurred by the Managers in providing the services within industry standards.

From time to time, the compensation committee also considers the appropriateness of granting to our directors, executive officers and certain key employees of the Managers restricted shares of our common stock, subject to vesting requirements, in order to align the interest of our directors, executive officers and such key employees with those of our shareholders. In determining the amount of these grants, the compensation committee considers the then-current market price of our common stock, the aggregate share holdings of our directors, management and key employees of the Managers, the results of the Company's operations for the year, and the contribution of the Board, management and the Managers to the Company's results.

On March 14, 2016, the Company, pursuant to the unanimous written consent of the Board of Directors, issued 10 common shares to the Manager, for settling $250, part of unpaid amount due in connection with services provided to the Company by the Manager. The common shares issued were valued at the consolidated closing bid price of the common stock at the day of the issuance.

C. Board Practices

Our Amended and Restated Articles of Incorporation provide that the Board be divided into three classes. Each class of directors serves a staggered three-year term. Mr. Filippas holds office until the 2018 Annual Meeting, Ms. Fonia holds office until the 2019 Annual Meeting and Mr. Varouxakis holds office until the 2020 Annual Meeting. There are no agreements between us and any director that provide for benefits upon termination or retirement.

Board Responsibilities, Structure and Requirements

Our Board of Directors oversees, counsels and directs management in our long-term interests and those of our shareholders. The Board's responsibilities include:

- Evaluating the performance of, and selecting, our President and Chief Executive Officer and our other executive officers;
- Reviewing and approving our major financial objectives and strategic and operating plans, business risks and actions;
- Overseeing the conduct of our business to evaluate whether the business is being effectively managed; and
- Overseeing the processes for maintaining the integrity of our financial statements and other publicly disclosed information in compliance with law.

Ion G. Varouxakis serves as both Chairman of the Board and as our President and Chief Executive Officer. The Board believes that the combined role of Chairman of the Board and President and Chief Executive Officer is the appropriate leadership structure for us at this time. This leadership model provides efficient and effective leadership of our business, and the Board believes Mr. Varouxakis is the appropriate person to lead both our Board and the management of our business.

We encourage our directors to attend formal training programs in areas relevant to the discharge of their duties as directors. We reimburse directors for all expenses they incur in attending such programs.

All of our directors are expected to comply with our Code of Business Conduct and Ethics and our Insider Trading Policy.

Director Independence

Our securities are listed on the OTC Pink market and we are not required to have any independent directors. The Board of Directors has determined that none of our current directors is an "independent director" within the meaning of the listing requirements of NASDAQ. The NASDAQ independence definition includes a series of objective tests, such as that the director is not our employee and has not engaged in various types of business dealings with us. As a result of our financial condition, we no longer have any independent directors and rely upon our management to also serve on the Board without additional compensation.

Meetings and Committees of the Board of Directors

The Board and its committees meet throughout the year generally on a quarterly schedule, and hold special meetings and act by written consent from time to time as appropriate. During the fiscal year ended December 31, 2017, our Board of Directors held two meetings and also approved certain actions by unanimous written consent. All of our directors attended at least 75% of the meetings of the Board of Directors and applicable committees on which they served. We strongly encourage all directors to attend our annual meeting of Shareholders, but we have no specific policy requiring attendance by directors at such meetings.

The Board delegates various responsibilities and authority to different Board committees. Committees regularly report on their activities and actions to the full Board. The committees of the Board of Directors are the audit committee, the compensation committee, the corporate governance committee, and the nominating committee. The Board has determined that none of the members of the audit committee, compensation committee, corporate governance committee and nominating committee is an independent director in accordance with the standards adopted by NASDAQ. Our Board or the applicable committee has adopted written charters for the audit, compensation, nominating and corporate governance committees and has adopted corporate governance guidelines that address the composition and duties of the Board and its committees. The charters for the audit, compensation, corporate governance and nominating committees and corporate governance guidelines are posted in the "Corporate Governance" section of our website at *www.freeseas.gr*, and each is available in print, without charge, to any shareholder. Each of the committees has the authority to retain independent advisors and consultants, with all fees and expenses to be paid by us.

Audit Committee

Our audit committee consists of Messrs. Varouxakis and Filippas and Ms. Fonia. None of the committee members are independent. Mr. Filippas has been designated the "Audit Committee Financial Expert" under the SEC rules.

The audit committee has powers and performs the functions customarily performed by such a committee (including those required of such a committee under the SEC). The audit committee is responsible for selecting and meeting with our independent registered public accounting firm regarding, among other matters, audits and the adequacy of our accounting and control systems.

Compensation Committee

Our compensation committee consists of Messrs. Varouxakis and Filippas and Ms. Fonia. None of the committee members are independent. The compensation committee reviews and approves the equity compensation of our executive officers. Currently, we do not pay cash compensation to our executive officers. We have entered into services agreements with Free Bulkers, OpenSeas Maritime and Prodigy Inc. (the "Manager(s)"), which are entities beneficially owned by Mr. Varouxakis, pursuant to which they provide us services related to accounting, financial reporting, implementation of Sarbanes-Oxley internal control over financial reporting procedures and general administrative and management services.

Nominating Committee

Our nominating committee consists of Messrs. Varouxakis and Filippas and Ms. Fonia. None of the committee members are independent. The nominating committee is responsible for overseeing the selection of persons to be nominated to serve on our Board.

In connection with the selection and nomination process, the nominating committee, along with the full Board of Directors, shall consider and determine the desired experience, mix of skills and other qualities necessary to assure appropriate Board composition, taking into account the current Board members and the specific needs of the Company and the Board. The criteria for selecting directors includes such factors as (i) the candidate’s ability to comprehend the Company’s strategic goals and to help guide the Company towards the accomplishment of those goals; (ii) the history of the candidate in conducting his/her personal and professional affairs with the utmost integrity and observing the highest standards of values, character and ethics; (iii) the candidate’s time availability for in-person participation at Board and committee meetings; (iv) the candidate’s judgment and business experience with related businesses or other organizations of comparable size; (v) the knowledge and skills the candidate would add to the Board and its committees, including the candidate’s knowledge of the rules and regulations of the SEC and NASDAQ, and accounting and financial reporting requirements; (vi) the candidate’s ability to satisfy the criteria for independence established by the SEC and NASDAQ; and (vii) the interplay of the candidate’s experience with the experience of other Board members.

Although the Company does not have a formal procedure, the nominating committee will consider all candidates recommended by the Company’s shareholders. The Company is relatively small and our shares of common stock are not widely held. As a result, the Company does not believe the adoption of a formal policy for consideration of shareholder nominees is appropriate at this time.

Corporate Governance Committee

Our corporate governance committee consists of Messrs. Varouxakis and Filippas and Ms. Fonia. Only Ms. Fonia is an independent director. The corporate governance committee ensures that we have and follow appropriate governance standards.

Shareholder Communication with the Board of Directors

Although our Board of Directors has not adopted a formal procedure for shareholders to communicate in writing with members of the Board of Directors, any such communications received by the Company will be forwarded to our Board of Directors. Because our Board of Directors is relatively small, and our shares of common stock are not widely held, the Company has not deemed it necessary to adopt a formal communication procedure at this time.

Corporate Governance Guidelines

The Board has adopted Corporate Governance Guidelines. The corporate governance committee is responsible for overseeing these guidelines and making recommendations to the Board concerning corporate governance matters. Among other matters, the guidelines address the following items concerning the Board and its committees:

Director qualifications generally and guidelines on the composition of the Board and its committees;

Director responsibilities and the standards for carrying out such responsibilities;

Board committee requirements;

Director compensation;

Director access to management and independent advisors;

Director orientation and continuing education requirements; and

CEO evaluation, management succession and CEO compensation.

Role of Board in Risk Oversight

We have a risk management process in which management is responsible for managing our risks and the Board and its committees provide review and oversight in connection with these efforts. Risks are identified, assessed and managed on an ongoing basis by management and addressed during periodic senior management meetings, resulting in both Board and committee discussions and public disclosure, as appropriate. The Board is responsible for overseeing management in the execution of its risk management responsibilities and for reviewing our approach to risk management. The Board administers this risk oversight function either through the full Board or through one of its standing committees, each of which examines various components of our enterprise risks as part of its responsibilities. An overall review of risk is inherent in the Board’s consideration of our long and short term strategies, acquisitions and significant financial matters. The audit committee oversees financial risks (including risks associated with accounting, financial reporting, enterprise resource planning, and collectability of receivables), legal and compliance risks and other risk management functions. The other Board committees are involved in the risk assessment process as needed.

Code of Conduct and Ethics

We have adopted a code of conduct and ethics applicable to our directors, officers and employees in accordance with applicable federal securities laws.

D. Employees

We currently have no employees. Our Managers are responsible for employing all of the executive officers and staff to execute and supervise our operations based on the strategy devised by the Board of Directors and subject to the approval of our Board of Directors and for recruiting, and employing, either directly or through a crewing agent, the senior officers and all other crew members for our vessels.

2014 Equity Incentive Plan

On July 30, 2014, the Company's Board of Directors approved the Company's 2014 Equity Incentive Plan (the "2014 Plan"). Under the terms of the 2014 Plan, the Company may issue (1) stock options (incentive and non-statutory), (2) restricted stock, (3) stock appreciation rights, or SARs, (4) restricted stock units, or RSUs, (5) other stock-based awards, and (6) cash-based awards. The Board determines the exercise price, vesting and expiration period of the grants under the 2014 Plan. However, the exercise price of an incentive stock option may not be less than 110% of fair value of the common stock at the date of the grant for a 10% or more shareholder and 100% of fair value for a grantee who is not a 10% shareholder. The fair value of the common stock is determined based on quoted market price or in absence of such quoted market price, by the Board in good faith. Additionally, the vesting period of the grants under the 2014 Plan may not be more than five years and expiration period not more than ten years.

Pursuant to the plan, there are no shares of the Company's common stock available for grant as of December 31, 2017.

Item 7. Major Shareholders and Related Party Transactions

A. Major Shareholders

None.

B. Related Party Transactions

Managers

The vessels owned and the vessels sold and leased back by the Company receive management services pursuant to ship management agreements between each of the subsidiaries and the Managers, Free Bulkers and OpenSeas Maritime.

Each of the Company's subsidiaries pays, as per its ship management agreement with the Managers, a monthly management fee of $19 (on the basis that the $/Euro exchange rate is 1.30 or lower; if on the first business day of each month the $/Euro exchange rate exceeds 1.30 then the management fee payable will be increased for the month in question, so that the amount payable in $ will be the equivalent in Euro based on 1.30 $/Euro exchange rate) plus a fee of $400 per day (not expressed in thousands) for superintendent attendance and other direct expenses.

The Company also pays the Managers a fee equal to 1.25% of the gross freight or hire from the employment of the Company's vessels. In addition, the Company pays a 1% commission on the gross purchase price of any new vessel acquired or the gross sale price of any vessel sold by the Company with the assistance of the Managers.

The Company also paid, as per its services agreement with Free Bulkers, a monthly fee of $136 until May 31, 2017 (on the basis that the $/Euro exchange rate is 1.35 or lower; if on the last business day of each month the $/Euro exchange rate exceeds 1.35 then the service fee payable will be adjusted for the following month in question, so that the amount payable in dollars will be the equivalent in Euro based on 1.35 $/Euro exchange rate) as compensation for services related to accounting, financial reporting, implementation of Sarbanes-Oxley internal control over financial reporting procedures and general administrative and management services plus expenses.

On June 1, 2017, the Company entered into a management services agreement with Prodigy Inc. (the "Manager"), for the provision of financial services, including all of our accounting, financial reporting and internal controls, and other back-office services, as well as the provision of use of space for the Company's offices at 20, Amerikis St., 10671, Athens, Greece. Our Chairman, Chief Executive Officer and President, Ion G. Varouxakis, is a shareholder of Prodigy Inc.

As of June 1, 2017, Free Bulkers is no longer required to provide any of the management services, except for those concerning the ship management agreement with M/V Free Neptune and the Company is no longer required to pay any remuneration, fees, bonuses or premises fee as of June 1, 2017 and beyond.

On September 26, 2016, the Company sold to unrelated third parties the M/V Free Maverick, a 1998-built, 23,994 dwt Handysize drybulk carrier for a gross sale price of $1,925. As a result of the sale the Company recognized a loss of $277. In this respect, the Company paid Free Bulkers $19 relating to the sale of the M/V Free Maverick during the year ended December 31, 2016. In addition, the Company has incurred commission expenses relating to its commercial agreement with the Managers amounting to $nil, $6 and $35 for the year ended December 31, 2017, 2016 and 2015, respectively, included in "Commissions" in the accompanying consolidated statements of operations.

On May 20, 2015, the M/V Free Hero, 1995-built, 24,318 dwt Handysize drybulk carrier and the M/V Free Goddess, 1995-built, 22,051 dwt Handysize drybulk carrier, were sold for a gross sale price of $5,500 each, and the Company's subsidiaries have entered into long-term bareboat agreements for such vessels with purchase options at a daily hire rate of $1,100 per vessel. The vessels have been renamed to Fiorello and Figaro, respectively.

On June 15, 2016, the bareboat hire agreement in connection with the M/V Fiorello was terminated. Subsequent to the termination of the hire, the vessel was sold for a gross sale price of $1,490 with the sale proceeds being applied towards obligations to the Bareboat Owners of the vessel and trade creditors.

On September 30, 2017, the bareboat hire agreement in connection with the M/V Figaro was terminated. Subsequent to the termination of the hire, the vessel was sold to unrelated third parties. The Company realized the amount of $1,924 as gain on settlement of liability in the accompanying consolidated statement of operations for the year ended December 31, 2017.

Fees and expenses charged by the Managers and the Manager are included in the Company's consolidated financial statements in "Management and other fees to a related party," "General and administrative expenses," "Operating expenses," and "Gain on sale of vessel". The total amounts charged for the year ended December 31, 2017, 2016, and 2015 amounted to $1,431 ($398 of management fees, $1,031 of services fees, $nil of superintendent fees and $2 for other expenses), $2,344 ($702 of management fees, $1,635 of services fees, $0 of superintendent fees and $7 for other expenses) and $2,800 ($1,070 of management fees, $1,635 of services fees, $88 of superintendent fees and $7 for other expenses), respectively.

The balance due from the Managers and the Manager as of December 31, 2017 and December 31, 2016 was $nil. The amount paid to the Managers and Manager for office space during the year ended December 31, 2017, 2016 and 2015 was $51, $139 and $140, respectively, and is included in “General and administrative expenses” in the consolidated statements of operations. The balance due to the Managers and the Manager as December 31, 2017 and December 31, 2016 was $3,280 and $2,107, respectively, and is included in the “Management and other fees to a related party” in the consolidated statements of operations.

C. Interest of Experts and Counsel

Not required.

Item 8. Financial Information

A. Consolidated Statements and Other Financial Information.

Please see “Item 18. Financial Statements” for a list of the financial statements filed as part of this annual report.

B. Significant Changes

Except as described in this annual report, since the date of the annual financial statements included in this annual report, no significant changes have occurred to our financial condition.

Item 9. The Offer and Listing

A. Offer and Listing Details

The closing high and low sales prices of our common stock as reported by NASDAQ, the OTCQB Market or the OTC Pink market, as applicable, for the years, quarters and months indicated, are as follows (adjusted to give effect of our (i) one share for ten (10) share reverse stock split that was effective on February 14, 2013, (ii) one share for five (5) share reverse stock split that was effective on December 2, 2013, (iii) one share for seven and one-half share (7.5) reverse stock split that was effective on May 11, 2015, (iv) one share for fifty (50) share reverse stock split that was effective on June 26, 2015, (v) one share for sixty (60) share reverse stock split that was effective on January 15, 2016, (vi) one share for two hundred (200) share reverse stock split that was effective on April 14, 2016, (vii) one share for five thousand (5,000) share reverse stock split that was effective on February 7, 2017 and (viii) one share for five thousand (5,000) share reverse stock split that was effective on February 6, 2018):

	Common Stock	
For the Years Ended:	High	Low
December 31, 2013	$3,262,500,000,000,000.00	$95,625,000,000,000.00
December 31, 2014	274,500,000,000,000.00	7,875,000,000,000.00
December 31, 2015	6,000,000,000.00	3,000,000,000.00
December 31, 2016	800,000,000.00	7,500.00
December 31, 2017	0.50	0.50

	Common Stock	
For the Quarters Ended:	High	Low
March 31, 2016	$800,000,000.00	$100,000,000.00
June 30, 2016	72,000,000.00	605,000.00
September 30, 2016	745,000.00	71,250.00
December 31, 2016	116,250.00	7,500.00
March 31, 2017	10,000.00	50.00
June 30, 2017	50.00	15.00
September 30, 2017	3.50	3.45
December 31, 2017	0.50	0.50
March 31, 2018	0.50	0.01

	Common Stock	
For the Months Ended:	High	Low
November 30, 2017	$0.50	$0.50
December 31, 2017	0.50	0.50
January 31, 2018	0.50	0.50
February 28, 2018	0.06	0.04
March 31, 2018	0.04	0.02
April 30, 2018	0.04	0.03

B. Plan of Distribution

Not applicable.

C. Markets

Our common stock began trading on the OTC Pink market on June 16, 2017 under the trading symbol "FREEF." Between April 22, 2016 and June 15, 2016, our common stock traded on the OTCQB market under the trading symbol "FREEF." Between February 26, 2013 and April 21, 2016, our common stock traded on the NASDAQ Capital Market under the trading symbol "FREE." Prior to that time, our common stock traded on the NASDAQ Global Market between November 8, 2007 and February 25, 2013 under the trading symbol "FREE." Prior to that time, our common stock was traded on the NASDAQ Capital Market under the symbol "FREE."

D. Selling Shareholders

Not required.

E. Dilution

Not required.

F. Expenses of the Issue

Not required.

Item 10. Additional Information

A. Share Capital

Not required.

B. Memorandum and Articles of Association

The information required herein was provided in the Registration Statement on Form F-1 (File No. 333-145203), the report on Form 6-K dated October 22, 2009, both previously filed by us with the Securities and Exchange Commission and incorporated herein by reference, and filed herewith as Exhibit 1.5.

One million shares of our preferred stock have been designated Series A Participating Preferred Stock in connection with our adoption of a shareholder rights plan as described below.

Shareholder Rights Plan

General

Each share of our common stock includes a right that entitles the holder to purchase from us a unit consisting of one-thousandth of a share of our Series A participating preferred stock at a purchase price of approximately $20 trillion per unit, subject to specified adjustments. The rights are issued pursuant to a rights agreement between us and American Stock Transfer & Trust Company, LLC, as rights agent. Until a right is exercised, the holder of a right will have no rights to vote or receive dividends or any other shareholder rights.

The rights may have anti-takeover effects. The rights will cause substantial dilution to any person or group that attempts to acquire us without the approval of our board of directors. As a result, the overall effect of the rights may be to render more difficult or discourage any attempt to acquire us. Because our board of directors can approve a redemption of the rights or a permitted offer, the rights should not interfere with a merger or other business combination approved by our board of directors.

We have summarized the material terms and conditions of the rights agreement and the rights below. For a complete description of the rights, we encourage you to read the rights agreement, which we have filed as an exhibit to this annual report.

Detachment of the Rights

The rights are attached to all certificates representing our outstanding common stock and will attach to all common stock certificates we issue prior to the rights distribution date that we describe below. The rights are not exercisable until after the rights distribution date and will expire at the close of business on the tenth anniversary date of the adoption of the rights plan, unless we redeem or exchange them earlier as described below. The rights will separate from the common stock and a rights distribution date will occur, subject to specified exceptions, on the earlier of the following two dates:

- 10 days following a public announcement that a person or group of affiliated or associated persons or an "acquiring person" has acquired or obtained the right to acquire beneficial ownership of 15% or more of our outstanding common stock; or
- 10 business days following the start of a tender or exchange offer that would result, if closed, in a person becoming an "acquiring person."

Existing shareholders and their affiliates are excluded from the definition of "acquiring person" for purposes of the rights, and therefore their ownership or future share acquisitions cannot trigger the rights. Specified "inadvertent" owners that would otherwise become an acquiring person, including those who would have this designation as a result of repurchases of common stock by us, will not become acquiring persons as a result of those transactions.

Our board of directors may defer the rights distribution date in some circumstances, and some inadvertent acquisitions will not result in a person becoming an acquiring person if the person promptly divests itself of a sufficient number of shares of common stock.

Until the rights distribution date:

- our common stock certificates will evidence the rights, and the rights will be transferable only with those certificates; and
- any new shares of common stock will be issued with rights and new certificates will contain a notation incorporating the rights agreement by reference.

As soon as practicable after the rights distribution date, the rights agent will mail certificates representing the rights to holders of record of common stock at the close of business on that date. After the rights distribution date, only separate rights certificates will represent the rights.

We will not issue rights with any shares of common stock we issue after the rights distribution date, except as our board of directors may otherwise determine.

Flip-In Event

A “flip-in event” will occur under the rights agreement when a person becomes an acquiring person. If a flip-in event occurs and we do not redeem the rights as described under the heading “—Redemption of Rights” below, each right, other than any right that has become void, as described below, will become exercisable at the time it is no longer redeemable for the number of shares of common stock, or, in some cases, cash, property or other of our securities, having a current market price equal to two times the exercise price of such right.

If a flip-in event occurs, all rights that then are, or in some circumstances that were, beneficially owned by or transferred to an acquiring person or specified related parties will become void in the circumstances the rights agreement specifies.

Flip-Over Event

A “flip-over event” will occur under the rights agreement when, at any time after a person has become an acquiring person:

- we are acquired in a merger or other business combination transaction; or
- 50% or more of our assets, cash flows or earning power is sold or transferred.

If a flip-over event occurs, each holder of a right, other than any right that has become void as we describe under the heading “—Flip-In Event” above, will have the right to receive the number of shares of common stock of the acquiring company having a current market price equal to two times the exercise price of such right.

Antidilution

The number of outstanding rights associated with our common stock is subject to adjustment for any stock split, stock dividend or subdivision, combination or reclassification of our common stock occurring prior to the rights distribution date. With some exceptions, the rights agreement does not require us to adjust the exercise price of the rights until cumulative adjustments amount to at least 1% of the exercise price. It also does not require us to issue fractional shares of our preferred stock that are not integral multiples of one one-hundredth of a share, and, instead we may make a cash adjustment based on the market price of the common stock on the last trading date prior to the date of exercise. The rights agreement reserves us the right to require, prior to the occurrence of any flip-in event or flip-over event that, on any exercise of rights, that a number of rights must be exercised so that we will issue only whole shares of stock.

Redemption of Rights

At any time until 10 days after the date on which the occurrence of a flip-in event is first publicly announced, we may redeem the rights in whole, but not in part, at a redemption price of $0.01 per right. The redemption price is subject to adjustment for any stock split, stock dividend or similar transaction occurring before the date of redemption. At our option, we may pay that redemption price in cash, shares of common stock or any other consideration our board of directors may select. The rights are not exercisable after a flip-in event until they are no longer redeemable. If our board of directors timely orders the redemption of the rights, the rights will terminate on the effectiveness of that action.

Exchange of Rights

We may, at our option, exchange the rights (other than rights owned by an acquiring person or an affiliate or an associate of an acquiring person, which have become void), in whole or in part. The exchange must be at an exchange ratio of one share of common stock per right, subject to specified adjustments at any time after the occurrence of a flip-in event and prior to:

any person other than our existing shareholders becoming the beneficial owner of common stock with voting power equal to 50% or more of the total voting power of all shares of common stock entitled to vote in the election of directors; or

the occurrence of a flip-over event.

Amendment of Terms of Rights

While the rights are outstanding, we may amend the provisions of the rights agreement only as follows:

- to cure any ambiguity, omission, defect or inconsistency;
- to make changes that do not adversely affect the interests of holders of rights, excluding the interests of any acquiring person; or
- to shorten or lengthen any time period under the rights agreement, except that we cannot change the time period when rights may be redeemed or lengthen any time period, unless such lengthening protects, enhances or clarifies the benefits of holders of rights other than an acquiring person.

At any time when no rights are outstanding, we may amend any of the provisions of the rights agreement, other than decreasing the redemption price.

C. Material Contracts

None.

D. Exchange Controls.

Under Marshall Islands law, there are currently no restrictions on the export or import of capital, including foreign exchange controls or restrictions that affect the remittance of dividends, interest or other payments to non-resident holders of our shares.

E. Taxation.

The following is a discussion of the material Marshall Islands and United States federal income tax consequences relevant to a U.S. Holder, as defined below, of our common stock. This discussion does not purport to deal with the tax consequences of owning common stock to all categories of investors, some of which, such as dealers in securities, investors whose functional currency is not the United States dollar, and investors that own, actually or under applicable constructive ownership rules, 10% or more of the voting power of our stock, may be subject to special rules. This discussion deals only with U.S. Holders that hold the common stock as a capital asset. You are encouraged to consult your own tax advisors concerning the overall tax consequences arising in your own particular situation under United States federal, state, local or foreign law of the ownership of common stock. **The discussion is not intended, and should not be construed, as legal or professional tax advice and does not exhaust all possible tax considerations.**

Marshall Islands Tax Consequences

We are incorporated in the Marshall Islands. Under current Marshall Islands law, we are not subject to tax on income or capital gains, and no Marshall Islands withholding tax will be imposed upon payments of dividends by us to our stockholders provided such stockholders are not residents of the Marshall Islands. Holders of our common stock who are not residents of, domiciled in, or carrying on any commercial activity in the Marshall Islands will not be subject to Marshall Islands tax on the sale or other disposition of our common stock.

United States Federal Income Tax Consequences

The following are the material United States federal income tax consequences to us of our activities and to U.S. Holders and Non-U.S. Holders, each as defined below, of the ownership and disposition of our common stock. The following discussion of United States federal income tax matters is based on the United States Internal Revenue Code of 1986, as amended, or the Code, judicial decisions, administrative pronouncements, and existing and proposed regulations issued by the United States Department of the Treasury, all of which are subject to change, possibly with retroactive effect. This discussion below is based, in part, upon Treasury Regulations promulgated under Section 883 of the Code, and in part, on the description of our business as described in “About Our Company” above and assumes that we conduct our business as described in that section.

TO ENSURE COMPLIANCE WITH TREASURY DEPARTMENT CIRCULAR 230, HOLDERS OF OUR COMMON STOCK ARE HEREBY NOTIFIED THAT: (A) ANY DISCUSSION OF FEDERAL TAX ISSUES IN THIS ANNUAL REPORT IS NOT INTENDED OR WRITTEN TO BE RELIED UPON, AND CANNOT BE RELIED UPON, BY HOLDERS FOR THE PURPOSE OF AVOIDING PENALTIES THAT MAY BE

IMPOSED ON HOLDERS UNDER THE INTERNAL REVENUE CODE; (B) SUCH DISCUSSION IS BEING USED IN CONNECTION WITH THE PROMOTION OR MARKETING (WITHIN THE MEANING OF CIRCULAR 230) BY THE ISSUERS OF THE TRANSACTIONS OR MATTERS ADDRESSED HEREIN; AND (C) HOLDERS SHOULD SEEK ADVICE BASED ON THEIR PARTICULAR CIRCUMSTANCES FROM AN INDEPENDENT TAX ADVISOR.

Taxation of Operating Income: In General

Unless exempt from United States federal income taxation under the rules discussed below, a foreign corporation is subject to United States federal income taxation in respect of any income that is derived from the use of vessels, from the hiring or leasing of vessels for use on a time, voyage or bareboat charter basis, from the participation in a shipping pool, partnership, strategic alliance, joint operating agreement, code sharing arrangements or other joint venture it directly or indirectly owns or participates in that generates such income, or from the performance of services directly related to those uses, which we refer to as “shipping income,” to the extent that the shipping income is derived from sources within the United States. For these purposes, 50% of shipping income that is attributable to transportation that begins or ends, but that does not both begin and end, in the United States, exclusive of certain U.S. territories and possessions, constitutes income from sources within the United States, which we refer to as “U.S.-Source Gross Transportation Income” or “USSGTI.”

Shipping income attributable to transportation that both begins and ends in the United States is considered to be 100% from sources within the United States. U.S. law prohibits us from engaging in transportation that produces income considered to be 100% from sources within the United States.

Shipping income attributable to transportation exclusively between non-U.S. ports will be considered to be 100% derived from sources outside the United States. Shipping income derived from sources outside the United States will not be subject to any United States federal income tax.

In the absence of exemption from tax under Section 883, our USSGTI would be subject to a 4% tax imposed without allowance for deductions as described below.

Exemption of Operating Income from United States Federal Income Taxation

Under Section 883 of the Code, we will be exempt from United States federal income taxation on our U.S.-source shipping income if:

- we are organized in a foreign country (our "country of organization") that grants an "equivalent exemption" to corporations organized in the United States;
- we satisfy one of the following ownership tests (discussed in more detail below): (1) more than 50% of the value of our stock is owned, directly or indirectly, by "qualified shareholders," which includes persons (i) who are "residents" of our country of organization or of another foreign country that grants an "equivalent exemption" to corporations organized in the United States, and (ii) who comply with certain documentation requirements, which we refer to as the "Qualified Shareholder Ownership Test," or (2) our stock is primarily and regularly traded on one or more established securities markets in our country of organization, in another country that grants an "equivalent exemption" to United States corporations, or in the United States, which we refer to as the "Publicly-Traded Test;" and we are not considered "closely held," which we refer to as the "Closely-Held Test;" and
- we meet certain substantiation, reporting and other requirements.

The Republic of the Marshall Islands, the jurisdiction where we and our ship-owning subsidiaries are incorporated, grants "equivalent exemptions" to United States corporations. Therefore, we should meet the first requirement for the Section 883 exemption. Additionally, we intend to comply with the substantiation, reporting and other requirements that are applicable under Section 883 of the Code. As a result, qualification for the Section 883 exemption will turn primarily on our ability to satisfy the second requirement enumerated above.

Since the 2007 tax year, we have claimed the benefits of the Section 883 tax exemption for our ship-owning subsidiaries on the basis of the Publicly-Traded Test. For 2015 and subsequent tax years, we anticipate that we will need to satisfy the Publicly-Traded Test in order to qualify for benefits under Section 883. While we expect to satisfy the Publicly-Traded Test for such years, there can be no assurance in this regard. Our ability to satisfy the Publicly-Traded Test is discussed below.

The regulations provide, in pertinent part, that the stock of a foreign corporation will be considered to be "primarily traded" on an established securities market in a country if the number of shares of each class of stock that are traded during the tax year on all established securities markets in that country exceeds the number of shares in each such class that are traded during that year on established securities markets in any other single country. Our common stock, our sole class of issued and outstanding stock, is “primarily traded” on the OTC Pink market.

Under the regulations, our stock will be considered to be “regularly traded” if one or more classes of our stock representing 50% or more of our outstanding shares, by total combined voting power of all classes of stock entitled to vote and by total combined value of all classes of stock, are listed on one or more established securities markets, which we refer to as the “listing threshold.” Our common stock, our sole class of issued and outstanding stock, is listed on the OTC Pink market, and accordingly, we will satisfy this listing requirement.

The regulations further require that with respect to each class of stock relied upon to meet the listing requirement: (i) such class of the stock is traded on the market, other than in minimal quantities, on at least 60 days during the tax year or 1/6 of the days in a short tax year; and (ii) the aggregate number of shares of such class of stock traded on such market is at least 10% of the average number of shares of such class of stock outstanding during such year or as appropriately adjusted in the case of a short tax year. We believe we will satisfy the trading frequency and trading volume tests. Even if this were not the case, the regulations provide that the trading frequency and trading volume tests will be deemed satisfied by a class of stock if, as we expect to be the case with our common stock, such class of stock is traded on an established market in the United States, and such class of stock is regularly quoted by dealers making a market in such stock. While we anticipate that we will satisfy the trading frequency and trading volume tests, satisfaction of these requirements is outside of our control and hence, no assurances can be provided that we will satisfy the Publicly-Traded Test each year.

In addition, even if the “primarily traded” and “regularly traded” portions of the Publicly-Traded Test described above are satisfied, the Closely-Held Test provides, in pertinent part, that a class of stock will not be considered to be “regularly traded” on an established securities market for any tax year in which 50% or more of the vote and value of the outstanding shares of such class of stock are owned, actually or constructively under specified stock attribution rules, on more than half the days during the tax year by persons who each own directly or indirectly 5% or more of the vote and value of such class of stock, who we refer to as “5% Shareholders.” For purposes of being able to determine our 5% Shareholders under the Closely-Held Test, the regulations permit us to rely on Schedule 13G and Schedule 13D filings with the Securities and Exchange Commission. The regulations further provide that an investment company that is registered under the Investment Company Act of 1940, as amended, will not be treated as a 5% Shareholder for purposes of the Closely-Held Test.

In the event the Closely-Held Test is triggered, the regulations provide that the Closely-Held Test will nevertheless not apply if we can establish that among the closely-held group of 5% Shareholders, sufficient shares are owned by those of our 5% Shareholders that are considered to be “qualified shareholders” (within the meaning of the regulations) to preclude non-qualified 5% Shareholders in the closely-held group from owning 50% or more of the value of such class of stock for more than half of the days during the tax year, which we refer to as the exception to the Closely-Held Test. Establishing such qualification and ownership by our direct and indirect 5% Shareholders will depend on their meeting the requirements of one of the qualified shareholder tests set out under the regulations applicable to 5% Shareholders and compliance with certain ownership certification procedures by each intermediary or other person in the chain of ownership between us and such qualified 5% Shareholders. Further, the regulations require, and we must certify, that no person in the chain of qualified ownership of shares relied on by us to qualify for exemption holds those shares in bearer form.

As of the date of this Registration Statement there are no 5% shareholders who, collectively, own 50% of more of our stock and we do not expect to have any such shareholders in the foreseeable future. Accordingly, as long we comply with substantiation, reporting and other requirements, we should not be prevented by the Closely-Held Test from meeting the Publicly-Traded test. However, the ability to avoid application of the Closely-Held Test is outside our control, and, as a result, there can be no assurance regarding whether we will satisfy the Publicly-Traded Test for any year. For this and other reasons, there can be no assurance that we or any of our subsidiaries will qualify for the benefits of Section 883 of the Code for any year.

Taxation in Absence of Exemption

To the extent the benefits of Section 883 are unavailable, our USSGTI, to the extent not considered to be “effectively connected” with the conduct of a U.S. trade or business, as described below, would be subject to a 4% tax imposed by Section 887 of the Code on a gross basis, without the benefit of deductions, otherwise referred to as the “4% Tax.” Since under the sourcing rules described above, no more than 50% of our shipping income would be treated as being derived from U.S. sources, the maximum effective rate of U.S. federal income tax on our shipping income would never exceed 2% under the 4% gross basis tax regime.

To the extent the benefits of the Section 883 exemption are unavailable, and our USSGTI is considered to be "effectively connected" with the conduct of a U.S. trade or business, as described below, any such "effectively connected" U.S.-source shipping income, net of applicable deductions, would be subject to the U.S. federal corporate income tax currently imposed at rates of up to 35%. In addition, we may be subject to the 30% "branch profits" taxes on earnings effectively connected with the conduct of such trade or business, as determined after allowance for certain adjustments, and on certain interest paid or deemed paid attributable to the conduct of a U.S. trade or business.

Our U.S.-source shipping income would be considered "effectively connected" with the conduct of a U.S. trade or business only if:

- We have, or are considered to have, a fixed place of business in the United States involved in the earning of shipping income; and

- substantially all of our U.S.-source shipping income is attributable to regularly scheduled transportation, such as the operation of a vessel that follows a published schedule with repeated sailings at regular intervals between the same points for voyages that begin or end in the United States or, in the case of income from the leasing of a vessel, is attributable to a fixed place of business in the United States.

We do not have a fixed place of business in the United States, and we do not intend to have, or permit circumstances that would result in having, any vessel operating to the United States on a regularly scheduled basis. Based on the foregoing and on the expected mode of our shipping operations and other activities, we believe that none of our U.S.-source shipping income will be "effectively connected" with the conduct of a U.S. trade or business.

United States Taxation of Gain on Sale of Vessels

If we qualify for the Section 883 exemption, then gain from the sale of any vessel may be exempt from tax under Section 883. Even if such gain is not exempt from tax under Section 883, we will not be subject to United States federal income taxation with respect to gain realized on a sale of a vessel, assuming that we are not, and have never been, engaged in a U.S. trade or business. Under certain circumstances, if we are so engaged, gain on the sale of vessels could be subject to U.S. federal income tax.

United States Federal Income Taxation of U.S. Holders

As used herein, the term “U.S. Holder” means a beneficial owner of common stock that is a United States citizen or resident, United States corporation or other United States entity taxable as a corporation, an estate the income of which is subject to United States federal income taxation regardless of its source, or a trust if a court within the United States is able to exercise primary jurisdiction over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust.

If a partnership holds our common stock, the tax treatment of a partner will generally depend upon the status of the partner and upon the activities of the partnership. If you are a partner in a partnership holding our common stock, you are encouraged to consult your tax advisor.

Distributions. Subject to the discussion of passive foreign investment companies (or “PFICs”) below, any distributions made by us with respect to our common stock will generally be taxable as dividend income to the extent of our current or accumulated earnings and profits, as determined under United States federal income tax principles. Distributions in excess of our earnings and profits will be treated first as a nontaxable return of capital to the extent of the U.S. Holder’s tax basis in his or her common stock on a dollar-for-dollar basis and thereafter as capital gain. Because we are not a United States corporation, U.S. Holders that are corporations will not be entitled to claim a dividends received deduction with respect to any distributions they receive from us. Dividends paid with respect to our common stock will generally be treated as passive category income or, in the case of certain types of U.S. Holders, general category income for purposes of computing allowable foreign tax credits for United States foreign tax credit purposes.

Dividends paid on our common stock to a U.S. Holder who is an individual, trust or estate, which we refer to as a “U.S. Individual Holder,” will generally be treated as “qualified dividend income” that is taxable to such a U.S. Individual Holder at preferential tax rates provided that (1) we are not a passive foreign investment company for the tax year during which the dividend is paid or the immediately preceding tax year (which we do not believe we are, have been or will be), (2) our common stock is readily tradable on an established securities market in the United States (such as the OTCQB), and (3) the U.S. Individual Holder has owned the common stock for more than 60 days in the 121-day period beginning 60 days before the date on which the common stock becomes ex-dividend. There is no assurance that any dividends paid on our common stock will be eligible for these preferential rates in the hands of a U.S. Individual Holder. Any distributions treated as dividends paid by us that are not eligible for these preferential rates will be taxed as ordinary income to a U.S. Individual Holder. Dividends paid by us to a U.S. Individual Holder are subject to the Net Investment Income Tax (generally, a tax of 3.8% on dividends, interest, and other investment income) provided that the U.S. Individual Holder's "modified adjusted income" exceeds a designated threshold. Each U.S. Individual Holder should consult his or her own tax advisor to determine the applicability of the Net Investment Income Tax.

Special rules may apply to any "extraordinary dividend" generally, a dividend in an amount which is equal to or exceeds ten percent of a stockholder's adjusted basis (or fair market value in certain circumstances) in a share of our stock paid by us. If we pay an "extraordinary dividend" on our stock that is treated as "qualified dividend income," then any loss derived by a U.S. Individual Holder from the sale or exchange of such stock will be treated as long-term capital loss to the extent of such dividend.

Sale, Exchange or Other Disposition of Common Stock. Assuming we do not constitute a passive foreign investment company for any tax year, a U.S. Holder generally will recognize taxable gain or loss upon a sale, exchange or other disposition of our common stock in an amount equal to the difference between the amount realized by the U.S. Holder from such sale, exchange or other disposition and the U.S. Holder's tax basis in such stock. Such gain or loss will be treated as long-term capital gain or loss if the U.S. Holder's holding period is greater than one year at the time of the sale, exchange or other disposition. Such capital gain or loss will generally be treated as U.S.-source income or loss, as applicable, for U.S. foreign tax credit purposes. A U.S. Holder's ability to deduct capital losses is subject to certain limitations.

Passive Foreign Investment Company Status and Significant Tax Consequences. Special United States federal income tax rules apply to a U.S. Holder that holds stock in a foreign corporation classified as a passive foreign investment company for United States federal income tax purposes. In general, we will be treated as a passive foreign investment company with respect to a U.S. Holder if, for any tax year in which such holder held our common stock, either:

- at least 75% of our gross income for such tax year consists of passive income (e.g., dividends, interest, capital gains and rents derived other than in the active conduct of a rental business); or

- at least 50% of the average value of the assets held by the corporation during such tax year produce, or are held for the production of, passive income.

For purposes of determining whether we are a passive foreign investment company, we will be treated as earning and owning our proportionate share of the income and assets, respectively, of any of our subsidiary corporations in which we own at least 25% of the value of the subsidiary's stock. Income earned, or deemed earned, by us in connection with the performance of services would not constitute passive income. By contrast, rental income would generally constitute "passive income" unless we were treated under specific rules as deriving our rental income in the active conduct of a U.S. trade or business. We may own, directly or indirectly, interests in other entities that are passive foreign investment companies, or subsidiary PFICs. If we are a passive foreign investment company, each U.S. Holder will be treated as owning its pro rata share by value of the stock of any such subsidiary PFICs.

Based on the rules governing PFICs and our current operations and future projections, we do not believe that we are, nor do we expect to become, a passive foreign investment company with respect to any tax year. Under IRS regulations the rental income that we derive from our shipping operations is not passive income if we regularly and directly perform active and substantial marketing, remarketing, management and operational functions with respect to the leasing of our vessels, which we do. Under a safe harbor rule contained in IRS regulations (applicable, among other circumstances, to vessels that are located outside the United States for more than 50% of the time during any taxable year, as our vessels are), the rental income we derive from our shipping operations is not passive income as long as our "active leasing expenses" (as defined in the regulations) equal or exceed 10% of our "adjusted leasing profit" (also as defined in the regulations). We believe that we met this safe harbor test during 2015 and we have no reason to believe that we will not meet it in future years. Accordingly, under the current IRS rules defining passive income, as applied to the conduct of our business, we do not believe that we are or will become a PFIC.

Nonetheless, the law governing the characterization of the income of companies like us is somewhat unsettled: for example, in a 2009 decision involving the deductibility of commissions (but not involving the PFIC rules), a U.S. appeals court held that the right of a customer to direct the destination and itinerary of a voyage that was otherwise under the operational control of the vessel's owner required that the charter income earned by the owner be characterized as rental income rather than income from the provision of services (a position which the Internal Revenue Service does not agree with). We believe that, whether or not this decision is correct, subsequent developments in the law specifically applicable to PFICs renders it irrelevant in determining our status as a PFIC. However, to date no court has held that this decision is irrelevant to determining the character of income for purposes of the PFIC rules.

We therefore expect to conduct our affairs in a manner that, under IRS regulations, prevents us from being classified as a PFIC with respect to any tax year. It should be noted, however, that such classification depends on the facts as they exist in each year and we cannot assure you that the nature of our operations will not change in the future in a manner that would result in our being classified as a PFIC. Accordingly, we describe below the tax consequences to a U.S. Holder of our being classified as a PFIC.

If we are determined to be a PFIC for any tax year (or portion thereof) that is included in the holding period of a U.S. Holder of our common stock, and the U.S. Holder did not make a timely qualified electing fund ("QEF") election for our first tax year as a PFIC in which the U.S. Holder held (or was deemed to hold) common stock, as described below, such holder generally will be subject to special rules with respect to:

- any gain recognized by the U.S. Holder on the sale or other disposition of its common stock; and
- any "excess distribution" made to the U.S. Holder (generally, any distributions to such U.S. Holder during a tax year of the U.S. Holder that are greater than 125% of the average annual distributions received by such U.S. Holder in respect of the common stock during the three preceding tax years of such U.S. Holder or, if shorter, such U.S. Holder's holding period for the common stock).

Under these rules,

- the U.S. Holder's gain or excess distribution will be allocated ratably over the U.S. Holder's holding period for the common stock;
- the amount allocated to the U.S. Holder's current tax year and any tax years in the U.S. Holder's holding period before the first day of our first tax year in which we are a PFIC, will be taxable as ordinary income;
- the amount allocated to other tax years (or portions thereof) of the U.S. Holder and included in its holding period will be taxed at the highest tax rate in effect for that year and applicable to the U.S. Holder; and
- the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such other tax year of the U.S. Holder.

In general, if we are determined to be a PFIC, a U.S. Holder will avoid the PFIC tax consequences described above in respect to our common stock by making a timely QEF election to include in income its pro rata share of our net capital gains (as long-term capital gain) and other earnings and profits (as ordinary income), on a current basis, in each case whether or not distributed, in the tax year of the U.S. Holder in which or with which our tax year ends. A U.S. Holder may make a separate election to defer the payment of taxes on undistributed income inclusions under the QEF rules, but if deferred, any such taxes will be subject to an interest charge.

Although a determination as to our PFIC status will be made annually, an initial determination that our company is a PFIC will generally apply for subsequent years to a U.S. Holder who held our common stock while we were a PFIC, whether or not we meet the test for PFIC status in those subsequent years. A U.S. Holder who makes the QEF election discussed above for our first tax year as a PFIC in which the U.S. Holder owns (or is deemed to own) our common stock, however, will not be subject to the PFIC tax and interest charge rules discussed above in respect to such shares. In addition, such U.S. Holder will not be subject to the QEF inclusion regime with respect to such shares for any tax year of ours that ends within or with a tax year of the U.S. Holder and in which we are not a PFIC. On the other hand, if the QEF election is not effective for each of our tax years in which we are a PFIC, and the U.S. Holder owns (or is deemed to hold) our common stock, the PFIC rules discussed below will continue to apply to such shares unless the holder makes a purging election, as described below, and pays the tax and interest charge with respect to the gain inherent in such shares attributable to the pre-QEF election period.

If a U.S. Holder has made a QEF election with respect to our common stock, and the special tax and interest charge rules do not apply to such shares (because of a timely QEF election for our first tax year as a PFIC in which the U.S. Holder owns (or is deemed to own) such shares or a purge of the PFIC taint pursuant to a purging election, as described below), any gain recognized on the sale of our common stock generally will be taxable as capital gain, and no interest charge will be imposed. As discussed above, U.S. Holders of a QEF are currently taxed on their pro rata shares of its earnings and profits, whether or not distributed. In such case, a subsequent distribution of such earnings and profits that were previously included in income generally should not be taxable as a dividend to such U.S. Holders. The tax basis of a U.S. Holder’s shares in a QEF will be increased by amounts that are included in income, and decreased by amounts distributed but not taxed as dividends, under the above rules. Similar basis adjustments apply to property if by reason of holding such property the U.S. Holder is treated under the applicable attribution rules as owning shares in a QEF.

The QEF election is made on a shareholder-by-shareholder basis and, once made, can be revoked only with the consent of the IRS. A U.S. Holder generally makes a QEF election by attaching a completed IRS Form 8621 (Return by a Shareholder of a Passive Foreign investment Company or Qualified Electing Fund), including the information provided in a PFIC annual information statement, to a timely filed U.S. federal income tax return for the tax year to which the election relates. Retroactive QEF elections generally may be made only by filing a protective statement with such return and if certain other conditions are met or with the consent of the IRS. U.S. Holders should consult with their tax advisors regarding the availability and tax consequences of a retroactive QEF election under their particular circumstances. In order to comply with the requirements of a QEF election, a U.S. Holder must receive a PFIC annual information statement from us. If we determine we are a PFIC for any tax year, we will endeavor to provide to a U.S. Holder such information as the IRS may require, including a PFIC annual information statement, in order to enable the U.S. Holder to make and maintain a QEF election. However, there is no assurance that we will have timely knowledge of our status as a PFIC in the future or of the required information to be provided.

If a U.S. Holder, at the close of its tax year, owns shares in a PFIC that are treated as "marketable stock," the U.S. Holder may make a mark-to-market election with respect to such shares for such tax year. If the U.S. Holder makes a valid mark-to-market election for the first tax year of the U.S. Holder in which the U.S. Holder owns (or is deemed to hold) common stock in us and for which we are determined to be a PFIC, such holder generally will not be subject to the PFIC rules described above in respect to its common stock. Instead, in general, the U.S. Holder will include as ordinary income each year the excess, if any, of the fair market value of its common stock at the end of its tax year over the adjusted basis in its common stock. The U.S. Holder also will be allowed to take an ordinary loss in respect of the excess, if any, of the adjusted basis of its common stock over the fair market value of its common stock at the end of its tax year (but only to the extent of the net amount of previously included income as a result of the mark-to-market election). The U.S. Holder's basis in its common stock will be adjusted to reflect any such income or loss amounts, and any further gain recognized on a sale or other taxable disposition of the common stock will be treated as ordinary income. The mark-to-market election is available only if our common stock is treated as marketable stock. If our common stock is listed on the OTCQB and is regularly traded on such market in accordance with applicable Treasury Regulations, our common stock will be treated as "marketable stock" for this purpose. U.S. Holders are advised to consult with their tax advisors regarding the availability and tax consequences of a mark-to-market election in respect to our common stock under their particular circumstances.

If we are a PFIC and, at any time, have a foreign subsidiary that is classified as a PFIC, U.S. Holders generally would be deemed to own a portion of the shares of such lower-tier PFIC, and generally could incur liability for the deferred tax and interest charge described above if we receive a distribution from, or dispose of all or part of our interest in, the lower-tier PFIC or the U.S. Holders otherwise were deemed to have disposed of an interest in the lower-tier PFIC. We will endeavor to cause any lower-tier PFIC to provide to a U.S. Holder the information that may be required to make or maintain a QEF election with respect to the lower- tier PFIC. However, there is no assurance that we will have timely knowledge of the status of any such lower-tier PFIC. In addition, we may not hold a controlling interest in any such lower-tier PFIC and thus there can be no assurance we will be able to cause the lower-tier PFIC to provide the required information. U.S. Holders are advised to consult with their tax advisors regarding the tax issues raised by lower-tier PFICs.

A U.S. Holder that owns (or is deemed to own) shares in a PFIC during any tax year of the U.S. Holder, may have to file an IRS Form 8621 (whether or not a QEF or mark-to-market election is made) and such other information as may be required by the U.S. Treasury Department.

The rules dealing with PFICs and with the QEF and mark-to-market elections are very complex and are affected by various factors in addition to those described above. Accordingly, U.S. Holders are advised to consult with their tax advisors concerning the application of the PFIC rules (and the QEF and mark-to-market elections) to our common stock under their particular circumstances.

United States Federal Income Taxation of “Non-U.S. Holders”

A beneficial owner of common stock that is not a U.S. Holder is referred to herein as a “Non-U.S. Holder.”

Dividends on Common Stock. Non-U.S. Holders generally will not be subject to United States federal income tax or withholding tax on dividends received from us with respect to our common stock, unless that income is effectively connected with the Non-U.S. Holder’s conduct of a trade or business in the United States. If the Non-U.S. Holder is entitled to the benefits of a United States income tax treaty with respect to those dividends, that income is taxable only if it is attributable to a permanent establishment maintained by the Non-U.S. Holder in the United States.

Sale, Exchange or Other Disposition of Common Stock. Non-U.S. Holders generally will not be subject to United States federal income tax or withholding tax on any gain realized upon the sale, exchange or other disposition of our common stock, unless:

- the gain is effectively connected with the Non-U.S. Holder’s conduct of a trade or business in the United States. If the Non-U.S. Holder is entitled to the benefits of an income tax treaty with respect to that gain, that gain is taxable only if it is attributable to a permanent establishment maintained by the Non-U.S. Holder in the United States; or

- the Non-U.S. Holder is an individual who is present in the United States for 183 days or more during the tax year of disposition and other conditions are met.

If the Non-U.S. Holder is engaged in a United States trade or business for United States federal income tax purposes, the income from the common stock, including dividends and the gain from the sale, exchange or other disposition of the stock that is effectively connected with the conduct of that trade or business will generally be subject to regular United States federal income tax in the same manner as discussed in the previous section relating to the taxation of U.S. Holders. In addition, if you are a corporate Non-U.S. Holder, your earnings and profits that are attributable to the effectively connected income, which are subject to certain adjustments, may be subject to an additional branch profits tax at a rate of 30%, or at a lower rate as may be specified by an applicable income tax treaty.

Backup Withholding and Information Reporting

In general, dividend payments, or other taxable distributions, made within the United States to you will be subject to information reporting requirements. Such payments will also be subject to backup withholding tax if you are a non-corporate U.S. Holder and you:

- fail to provide an accurate taxpayer identification number;

- are notified by the Internal Revenue Service that you have failed to report all interest or dividends required to be shown on your federal income tax returns; or

- in certain circumstances, fail to comply with applicable certification requirements.

Non-U.S. Holders may be required to establish their exemption from information reporting and backup withholding by certifying their status on Internal Revenue Service Form W-8BEN, W-8ECI or W-8IMY, as applicable.

If you sell your stock to or through a United States office or broker, the payment of the proceeds is subject to both United States backup withholding and information reporting unless you certify that you are a non-U.S. person, under penalties of perjury, or you otherwise establish an exemption. If you sell your stock through a non-United States office of a non-United States broker and the sales proceeds are paid to you outside the United States, then information reporting and backup withholding generally will not apply to that payment. However, United States information reporting requirements, but not backup withholding, will apply to a payment of sales proceeds, even if that payment is made to you outside the United States, if you sell your stock through a non-United States office of a broker that is a United States person or has some other contacts with the United States.

Backup withholding tax is not an additional tax. Rather, you generally may obtain a refund of any amounts withheld under backup withholding rules that exceed your income tax liability by filing a refund claim with the Internal Revenue Service.

We encourage each stockholder to consult with his, her or its own tax advisor as to particular tax consequences to it of holding and disposing of our shares, including the applicability of any state, local or foreign tax laws and any proposed changes in applicable law.

F. Dividends and paying agents

Not applicable.

G. Statement by experts

Not applicable.

H. Documents on display

This annual report and the exhibits thereto and any other document we file pursuant to the Securities Exchange Act of 1934, as amended (the “Exchange Act”) may be inspected without charge and copied at prescribed rates at the following

Securities and Exchange Commission public reference rooms: 100 F Street, N.E., Room 1580, Washington, D.C. 20549. You may obtain information on the operation of the Securities and Exchange Commission's public reference room in Washington, D.C. by calling the Securities and Exchange Commission at 1-800-SEC-0330 or by visiting the Securities and Exchange Commission's website athttp://www.sec.gov, and may obtain copies of our filings from the public reference room by calling 1-800-SEC-0330. The Exchange Act file number for our Securities and Exchange Commission filings is 000-49760.

The Securities and Exchange Commission maintains a website at www.sec.gov that contains reports, proxy and information statements, and other information regarding registrants that make electronic filings with the Securities and Exchange Commission using its EDGAR (Electronic Data Gathering, Analysis, and Retrieval) system.

We will also provide without charge to each person, including any beneficial owner, upon written or oral request of that person, a copy of any and all of the information that has been incorporated by reference in this annual report. Please direct such requests to Dimitris Filippas, Chief Financial Officer, FreeSeas Inc., 20, Amerikis Street, 10671, Athens, Greece and our telephone number is +30-210-729-7015.

I. Subsidiary Information

Not applicable.

Item 11. Quantitative and Qualitative Disclosure About Market Risk

Interest Rate Fluctuation

The international drybulk industry is a capital-intensive industry, requiring significant amounts of investment. Much of this investment is provided in the form of long-term debt. Our debt usually contains interest rates that fluctuate with LIBOR. Increasing interest rates could adversely impact future earnings. The Company was party of two interest rate swap agreements which were fully unwound on February 3, 2014.

Our interest expense is affected by changes in the general level of interest rates. The only loan with NBG on M/V Free Neptune matured on December 16, 2016.

Please see “Management’s Discussion and Analysis of Financial Condition and Results of Operations — Long Term Debt” for a full description of the loan.

Interest Rate Risk

We are exposed to interest rate risk associated with our variable rate borrowings, and our objective is to manage the impact of such fluctuations on earnings and cash flows of our borrowings. In this respect, we use interest rate swaps to manage net exposure to interest rate fluctuations related to our borrowings and to lower our overall borrowing costs. The Company was party of two interest rate swap agreements which were fully unwound on February 3, 2014.

Our derivative financial instruments are valued using pricing models that are used to value similar instruments by market participants. Where possible, we verify the values produced by our pricing models to market prices. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit spreads, measures of volatility and correlations of such inputs. Model inputs can generally be verified and do not involve significant management judgment. Such instruments are typically classified within Level 2 of the fair value hierarchy.

Foreign Exchange Rate Risk

We generate all of our revenues in U.S. dollars, but incur a portion of our expenses in currencies other than U.S. dollars. For accounting purposes, expenses incurred in Euros are converted into U.S. dollars at the exchange rate prevailing on the date of each transaction. At December 31, 2017, 2016 and 2015, approximately 17%, 4% and 4%, respectively, of our outstanding accounts payable was denominated in currencies other than the U.S. dollar (mainly in the Euro). As an indication of the extent of our sensitivity to foreign exchange rate changes, an increase of an additional 10% in the value of other currencies against the dollar would have decreased our net income and cash flows in 2017 by approximately $135 based upon the accounts payable we had denominated in currencies other than the U.S. dollar as of December 31, 2017.

Credit Risk

Financial instruments, which potentially subject us to significant concentrations of credit risk, consist principally of cash and cash equivalents, trade accounts receivable, insurance claims and derivative contracts (interest rate swaps). We place our cash and cash equivalents, consisting mostly of deposits, with high credit qualified financial institutions.

We monitor the credit risk regarding charterer's turnover in order to review its reliance on individual charterers. We do not obtain rights to collateral to reduce its credit risk. We are exposed to credit risk in the event of non-performance by counter parties to derivative instruments; however, we limit our exposure by diversifying among counter parties with high credit ratings. In addition, the counterparty to the derivative financial instrument is a major financial institution in order to manage exposure to non-performance counterparties.

Charter Market Risk

Our revenues, earnings and profitability are affected by the prevailing charter market rates. During 2017, the BDI has remained volatile, ranging from a low of 685 on February 14, 2017 to a high of 1,338 on March 29, 2017. Market participants confidence remains at high level despite: (i) recent fears over trade war between US and China and (ii) regulatory concerns regarding the most pragmatic post-2020 bunker solution, since demand is improving and oversupply is easing. The BDI ended the first quarter of 2018 at 1,055 points, i.e. 23% lower from where it ended in 2017. The most recent fall is attributed mainly to the latest escalation of US-China trade war threats.

Item 12. Description of Securities Other than Equity Securities

Not applicable.

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

Please see “Item 5. Operating and Financial Review and Prospects - Recent Developments” and “- Long-Term Debt” for a full description of loan defaults.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

Except as described elsewhere in this document, there have been no changes to the instruments defining the rights of the holders of any class of registered securities, and the rights of holders of the registered securities have not been altered by the issuance or modification of any other class of securities in 2016 (see “Item 10. Additional Information — B. Memorandum and Articles of Incorporation”) for a description of this plan. There are no restrictions on working capital and no removal or substitution of assets securing any class of our registered securities.

Item 15. Controls and Procedures.

Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of December 31, 2017. Disclosure controls and procedures are defined under SEC rules as controls and other procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within required time periods. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate, to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention of overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based on our evaluation, our chief executive officer and our chief financial officer have concluded that our disclosure controls and procedures were not effective as of December 31, 2017 due to our inability to file this annual report on Form 20-F within the SEC deadline of four months after our year end (subject to an allowable extension of 15 days).

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as required under applicable United States securities regulatory requirements. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the company's chief executive and chief financial officers and effected by the company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use of disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. A system of internal controls can provide only reasonable, not absolute, assurance that the objectives of the control system are met, no matter how well the system is conceived or operated. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2017. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control – Integrated Framework (2013). Based on that evaluation under this framework, our management concluded that as of December 31, 2017, our internal control over financial reporting was effective.

Attestation Report of the Registered Public Accounting Firm

This annual report does not include an attestation report by our independent registered public accounting firm regarding internal control over financial reporting. As we are neither a large accelerated filer nor an accelerated filer, our management's report was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit us to provide only management's report in this annual report.

Changes to Internal Controls and Procedures for Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the year ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Item 16. [Reserved]

Item 16A. Audit Committee Financial Expert.

Our board has determined that Mr. Dimitris Filippas qualifies as an "audit committee financial expert" as defined by rules of the Securities and Exchange Commission. For a brief listing of Mr. Filippas' relevant experience, see Item 6.A. "Directors, Senior Management and Employees - Directors and Senior Management."

Item 16B. Code of Ethics.

We have adopted a code of ethics that applies to our chief executive officer and all senior financial officers of our company, including the chief financial officer, chief accounting officer or controller, or persons performing similar functions. Our code of ethics has been filed as an exhibit to this annual report and is available on the Corporate Governance section of our website at www.freeseas.gr. We will also provide a paper copy of our Code of Business Conduct and Ethics free of charge upon written request of a shareholder. Shareholders may direct their requests to the attention of Dimitris Filippas, Chief Financial Officer.

Item 16C. Principal Accountant Fees and Services.

Independent Public Accountants Fees

The aggregate fees billed for the last two fiscal years for professional services rendered by our auditor are as follows:

	2017	2016
Audit fees (1)	$ 30	$ 40
Audit-related fees	—	—
Tax fees	—	—
Other fees	—	—
Total	$ 30	$ 40

(1) Audit fees represent fees for professional services related to the audit of our financial statements for the years ended December 31, 2017 and 2016.

Audit Committee Pre-Approved Policies and Procedures

Our audit committee pre-approved all audit, audit-related and non-audit services not prohibited by law to be performed by our independent auditors and associated fees prior to the engagement of the independent auditor with respect to such services.

Item 16D. Exemptions from the Listing Standards for Audit Committees.

Not applicable.

Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers.

There were no purchases of our common shares made by us or on our behalf or by any affiliated purchaser during the fiscal year ended December 31, 2017.

Item 16F. Change in Registrant's Certifying Accountant.

None.

Item 16G. Corporate Governance.

Not applicable.

Item 16H. Mine Safety Disclosure.

Not applicable.

PART III

Item 17. Financial Statements.

Not applicable.

Item 18. Financial Statements

See Financial Statements attached hereto as pages F-1 to F-32

Item 19. Exhibits

Exhibit No.:	Exhibit Description	Where Filed
1.1	Amended and Restated Articles of Incorporation of FreeSeas Inc. (formerly known as Adventure Holdings S.A.)	Exhibit 3.1 to Registrant's Registration Statement on Form F-1 (File No. 333-124825) filed on May 11, 2005 and incorporated herein by reference
1.2	Amended and Restated By-Laws of FreeSeas Inc. (formerly known as Adventure Holdings S.A.)	Exhibit 3.2 to Registrant's Registration Statement on Form F-1 (File No. 333-124825) filed on May 11, 2005 and incorporated herein by reference
1.3	First Amendment to the Amended and Restated Bylaws of FreeSeas Inc.	Exhibit 3.3 to Amendment No. 1 to Registrant's Registration Statement on Form F-1 (File No. 333-124825) filed on October 15, 2007 and incorporated herein by reference
1.4	First Amendment to the Amended and Restated Articles of Incorporation of FreeSeas Inc.	Exhibit 99.3 to Registrant's Form 6-K filed on October 22, 2009 and incorporated herein by reference
1.5	Amendment to the Amended and Restated Articles of Incorporation of FreeSeas Inc.	Exhibit 1.5 to Registrant's Annual Report on Form 20-F for the year ended December 31, 2010 and incorporated herein by reference

1.6	Certificate of Amendment to the Amended and Restated Articles of Incorporation, as filed with the Registrar of Corporations of the Marshall Islands on February 12, 2013	Exhibit 3.01 to Registrant's Form 6-K filed on February 14, 2013 and incorporated herein by reference
1.7	Certificate of Amendment to the Amended and Restated Articles of Incorporation, as filed with the Registrar of Corporations of the Marshall Islands on November 26, 2013	Exhibit 3.01 to Registrant's Form 6-K, as filed on December 2, 2013 and incorporated herein by reference.
1.8	Form of Certificate of Designation, Rights and Preferences of the Series D Convertible Preferred Stock	Exhibit 3.08 to Amendment No. 1 to Registrant's Form F-1 (File. No. 333-195166), filed on May 1, 2014 and incorporated herein by reference.
1.9	Certificate of Amendment to the Amended and Restated Articles of Incorporation, as filed with the Registrar of Corporations of the Marshall Islands on May 5, 2015.	Exhibit 3.01 to Registrant's Form 6-K, as filed on May 8, 2015 and incorporated herein by reference.
1.10	Certificate of Amendment to the Amended and Restated Articles of Incorporation, as filed with the Registrar of Corporations of the Marshall Islands on June 19, 2015.	Exhibit 3.01 to Registrant's Form 6-K, as filed on June 25, 2015 and incorporated herein by reference.
1.11	Certificate of Amendment to the Amended and Restated Articles of Incorporation, as filed with the Registrar of Corporations of the Marshall Islands on January 8, 2016.	Exhibit 3.01 to Registrant's Form 6-K, as filed on January 14, 2016 and incorporated herein by reference.

Exhibit No.:	Exhibit Description	Where Filed
1.12	Certificate of Amendment to the Amended and Restated Articles of Incorporation, as filed with the Registrar of Corporations of the Marshall Islands on April 11, 2016.	Exhibit 3.01 to Registrant's Form 6-K, as filed on April 13, 2016 and incorporated herein by reference.
1.13	Certificate of Amendment to the Amended and Restated Articles of Incorporation, as filed with the Registrar of Corporations of the Marshall Islands on February 3, 2017.	Exhibit 3.01 to Registrant's Form 6-K, as filed on February 6, 2017 and incorporated herein by reference.
1.14	Certificate of Amendment to the Amended and Restated Articles of Incorporation, as filed with the Registrar of Corporations of the Marshall Islands on February 2, 2018.	Exhibit 3.01 to Registrant's Form 6-K, as filed on February 6, 2018 and incorporated herein by reference.
2.1	Specimen Common Stock Certificate	Exhibit 4.1 to Amendment No. 1 to Registrant's Registration Statement on Form F-1 (File No. 333-124825) filed on July 22, 2005 and incorporated herein by reference
2.2	Shareholder Rights Agreement entered into effective as of January 14, 2009 by and between FreeSeas Inc. and American Stock Transfer & Trust Company, LLC	Exhibit 2.9 to Registrant's Annual Report on Form 20-F for the year ended December 31, 2008 and incorporated herein by reference
4.1	Amended and Restated Services Agreement dated October 1, 2008 between FreeSeas Inc. and Free Bulkers S.A.	Exhibit 4.61 to Registrant's Annual Report on Form 20-F for the year ended December 31, 2008 and incorporated herein by reference
4.2	Supplemental Agreement dated June 8, 2011 between FreeSeas, Inc. and Free Bulkers S.A.	Exhibit 4.12 to Registrant's amended Annual Report on Form 20-F/A for the year ended December 31, 2011 and incorporated herein by reference
4.3	Addendum No. 1 dated September 17, 2009 to the Amended and Restated Services Agreement dated October 1, 2008 by and between FreeSeas Inc. and Free Bulkers S.A.	Exhibit 99.12 to Registrant's 6-K filed on October 22, 2009 and incorporated herein by reference
4.4	Form of Standard Ship Management Agreement by and between Free Bulkers S.A. and each of Adventure Five S.A. through Adventure Twelve S.A.	Exhibit 99.13 to Registrant's 6-K filed on October 22, 2009 and incorporated herein by reference
4.5	Form of Addendum No. 2 to BIMCO Management Agreement by and between Free Bulkers S.A. and each of Adventure Two S.A. and Adventure Three S.A and Form of Addendum No. 1 to	Exhibit 99.14 to Registrant's 6-K filed on October 22, 2009 and incorporated herein by reference

	BIMCO Management Agreement by and between Free Bulkers S.A. and each of Adventure Five S.A. through Adventure Twelve S.A.	
4.6	Loan Agreement dated December 15, 2009 among Adventure Nine, Adventure Twelve and First Business Bank	Exhibit 4.60 to Registrant's Annual Report on Form 20-F for the year ended December 31, 2009 and incorporated herein by reference
4.7	First Priority Mortgage on the M/V *Free Impala* in favor of First Business Bank	Exhibit 4.61 to Registrant's Annual Report on Form 20-F for the year ended December 31, 2009 and incorporated herein by reference
4.8	First Preferred Mortgage on the M/V *Free Neptune* in favor of First Business Bank	Exhibit 4.62 to Registrant's Annual Report on Form 20-F for the year ended December 31, 2009 and incorporated herein by reference
4.9	Deed of Covenants dated December 16, 2009 between Adventure Nine and First Business Bank	Exhibit 4.63 to Registrant's Annual Report on Form 20-F for the year ended December 31, 2009 and incorporated herein by reference

68

Exhibit No.:	Exhibit Description	Where Filed
4.10	First Supplemental Agreement dated January 27, 2012 among FBB – First Business Bank S.A., Adventure Nine S.A., Adventure Twelve S.A., FreeSeas Inc. and Free Bulkers S.A.	Filed as Exhibit 4.30 to Registrant's Annual Report on Form 20-F for the year ended December 31, 2011 filed on May 7, 2012 and incorporated herein by reference
4.11	Form of Series C Warrant	Exhibit 4.03 to Amendment No. 1 to Registrant's Form F-1 (File. No. 333-195166), filed on May 1, 2014 and incorporated herein by reference.
4.12	Securities Purchase Agreement, dated June 13, 2015, by and between the Company and Casern Holdings Ltd.	Exhibit 99.1 to Registrant's Form 6-K, as filed on June 8, 2015 and incorporated herein by reference.
4.13	Form of Convertible Note, dated June 13, 2015, issued to Casern Holdings Ltd.	Exhibit 99.2 to Registrant's Form 6-K, as filed on June 8, 2015 and incorporated herein by reference.
4.14	Form of Securities Purchase Agreement, dated July 13, 2015, by and between the Company and AMVS Value Fund Ltd.	Exhibit 99.1 to Registrant's Form 6-K, as filed on July 15, 2015 and incorporated herein by reference.
4.15	Form of Convertible Note, dated July 13, 2015, issued to AMVS Value Fund Ltd.	Exhibit 99.2 to Registrant's Form 6-K, as filed on July 15, 2015 and incorporated herein by reference.
4.16	Form of Registration Rights Agreement, dated July 13, 2015, by and between the Company and AMVS Value Fund Ltd.	Exhibit 99.3 to Registrant's Form 6-K, as filed on July 15, 2015 and incorporated herein by reference.
4.17	Form of Securities Purchase Agreement, dated September 2, 2015, by and between the Company and Casern Holdings Ltd.	Exhibit 99.1 to Registrant's Form 6-K, as filed on September 8, 2015 and incorporated herein by reference.
4.18	Form of Convertible Note, dated September 2, 2015, issued to Casern Holdings Ltd.	Exhibit 99.2 to Registrant's Form 6-K, as filed on September 8, 2015 and incorporated herein by reference.
4.19	Form of Registration Rights Agreement, dated September 2, 2015, by and between the Company and Casern Holdings Ltd.	Exhibit 99.3 to Registrant's Form 6-K, as filed on September 8, 2015 and incorporated herein by reference.
4.20	Form of Securities Purchase Agreement, dated October 26, 2015, by and between the Company and ALSA Holdings Ltd.	Exhibit 99.1 to Registrant's Form 6-K, as filed on October 29, 2015 and incorporated herein by reference.

4.21	Form of Convertible Note, dated October 26, 2015, issued to ALSA Holdings Ltd.	Exhibit 99.2 to Registrant's Form 6-K, as filed on October 29, 2015 and incorporated herein by reference.
4.22	Form of Securities Purchase Agreement, dated December 8, 2015, by and between the Company and MTR3S Holding Ltd.	Exhibit 99.1 to Registrant's Form 6-K, as filed on December 11, 2015 and incorporated herein by reference.
4.23	Form of Convertible Note, dated December 8, 2015, issued to MTR3S Holding Ltd.	Exhibit 99.2 to Registrant's Form 6-K, as filed on December 11, 2015 and incorporated herein by reference.
4.24	Form of Securities Purchase Agreement, dated January 6, 2016, by and between the Company and Alpha Capital Anstalt	Exhibit 99.1 to Registrant's Form 6-K, as filed on January 19, 2016 and incorporated herein by reference.

Exhibit No.:	Exhibit Description	Where Filed
4.25	Form of Convertible Note, dated January 6, 2016, issued to Alpha Capital Anstalt	Exhibit 99.2 to Registrant's Form 6-K, as filed on January 19, 2016 and incorporated herein by reference.
4.26	Form of Securities Purchase Agreement, dated March 1, 2016, by and between the Company and MTR3S Holding Ltd.	Exhibit 99.1 to Registrant's Form 6-K, as filed on March 4, 2016 and incorporated herein by reference.
4.27	Form of Convertible Note, dated March 1, 2016, issued to MTR3S Holding Ltd.	Exhibit 99.2 to Registrant's Form 6-K, as filed on March 4, 2016 and incorporated herein by reference.
4.28	Debt Settlement Agreement and Release, dated May 10, 2016, by and between FreeSeas Inc. and M.I.E. Company Ltd.	Exhibit 4.28 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.29	Form of Convertible Note, dated May 10, 2016, issued to M.I.E. Company Ltd.	Exhibit 4.29 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.30	Securities Purchase Agreement, dated May 25, 2016, by and between FreeSeas Inc. and Crown Bridge Partners, LLC	Exhibit 4.30 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.31	Form of Convertible Note, dated May 25, 2016, issued to Crown Bridge Partners, LLC	Exhibit 4.31 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.32	Debt Settlement Agreement and Release, dated June 27, 2016, by and between FreeSeas Inc. and E. Stavropoulos & Co O.E. “Hydra Travel”	Exhibit 4.32 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.33	Form of Convertible Note, dated June 27, 2016, issued to E. Stavropoulos & Co O.E. “Hydra Travel”	Exhibit 4.33 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.34	Debt Settlement Agreement and Release, dated June 27, 2016, by and between FreeSeas Inc. and Marine Plus S.A.	Exhibit 4.34 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.35	Form of Convertible Note, dated June 27, 2016, issued to Marine Plus S.A.	Exhibit 4.35 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.

4.36	Debt Settlement Agreement and Release, dated June 27, 2016, by and between FreeSeas Inc. and Medpool Ltd.	Exhibit 4.36 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.37	Form of Convertible Note, dated June 27, 2016, issued to Medpool Ltd.	Exhibit 4.37 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.38	Debt Settlement Agreement, dated July 11, 2016, by and between FreeSeas Inc. and Sichenzia Ross Friedman Ference LLP	Exhibit 4.38 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.39	Form of Convertible Note, dated July 11, 2016, issued to Sichenzia Ross Friedman Ference LLP	Exhibit 4.39 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.40	Debt Settlement Agreement and Release, dated August 16, 2016, by and between FreeSeas Inc. and Anyland Travel Ltd.	Exhibit 4.40 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.41	Form of Convertible Note, dated August 16, 2016, issued to Anyland Travel Ltd.	Exhibit 4.41 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.

Exhibit No.:	Exhibit Description	Where Filed
4.42	Debt Settlement Agreement and Release, dated August 16, 2016, by and between FreeSeas Inc. and M. Dalakos – I. Fassolis – N. Theofanopoulos & Partners Law Firm	Exhibit 4.42 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.43	Form of Convertible Note, dated August 16, 2016, issued to M. Dalakos – I. Fassolis – N. Theofanopoulos & Partners Law Firm	Exhibit 4.43 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.44	Securities Purchase Agreement, dated August 16, 2016, by and between FreeSeas Inc. and YES Properties, Inc.	Exhibit 4.44 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.45	Form of Convertible Note, dated August 16, 2016, issued to YES Properties, Inc.	Exhibit 4.45 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.46	Securities Purchase Agreement, dated November 21, 2016, by and between FreeSeas Inc. and Crede CG III, Ltd.	Exhibit 4.46 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.47	Form of Convertible Note, dated November 21, 2016, issued to Crede CG III, Ltd.	Exhibit 4.47 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.48	Securities Purchase Agreement, dated November 21, 2016, by and between FreeSeas Inc. and APG Capital Holdings, LLC	Exhibit 4.48 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.49	Form of Convertible Note, dated November 21, 2016, issued to APG Capital Holdings, LLC	Exhibit 4.49 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.50	Securities Purchase Agreement, dated November 30, 2016, by and between FreeSeas Inc. and Adar Bays, LLC	Exhibit 4.50 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.51	Form of Convertible Note, dated November 30, 2016, issued to Adar Bays, LLC	Exhibit 4.51 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.52	Securities Purchase Agreement, dated December 30, 2016, by and between FreeSeas Inc. and MTR3S Holding Ltd.	Exhibit 4.52 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.

4.53	Form of Convertible Note, dated December 30, 2016, issued to MTR3S Holdings Ltd.	Exhibit 4.53 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.54	Form of Convertible Note, dated January 17, 2017, issued to LG Capital Funding, LLC	Exhibit 4.54 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.55	Securities Purchase Agreement, dated January 18, 2017, by and between FreeSeas Inc. and LG Capital Funding, LLC	Exhibit 4.55 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.56	Form of Convertible Note, dated January 18, 2017, issued to LG Capital Funding, LLC	Exhibit 4.56 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.57	Securities Purchase Agreement, dated February 13, 2017, by and between FreeSeas Inc. and Power Up Lending Group Ltd.	Exhibit 4.57 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.58	Form of Convertible Note, dated February 13, 2017, issued to Power Up Lending Group Ltd.	Exhibit 4.58 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.

Exhibit No.:	Exhibit Description	Where Filed
4.59	Securities Purchase Agreement, dated February 16, 2017, by and between FreeSeas Inc. and Crown Bridge Partners, LLC	Exhibit 4.59 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.60	Form of Convertible Note, dated February 16, 2017, issued to Crown Bridge Partners, LLC	Exhibit 4.60 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.61	Securities Purchase Agreement, dated February 22, 2017, by and between FreeSeas Inc. and APG Capital Holdings, LLC	Exhibit 4.61 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.62	Form of Convertible Note, dated February 22, 2017, issued to APG Capital Holdings, LLC	Exhibit 4.62 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.63	Form of Convertible Note, dated February 22, 2017, issued to APG Capital Holdings, LLC	Exhibit 4.63 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.64	Securities Purchase Agreement, dated February 24, 2017, by and between FreeSeas Inc. and Oakmore Opportunity Fund I, LP	Exhibit 4.64 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.65	Form of Convertible Note, dated February 24, 2017, issued to Oakmore Opportunity Fund I, LP	Exhibit 4.65 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.66	Form of Convertible Note, dated March 20, 2017, issued to LG Capital Funding, LLC	Exhibit 4.66 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.67	Form of Convertible Note, dated March 20, 2017, issued to LG Capital Funding, LLC	Exhibit 4.67 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.68	Securities Purchase Agreement, dated March 28, 2017, by and between FreeSeas Inc. and Cerebus Finance Group, Ltd.	Exhibit 4.68 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.69	Form of Convertible Note, dated March 28, 2017, issued to Cerebus Finance Group Ltd.	Exhibit 4.69 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.

4.70	Securities Purchase Agreement, dated April 7, 2017, by and between FreeSeas Inc. and GS Capital Partners, LLC	Exhibit 4.70 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.71	Form of Convertible Note, dated April 7, 2017, issued to GS Capital Partners, LLC	Exhibit 4.71 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.72	Securities Purchase Agreement, dated July 21, 2017, by and between FreeSeas Inc. and LG Capital Funding, LLC	Exhibit 4.72 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.73	Form of Convertible Note, dated July 21, 2017, issued to LG Capital Funding, LLC	Exhibit 4.73 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.74	Form of Convertible Note, dated July 21, 2017, issued to LG Capital Funding, LLC	Exhibit 4.74 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.75	Securities Purchase Agreement, dated July 24, 2017, by and between FreeSeas Inc. and Adar Bays, LLC	Exhibit 4.75 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.76	Form of Convertible Note, dated July 24, 2017, issued to Adar Bays, LLC	Exhibit 4.76 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.77	Securities Purchase Agreement, dated August 17, 2017, by and between FreeSeas Inc. and LG Capital Funding, LLC	Exhibit 4.77 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.78	Form of Convertible Note, dated August 17, 2017, issued to LG Capital Funding, LLC	Exhibit 4.78 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.79	Form of Convertible Note, dated August 17, 2017, issued to LG Capital Funding, LLC	Exhibit 4.79 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
4.80	Securities Purchase Agreement, dated October 30, 2017, by and between FreeSeas Inc. and Power Up Lending Group Ltd.	Filed herewith
4.81	Form of Convertible Note, dated October 30, 2017, issued to Power Up Lending Group Ltd.	Filed herewith
4.82	Securities Purchase Agreement, dated November 1, 2017, by and between FreeSeas Inc. and Power Up Lending Group Ltd.	Filed herewith
4.83	Form of Convertible Note, dated November 1, 2017, issued to Power Up Lending Group Ltd.	Filed herewith

4.84	Debt Settlement Agreement and Release, dated February 14, 2018, by and between FreeSeas Inc. and M. Dalakos – I. Fassolis – N. Theofanopoulos & Partners Law Firm	Filed herewith
4.85	Form of Convertible Note, dated February 14, 2018, issued to M. Dalakos – I. Fassolis – N. Theofanopoulos & Partners Law Firm	Filed herewith
4.86	Securities Purchase Agreement, dated February 16, 2018, by and between FreeSeas Inc. and Geneva Roth Remark Holdings, Inc.	Filed herewith
4.87	Form of Convertible Note, dated February 16, 2018, issued to Geneva Roth Remark Holdings, Inc.	Filed herewith
4.88	Debt Settlement Agreement and Release, dated March 1, 2018, by and between FreeSeas Inc. and Marine Plus S.A.	Filed herewith
4.89	Form of Convertible Note, dated March 1, 2018, issued to Marine Plus S.A.	Filed herewith

Exhibit No.:	Exhibit Description	Where Filed
8.1	Subsidiaries of the Registrant	Exhibit 8.1 to Registrant's Form 20-F, as filed on August 17, 2017 and incorporated herein by reference.
12.1	Certification of the Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended	Filed herewith
12.2	Certification of the Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended	Filed herewith
13.1	Certification of the Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
13.2	Certification of the Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith
16.1	Letter from RBSM LLP	Exhibit 99.1 to Registrant's Form 6-K, as filed on June 13, 2017 and incorporated herein by reference.
101 INS	XBRL Instance Document	Submitted herewith
101 SCH	XBRL Taxonomy Extension Schema Document	Submitted herewith
101 CAL	XBRL Taxonomy Calculation Linkbase Document	Submitted herewith
101 LAB	XBRL Taxonomy Labels Linkbase Document	Submitted herewith
101 PRE	XBRL Taxonomy Presentation Linkbase Document	Submitted herewith
101 DEF	XBRL Taxonomy Extension Definition Linkbase Document	Submitted herewith

SIGNATURES

The Registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

FREESEAS INC.

Dated: May 14, 2018 By: */s/ DIMITRIS FILIPPAS*
Dimitris Filippas
Chief Financial Officer

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
FreeSeas Inc.
Athens, Greece

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of FreeSeas Inc. and Subsidiaries (“the Company”) as of December 31, 2017 and 2016, and the related consolidated statements of operations, shareholders’ equity (deficit), and cash flows for each of the three years ended December 31, 2017, and the related notes (collectively referred to as the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits, we are required to obtain an understanding of internal control over financial reporting, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

Consideration of the Company's Ability to Continue as a Going Concern

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 3 to the consolidated financial statements, the Company has incurred net losses for the prior three years and cash flow projections for 2018 indicate that cash on hand will not be sufficient to cover debt repayments and operating expenses and capital expenditure requirements. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 3. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

We have served as the Company's auditor since 2017.

Spokane, Washington

May 14, 2018

F-2

FREESEAS INC.

CONSOLIDATED BALANCE SHEETS

(All amounts in thousands of United States Dollars, except for share and per share data)

	Notes	December 31, 2017	December 31, 2016
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		$11	$52
Trade receivables, net of provision of nil and $3,073 for 2017 and 2016, respectively.		149	149
Inventories		4	235
Deferred charges - current portion		—	1
Prepayments and other		155	158
Guarantee Deposit		192	189
Other Current Assets		25	25
Total current assets		536	809
Vessels, net	5	2,009	2,122
Total assets		$2,545	$2,931
LIABILITIES AND SHAREHOLDERS’ (DEFICIT) EQUITY			
CURRENT LIABILITIES:			
Accounts payable		$7,412	$8,127
Convertible notes, net	8	853	1,558
Derivative liability	8	1,624	—
Accrued liabilities	7	9,985	7,134
Due to related party	4	3,280	2,107
Bank loans - current portion	9	17,598	17,598
Total current liabilities		40,752	36,524
Total liabilities		40,752	36,524
Commitments and Contingencies	10	—	—
SHAREHOLDERS’ (DEFICIT) EQUITY:			
Preferred Stock, $0.001 par value; 5,000,000 shares authorized, Series D Convertible Preferred Stock, $0.001 par value, 250,000 shares designated, 8,160 issued and	14	—	—

outstanding at December 31, 2017 and December 31, 2016.			
Common stock, $0.001 par value; 10,000,000,000 shares authorized, 798,423 and 34 shares issued and outstanding at December 31, 2017 and December 31, 2016, respectively.	12,14	1	—
Additional paid-in capital		227,298	224,792
Accumulated deficit		(265,506)	(258,385)
Total shareholders' (deficit) equity		(38,207)	(33,593)
Total liabilities and shareholders' (deficit) equity		$2,545	$2,931

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

F-3

FREESEAS INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(All amounts in thousands of United States Dollars, except for share and per share data)

	Years Ended December 31,		
	2017	2016	2015
OPERATING REVENUES	$—	$506	$2,304
OPERATING EXPENSES:			
Voyage expenses	(727)	(609)	(1,831)
Commissions	—	(18)	(174)
Vessel operating expenses	(1,148)	(2,183)	(4,967)
Depreciation expense (Note 5)	(113)	(1,939)	(3,585)
Management and other fees to a related party (Note 4)	(398)	(702)	(1,070)
General and administrative expenses	(1,545)	(3,049)	(4,252)
Provision and write-offs of insurance claims and bad debts	—	1,185	525
Loss on sale of vessels (Note 5)	—	(277)	(7,620)
Loss on commitment and contingency	—	—	(2,000)
Contractual derivative obligation	—	(5,442)	(3,300)
Bareboat Hire	—	—	(493)
Vessels impairment charge (Note 5)	—	(4,286)	(18,891)
Loss from operations	(3,931)	(16,814)	(45,354)
OTHER INCOME (EXPENSE):			
Interest and finance costs	(3,031)	(3,632)	(5,026)
Loss on derivative liability (Note 8)	(1,491)	—	—
Loss on note issuance	(344)	—	—
Gain on settlement of liability (Note 6)	1,924	—	—
Gain on settlement of payable	—	(37)	313
Other income/ (expense)	(248)	(28)	177
Loss due to capital lease write-off (Note 6)	—	—	(3,058)
Other income (expense)	(3,190)	(3,697)	(7,595)
Net loss	$(7,121)	$(20,511)	$(52,949)
Basic loss per share	$(49)	$(4,102,200)	$—
Diluted loss per share	$(49)	$(4,102,200)	$—
Basic weighted average number of shares	144,922	5	—
Diluted weighted average number of shares	144,922	5	—

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

FREESEAS INC.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)

(All amounts in thousands of United States Dollars, except for share data)

	Preferred Shares (Note 14)	**Preferred Shares $**	Common Shares (Note 14)	Common Shares $	Additional Paid-in Capital	Accumulated deficit	Total Shareholders' Equity (Deficit)
Balance December 31, 2014	8,160	—	—	—	209,930	(184,927)	25,004
Net loss	—	—	—	—	—	(52,949)	(52,949)
Stock compensation expense	—	—	—	—	898	—	898
Cashless warrants exercised	—	—	—	—	—	—	—
Stock issued for settlement of liability	—	—	—	—	1,004		1,004
Common stock issued for convertible notes	—	—	—	—	9,282	—	9,282
Balance December 31, 2015	8,160	$ —	—	$ —	$ 221,114	$ (237,874)	$ (16,760)
Net loss	—	—	—	—	—	(20,511)	(20,511)
Stock compensation expense	—	—	—	—	206	—	206
Cashless warrants exercised	—	—	4	—	214	—	214
Stock issued for Management	—	—	—	—	287	—	287
Common stock issued for convertible notes	—	—	30	—	2,971	—	2,971
Balance December 31, 2016	8,160	$ —	34	$ —	$ 224,792	$ (258,385)	$ (33,593)
Net loss	—	—	—	—	—	(7,121)	(7,121)
Common stock issued for convertible notes	—	—	798,389	1	2,506	—	2,507
Balance December 31, 2017	8,160	$ —	798,423	$ 1	$ 227,298	$ (265,506)	$ (38,207)

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

FREESEAS INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(All amounts in tables in thousands of United States Dollars)

	Years Ended December 31, 2017	December 31, 2016	December 31, 2015
Cash Flows from Operating Activities:			
Net loss	$(7,121)	$(20,511)	$(52,949)
Adjustments to reconcile net loss to net used in operating activities			
Depreciation expense (Note 5)	113	1,939	3,585
Loss on sale of vessel	—	277	7,620
Amortization of debt discount	807	1,550	3,515
Loss on derivative liability (Note 8)	1,491		
Loss on note issuance	344		
Derivatives liability			
Gain on settlement of payable	—	(37)	(313)
Gain on settlement of liability	(1,924)		
Shares issued to settle fees owed to the Manager	—	287	—
Amortization of deferred financing fees	1	6	8
Stock-based compensation charge (Note 13)	—	206	898
Loss on write off of capital lease	—	—	3,057
Loss on commitment and contingency	—	—	2,000
Vessel impairment loss (Note 5)	—	4,286	18,891
Changes in:			
-Trade receivables	—	57	388
-Insurance claims	—	—	—
-Due from related party	—	—	433
-Inventories	231	241	(310)
-Prepayments and other	3	357	174
-Accounts payable	1,209	199	1,184
-Accrued liabilities	2,851	1,188	1,357
-Unearned revenue	—	—	(52)
-Due to related party	1,173	1,107	713
-Guarantee Deposits	(3)	(25)	(164)
Net Cash used in Operating Activities	(825)	(8,873)	(9,965)
Cash flows from Financing Activities:			
Proceeds from convertible notes	784	1,533	6,489
Write-off of lease advance payments	—	7,000	—
Payments on capital lease	—	(1,300)	

			—
Net Cash provided by Financing Activities	784	7,233	6,489
Cash flows from Investing Activities:			
Proceeds from sale of vessels, net	—	1,672	3,451
Net Cash provided by Investing Activities	—	1,672	3,451
Net increase (decrease) in cash and cash equivalents	(41)	32	(25)
Cash and cash equivalents, beginning of year	52	20	45
Cash and cash equivalents, end of year	$ 11	$ 52	$ 20
Supplemental Cash Flow Information:			
Non-Cash Operating Activities:			
Shares issued to settle fees owed to the Manager	$—	$ 287	$—
Notes converted to common stock	$ 2,507	$ 2,971	$ 5,389
Beneficial Conversion feature	$—	$—	$—
Bareboat Charter Lease	$—	$—	$ (8,400)
Convertible notes issued in settlement of accounts payable	$ 214	$ 526	$—
Cashless warrants exercised	$—	$ 214	$—
Adjustments for settlement put option liability	$—	$ 2,075	$—
Stock issued in settlement of liabilities	$—	$—	$ 1,004

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

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

1. Basis of Presentation and General Information

The accompanying consolidated financial statements include the accounts of FreeSeas Inc. and its wholly owned subsidiaries (collectively, the “Company” or “FreeSeas”). FreeSeas, formerly known as Adventure Holdings S.A., was incorporated in the Marshall Islands on April 23, 2004 for the purpose of being the ultimate holding company of ship-owning companies.

We have contracted the management of our fleet to entities controlled (our Managers) by Ion G. Varouxakis, our Chairman, President and Chief Executive Officer. Our Managers provide technical management of our fleet, commercial management of our fleet, financial reporting and accounting services and office space (see Note 4).

Effective January 15, 2016, April 14, 2016, February 7, 2017 and February 6, 2018 the Company effectuated a 60-to-1, a 200-to-1, a 5,000-to-1 reverse stock split and a 5,000-to-1 reverse stock split respectively, on its issued and outstanding common stock (Note 14). All share and per share amounts disclosed in the financial statements give effect to the reverse stock splits retroactively, for all periods presented.

On April 21, 2016, the Company was notified by The NASDAQ Stock Market LLC (“NASDAQ”) that its pending appeal before the NASDAQ Listing Qualifications Hearing Panel had been denied, and that trading in the Company’s common stock was suspended on NASDAQ effective with the open of business on Monday April 25, 2016. On April 25, 2016, the Company’s common stock began trading on the OTCQB market operated by OTC Markets Group Inc. (“OTC Markets”) under the trading symbol “FREEF.” On June 15, 2017, the Company was notified by the OTC Markets that as a result of the Company’s failure to timely file its 2016 annual report on Form 20-F, the Company’s common stock has been removed from the OTCQB market and is currently quoted on the OTC Pink market operated by the OTC Markets, effective June 16, 2017, under the same trading symbol of “FREEF”.

On May 20, 2015, the M/V Free Hero, 1995-built, 24,318 dwt Handysize dry bulk carrier and the M/V Free Goddess, 1995-built, 22,051 dwt Handysize dry bulk carrier, have been sold for a gross sale price of $5,500 each, and the Company’s subsidiaries have entered into long-term bareboat agreements for such vessels with purchase options at a daily hire rate of $1,100 per vessel (not expressed in thousands). The vessels have been renamed to Fiorello and Figaro, respectively (Note 6).

On June 15, 2016, the bareboat hire agreement in connection with the M/V Fiorello was terminated. Subsequent to the termination of the hire, the vessel was sold for a gross sale price of $1,490 with the sale proceeds being applied towards obligations to the Bareboat Owners of the vessel and trade creditors (Note 6).

On September 26, 2016, the Company sold to unrelated third parties the M/V Free Maverick, a 1998-built, 23,994 dwt Handysize dry bulk carrier for a gross sale price of $1,925. As a result of the sale the Company recognized a loss of $277 (Note 5).

On September 30, 2017, the bareboat hire agreement in connection with the M/V Figaro was terminated. Subsequent to the termination of the hire, the vessel was sold to unrelated third parties. The Company realized the amount of $1,924 as gain on settlement of liability in the accompanying consolidated statement of operations for the year ended December 31, 2017, (Note 6).

As of December 31, 2017, the Company owns and operates one Handysize dry bulk carrier. As of December 31, 2017, FreeSeas is the owner of the outstanding shares of the following subsidiaries:

Company	% Owned	M/V	Type	Dwt	Year Built/ Expected Year of Delivery	Date of Acquisition	Date of Disposal	Date of Contract/ Bareboat Charter Termination	Date of Initiation of Bareboat Charter
Adventure Two S.A.	100%	*Free Destiny*	Handysize	25,240	1982	08/04/04	08/27/10	N/A	N/A
Adventure Three S.A.	100%	*Free Envoy*	Handysize	26,318	1984	09/29/04	05/13/11	N/A	N/A
Adventure Four S.A.	100%	*Free Fighter*	Handysize	38,905	1982	06/14/05	04/27/07	N/A	N/A
Adventure Five S.A.	100%	*Free Goddess*	Handysize	22,051	1995	10/30/07	05/20/15	N/A	N/A
Adventure Six S.A.	100%	*Free Hero*	Handysize	24,318	1995	07/03/07	05/20/15	N/A	N/A
Adventure Seven S.A.	100%	*Free Knight*	Handysize	24,111	1998	03/19/08	02/18/14	N/A	N/A
Adventure Eight S.A.	100%	*Free Jupiter*	Handymax	47,777	2002	09/05/07	09/16/14	N/A	N/A
Adventure Nine S.A.	100%	*Free Impala*	Handysize	24,111	1997	04/02/08	09/24/14	N/A	N/A
Adventure Ten S.A.	100%	*Free Lady*	Handymax	50,246	2003	07/07/08	11/08/11	N/A	N/A
	100%		Handysize	23,994	1998	09/01/08	09/26/16	N/A	N/A

Adventure Eleven S.A.		*Free Maverick*								
Adventure Twelve S.A.	100	%	*Free Neptune*	Handysize	30,838	1996	08/25/09	N/A	N/A	N/A
Largo Al Factotum S.A.	100	%	*Hull 1*	Handysize	33,600	2012	N/A	N/A	04/28/12	N/A
Adventure Fifteen S.A.	100	%	*Hull 2*	Handysize	33,600	2012	N/A	N/A	06/04/12	N/A
Nemorino Shipping S.A.	100	%	*Nemorino*	Handymax	47,777	2002	N/A	N/A	09/09/15	09/16/14
Fiorello Shipping S.A.	100	%	*Fiorello*	Handysize	24,318	1995	N/A	N/A	06/15/16	05/20/15
Figaro Shipping S.A.	100	%	*Figaro*	Handysize	22,051	1995	N/A	N/A	09/30/17	05/20/15
Standcorp International Limited	51	%	*N/A*	N/A	N/A	N/A	N/A	N/A	N/A	N/A

F-7

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

2. Significant Accounting Policies

a) Principles of Consolidation: The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (or "U.S. GAAP") and include in each of the three years in the period ended December 31, 2017 the accounts and operating results of the Company and its wholly-owned subsidiaries referred to in Note 1 above. All inter-company balances and transactions have been eliminated upon consolidation. FreeSeas as the holding company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity. Under ASC 810 "Consolidation" a voting interest entity is an entity in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make financial and operating decisions. The holding company consolidates voting interest entities in which it owns all, or at least a majority (generally, greater than 50%) of the voting interest. Variable interest entities ("VIE") are entities as defined under ASC 810 that in general either do not have equity investors with voting rights or that have equity investors that do not provide sufficient financial resources for the entity to support its activities. The determination of whether a reporting entity is required to consolidate another entity is based on, among other things, the other entity's design and purpose and the reporting entity's power, through voting or similar rights, to direct the activities of the other entity that most significantly impact the other entity's economic performance. A controlling financial interest in a VIE is present when a company has the obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE, or both. Only one reporting entity, known as the primary beneficiary, is expected to be identified as having a controlling financial interest and thus is required to consolidate the VIE. The Company evaluates all arrangements that may include a variable interest in an entity to determine if it may be the primary beneficiary, and would be required to include assets, liabilities and operations of a VIE in its consolidated financial statements. As of December 31, 2017, and 2016, no such interest existed.

b) Use of Estimates: The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

c) Concentration of Credit Risk: Financial instruments, which potentially subject the Company to significant concentrations of credit risk, consist principally of cash and cash equivalents, trade accounts receivable, insurance claims, prepayments and advances, and derivative contracts (interest rate swaps). The Company places its cash and cash equivalents, consisting mostly of deposits, with high credit qualified financial institutions. The Company monitors the credit risk regarding charterer’s turnover in order to review its reliance on individual charterers. The Company does not obtain rights to collateral to reduce its credit risk. The Company is exposed to credit risk in the event of non-performance by counter parties to derivative instruments; however, the Company limits its exposure by diversifying among counter parties with high credit ratings. Credit risk with respect to trade account receivable is considered high due to the fact that the Company’s total income is derived from a few charterers. For the year ended December 31, 2017, there were no charterers individually accounted for more than 10% of the Company’s voyage revenues, two charterers individually accounted for more than 10% of the Company’s voyage revenues for the year ended December 31, 2016, and two charterers individually accounted for more than 10% of the Company’s voyage revenues for the year ended December 31, 2015 as follows:

Charterer	2017	2016	2015
A	—	73 %	39 %
B	—	24 %	31 %

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

d) Foreign Currency Translation: The functional currency of the Company is the U.S. Dollar because the Company's vessels operate in international shipping markets, and therefore primarily transact business in U.S. Dollars. The Company's accounting records are maintained in U.S. Dollars. Transactions involving other currencies during the year are converted into U.S. Dollars using the exchange rates in effect at the time of the transactions. At the balance sheet date, monetary assets and liabilities, which are denominated in other currencies, are translated into U.S. Dollars at the year-end exchange rates. Resulting gains or losses are included in other income/loss in the accompanying consolidated statements of operations.

e) Cash and Cash Equivalents: The Company considers highly liquid investments such as time deposits and certificates of deposit with an original maturity of three months or less to be cash equivalents.

f) Trade Receivables, net: The amount shown as Trade Receivables at each balance sheet date includes receivables from charterers for hire, freight and demurrage billings, net of an allowance for doubtful debts. An estimate is made of the allowance for doubtful debts based on a review of all outstanding amounts at year end, and an allowance is made for any accounts which management believes are not recoverable.

g) Insurance Claims: Insurance claims comprise claims submitted and/or claims in the process of compilation for submission (claims pending) relating to hull and machinery or protection and indemnity insurance coverage. They are recorded as incurred on the accrual basis and represent the claimable expenses incurred, net of deductibles, the recovery of which is probable under the related insurance policies and the Company can make an estimate of the amount to be reimbursed. Any non-recoverable amounts are included in accrued liabilities and depending on their nature, are classified as operating expenses or voyage expenses in the statements of operations. The classification of insurance claims (if any) into current and non-current assets is based on management's expectations as to their collection dates.

h) Inventories: Inventories, which are comprised of bunkers and lubricants remaining on board of the vessels at year end, are valued at the lower of cost, as determined on a first-in, first-out basis, or market.

i) Vessels' Cost: Vessels are stated at cost, which consists of the contract purchase price and any material expenses incurred upon acquisition (initial repairs, improvements, delivery expenses and other expenditures to prepare the vessel for her initial voyage). Subsequent expenditures for conversions and major improvements are also capitalized when they appreciably extend the life, increase the earning capacity or improve the efficiency or safety of the vessels. Otherwise, these expenditures are charged to expense as incurred.

j) Vessels' Depreciation: The cost of the Company's vessels is depreciated on a straight-line basis over the vessels' remaining economic useful lives from the acquisition date, after considering the estimated residual value (vessel's residual value is equal to the product of its lightweight tonnage and estimated scrap rate). Effective April 1, 2009 and following management's reassessment of the useful lives of the Company's assets, the fleets useful life was increased from 27 to 28 years since the date of initial delivery from the shipyard. Management's estimate was based on the current vessels' operating condition, as well as the conditions prevailing in the market for the same type of vessels.

k) Vessels held for sale: It is the Company's policy to dispose of vessels when suitable opportunities arise and not necessarily to keep them until the end of their useful life. The Company classifies assets and disposal groups of assets as being held for sale in accordance with ASC 360, "Property, Plant and Equipment," when the following criteria are met: (i) management possessing the necessary authority has committed to a plan to sell the asset; (ii) the asset is immediately available for sale on an "as is" basis; (iii) an active program to find the buyer and other actions required to execute the plan to sell the asset have been initiated; (iv) the sale of the asset is probable, and transfer of the asset is expected to qualify for recognition as a completed sale within one year; (v) the asset is being actively marketed for sale at a price that is reasonable in relation to its current fair value and (vi) actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. Long-lived assets or disposal groups classified as held for sale are measured at the lower of their carrying amount or fair value less cost to sell. These assets are not depreciated once they meet the criteria to be held for sale and are classified in current assets on the consolidated balance sheet.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

l) Impairment of Long-lived Assets: The Company follows the guidance under ASC 360, “Property, Plant and Equipment,” which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The standard requires that, long-lived assets and certain identifiable intangibles held and used or disposed of by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. When the estimate of undiscounted cash flows, excluding interest charges, expected to be generated by the use of the asset is less than its carrying amount, the Company should evaluate the asset for an impairment loss. Measurement of the impairment loss is based on the fair value of the asset which is determined based on management estimates and assumptions and by making use of available market data. The fair values are determined through Level 2 inputs of the fair value hierarchy as defined in ASC 820 “Fair value measurements and disclosures” and are derived principally from or by corroborated or observable market data. Inputs, considered by management in determining the fair value, include independent broker’s valuations, FFA indices, average charter hire rates and other market observable data that allow value to be determined. The Company evaluates the carrying amounts and periods over which long-lived assets are depreciated to determine if events have occurred which would require modification to their carrying values or useful lives. In evaluating useful lives and carrying values of long-lived assets, management reviews certain indicators of potential impairment, such as future undiscounted net operating cash flows, vessel sales and purchases, business plans and overall market conditions. In performing the recoverability tests the Company determines future undiscounted net operating cash flows for each vessel and compares it to the vessel’s carrying value. The future undiscounted net operating cash flows are determined by considering the Company’s alternative courses of action, estimated vessel’s utilization, its scrap value, the charter revenues from existing time charters for the fixed fleet days and an estimated daily time charter equivalent for the unfixed days over the remaining estimated useful life of the vessel, net of vessel operating expenses adjusted for inflation, and cost of scheduled major maintenance. When the Company’s estimate of future undiscounted net operating cash flows for any vessel is lower than the vessel’s carrying value, the carrying value is written down, by recording a charge to operations, to the vessel’s fair market value.

As of December 31, 2017, the Company did not perform an impairment assessment of its long-lived asset M/V Free Neptune, since the impairment charge of $4,286 recorded last year reduced the vessel’s carrying value below her scrap value of $2,756.

m) Accounting for Special Survey and Dry-docking Costs: Effective as of January 1, 2014, the Company changed the deferral method of accounting for special survey and dry-docking costs whereby actual costs incurred were deferred and amortized over periods of five and two and a half years, respectively. The Company now follows the direct expense method of accounting for special survey and dry-docking costs whereby costs are expensed in the period incurred for the vessels.

n) Financing Costs: Fees incurred for obtaining new loans are deferred and amortized over the loans' respective repayment periods, using the effective interest rate method. These charges are included in the balance sheet line item Deferred Charges. Any unamortized balance of costs relating to loans repaid or refinanced is expensed in the period the repayment or refinancing is made, if the refinancing is deemed to be a debt extinguishment under the provision of ASC 470-50 "Debt: Modifications and Extinguishments."

o) Unearned Revenue: Unearned revenue includes cash received prior to the balance sheet date and is related to revenue earned after such date. These amounts are recognized as revenue over the voyage or charter period.

p) Interest Rate Swaps: The Company used interest rate swaps to manage net exposure to interest rate changes related to its borrowings. Such swap agreements designated as "economic hedges" were recorded at fair value with changes in the derivatives' fair value recognized in earnings unless specific hedge accounting criteria were met. During the years ended December 31, 2015, 2016 and 2017, there was no derivative transaction meeting such hedge accounting criteria; therefore, the change in their fair value was recognized in earnings.

q) Financial Instruments: The principal financial assets of the Company consist of cash and cash equivalents, trade receivables (net of allowance), insurance claims, prepayments and advances. The principal financial liabilities of the Company consist of accounts payable, accrued liabilities and long-term debt. The carrying amounts reflected in the accompanying consolidated balance sheets of financial assets and liabilities, approximate their respective fair values.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

r) Fair Value Measurements: The Company follows the provisions of ASC 820, “Fair Value Measurements and Disclosures” which defines, and provides guidance as to the measurement of fair value. ASC 820 creates a hierarchy of measurement and indicates that, when possible, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets and the lowest priority (Level 3) to unobservable data, for example, the reporting entity’s own data. Under the standard, fair value measurements are separately disclosed by level within the fair value hierarchy. ASC 820 applies when assets or liabilities in the financial statements are to be measured at fair value but does not require additional use of fair value beyond the requirements in other accounting principles.

Derivatives are considered a Level 3 fair values. The fair values are determined through Level 3 inputs of the fair value hierarchy as defined in ASC 820 “Fair value measurements and disclosures”. Level 3: Unobservable inputs that are not corroborated by market data and that are significant to the fair value of the assets or liabilities.

s) Fair value option: In February, 2007, the FASB issued ASC 825, “Financial Instruments,” which permits companies to report certain financial assets and financial liabilities at fair value. ASC 825 was effective for the Company as of January 1, 2008 at which time the Company could elect to apply the standard prospectively and measure certain financial instruments at fair value. The Company evaluated the guidance contained in ASC 825 and elected not to report any existing financial assets or liabilities at fair value that are not already reported at fair value, therefore the adoption of the statement had no impact on its financial position and results of operations. The Company retains the ability to elect the fair value option for certain future assets and liabilities acquired under this pronouncement.

t) Accounting for Revenue and Expenses: Revenue is recorded when services are rendered, the Company has a signed charter agreement or other evidence of an arrangement, the price is fixed or determinable, and collection is reasonably assured. A voyage charter involves the carriage of a specific amount and type of cargo from specific load port(s) to specific discharge port(s), subject to various cargo handling terms, in return for payment of an agreed upon freight rate per ton of cargo. A time charter involves placing a vessel at the charterers’ disposal for a period of time during which the charterer uses the vessel in return for the payment of a specified daily hire rate. Short period charters for less than three months are referred to as spot charters. Time charters extending three months to a year are generally referred to as medium term charters. All other time charters are considered long term. Voyage revenues for the transportation of cargo are recognized ratably over the estimated relative transit time of each voyage. A voyage is deemed to commence when a vessel is available for loading of its next fixed cargo and is deemed to end upon the completion of the discharge of the current cargo. Revenues from time chartering of vessels are accounted for as operating leases and are thus recognized on a straight line basis as the average revenue over the rental periods of such charter agreements, as service is provided. Voyage expenses, primarily consisting of port, canal and bunker expenses that are unique to a particular charter, are paid for by the charterer under time charter arrangements or by the Company under voyage charter arrangements, except for commissions, which are always paid for by the Company, regardless of charter type. All voyage and vessel operating expenses are expensed as incurred, except for commissions. Commissions are deferred over the related voyage charter period to the extent revenue has been deferred since commissions are earned as the Company's revenues are earned. Probable losses on voyages in progress are provided for in full at the time such losses can be estimated.

u) Profit Sharing Arrangements: From time to time, the Company has entered into profit sharing arrangements with its charterers, whereby the Company may have received additional income at an agreed percentage of net earnings earned by such charterer, where those earnings are over the base rate of hire and settled periodically during the term of the charter agreement. Revenues generated from the profit sharing arrangements are recorded in the period they are earned.

v) Repairs and Maintenance: All repair and maintenance expenses, including major overhauling and underwater inspection expenses, are charged against income as incurred and are included in vessel operating expenses in the accompanying consolidated statements of operations.

w) Stock-Based Compensation: Following the provisions of ASC 718, "Compensation- Stock Compensation" the Company recognizes all share-based payments to employees, including grants of employee stock options, in the consolidated statements of operations based on their fair values on the grant date. Compensation cost on stock-based awards with graded vesting is recognized on an accelerated basis as though each separately vesting portion of the award was in substance, a separate award.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

x) Earnings/(Losses) per Share: Basic earnings/(losses) per share are computed by dividing net income (loss) by the weighted average number of common shares outstanding during the periods presented. Diluted earnings per share reflect the potential dilution that would occur if securities or other contracts to issue common stock were exercised. Dilution has been computed by the treasury stock method whereby all of the Company's dilutive securities (warrants, options and restricted shares) are assumed to be exercised and the proceeds used to repurchase common shares at the weighted average market price of the Company's common stock during the relevant periods. The incremental shares (the difference between the number of shares assumed issued and the number of shares assumed purchased) are included in the denominator of the diluted earnings/(losses) per share computation unless such inclusion would be anti-dilutive.

y) Segment Reporting: The Company reports financial information and evaluates its operations by total charter revenues. The Company does not have discrete financial information to evaluate the operating results for each type of charter. Although revenue can be identified for these types of charters, management does not identify expenses, profitability or other financial information for these charters. As a result, management, including the chief operating decision makers, review operating results solely by revenue per day and operating results of the fleet and thus the Company has determined that it operates under one reportable segment. Furthermore, when the Company charters a vessel to a charterer, the charterer is free to trade the vessel worldwide and, as a result, the disclosure of geographic information is impracticable.

z) Subsequent Events: The Company evaluates subsequent events or transactions up to the date in which the financial statements are issued according to the requirements of ASC 855.

aa) Convertible Debt Instruments: The Company evaluates and accounts for conversion options embedded in its convertible instruments in accordance with accounting standards for “Accounting for Derivative Instruments and Hedging Activities.” Accounting standards generally provides three criteria that, if met, require companies to bifurcate conversion options from their host instruments and account for them as free standing derivative financial instruments. These three criteria include circumstances in which (a) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract, (b) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value under otherwise applicable generally accepted accounting principles with changes in fair value reported in earnings as they occur, and (c) a separate instrument with the same terms as the embedded derivative instrument would be considered a derivative instrument. Professional standards also provide an exception to this rule when the host instrument is deemed to be conventional as defined under professional standards as “The Meaning of

Conventional Convertible Debt Instrument." The Company accounts for convertible instruments (when it has determined that the embedded conversion options should not be bifurcated from their host instruments) in accordance with professional standards when "Accounting for Convertible Securities with Beneficial Conversion Features," as those professional standards pertain to "Certain Convertible Instruments."

Accordingly, the Company records, when necessary, discounts to convertible notes for the intrinsic value of conversion options embedded in debt instruments based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note. Debt discounts under these arrangements are amortized over the term of the related debt to their earliest date of redemption. The Company also records when necessary deemed dividends for the intrinsic value of conversion options embedded in preferred shares based upon the differences between the fair value of the underlying common stock at the commitment date of the note transaction and the effective conversion price embedded in the note.

ASC 815-40 provides that, among other things, generally, if an event is not within the entity's control could or require net cash settlement, then the contract shall be classified as an asset or a liability.

The Company has determined there are derivative liabilities as of December 31, 2017. As of December 31, 2016, was deemed immaterial to the financial statements.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

The following assumptions were used in the Black-Scholes option-pricing model to determine the fair value of the derivative liabilities at December 31, 2017:

Market value of common stock on measurement date	$0.0001
Discount	35%-54%
Risk free interest rate (1)	2.40%
Expected life in years	0.44 - 1 year
Expected volatility (2)	711.17%
Expected dividend yield (3)	None

(1) The risk-free interest rate was determined by management using the applicable Treasury Bill as of the measurement date.
(2) The historical trading volatility was determined by calculating the volatility of the Company's stock at December 31, 2017
(3) The Company does not expect to pay a dividend in the foreseeable future.

bb) Recent Accounting Pronouncements:

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers: Topic 606, or ASU 2014-09, to supersede nearly all existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Adoption of ASU 2014-09 was initially required for fiscal and interim reporting periods beginning after December 15, 2016 using either of two methods: (i) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (ii) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined per ASU 2014-09.

In February 2015, the FASB issued new guidance to improve consolidation guidance for legal entities ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis), effective for fiscal years beginning after December 15, 2015 and interim periods within those years and early adoption is permitted. The new standard is intended to improve targeted areas of the consolidation guidance for legal entities such as limited partnerships, limited liability corporations, and securitization structures. The amendments in the ASU affect the consolidation evaluation for reporting organizations. In addition, the amendments in this ASU simplify and improve current GAAP by reducing the number of consolidation models. Adoption of ASU 2015-02 did not have a material impact on the Company's consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01 "Income Statement-Extraordinary and Unusual Items: Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items". The concept of extraordinary items is removed and instead items that are both unusual in nature and infrequently occurring should be presented within income from continuing operations or disclosed in notes to financial statements because those items satisfy the conditions for an item that is unusual in nature or infrequently occurring. The new accounting guidance is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2015. Early application is permitted. Companies have the option to apply the amendments of ASU No. 2015-01 either prospectively or retrospectively. Adoption of ASU 2015-01 did not have a material impact on the Company's consolidated financial statements.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

In April 2015, FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, to simplify presentation of debt issuance costs by requiring that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The ASU does not affect the recognition and measurement guidance for debt issuance costs. For public companies, the ASU is effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early application is permitted. Adoption of ASU 2015-03 did not have a material impact on the Company’s results of operations, cash flows or financial condition.

In August 2015, FASB issued ASU No. 2015-14, Revenue from Contracts with Customers - Deferral of the Effective Date: Topic 606, or ASU 2015-14, that deferred the effective date of ASU 2014-09 by one year. Application of the new revenue standard is permitted for fiscal and interim reporting periods beginning after December 15, 2016 and required for fiscal and interim reporting periods beginning after December 15, 2017. The Company is currently evaluating the impact of the adoption of ASU 2014-09. The Company will be required to make additional disclosures under the new guidance. However, at this time, the Company does not expect adoption of ASU 2014-09 to have a material impact on its consolidated financial statements.

In July 2015, FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory: Topic 330, or ASU 2015-11. Topic 330 previously required an entity to measure inventory at the lower of cost or market. Market could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. ASU 2015-11 requires that inventory measured using either the first-in-first-out (FIFO) or average cost method now be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The Company adopted ASU 2015-11 at the beginning of the first quarter of 2017. Adoption of ASU 2015-11 did not have a material impact on the Company’s consolidated financial statements.

In November 2015, FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes: Topic 740, or ASU 2015-17. Current GAAP requires the deferred taxes for each jurisdiction to be presented as a net current asset or liability and net noncurrent asset or liability. This requires a jurisdiction-by-jurisdiction analysis based on the classification of the assets and liabilities to which the underlying temporary differences relate, or, in the case of loss or credit carryforwards, based on the period in which the attribute is expected to be realized. Any valuation allowance is then required to be allocated on a pro rata basis, by jurisdiction, between current and noncurrent deferred tax assets. The new guidance requires that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as noncurrent on the balance sheet. As a result, each jurisdiction will now only have one net noncurrent deferred tax asset or liability. The guidance does not change the existing requirement that only permits offsetting within a jurisdiction. Adoption of ASU 2015-17 did not have a material impact on the Company's consolidated financial statements.

In February 2016, FASB issued ASU No. 2016-02, Leases: Topic 842, or ASU 2016-02, that replaces existing lease guidance. The new standard is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet. Under the new guidance, leases will continue to be classified as either finance or operating, with classification affecting the pattern of expense recognition in the Consolidated Statements of Operations. Lessor accounting is largely unchanged under ASU 2016-02. Adoption of ASU 2016-02 is required for fiscal reporting periods beginning after December 15, 2018, including interim reporting periods within those fiscal years with early adoption being permitted. The new standard is required to be applied with a modified retrospective approach to each prior reporting period presented with various optional practical expedients. While the Company expects adoption to lead to a material increase in the assets and liabilities recorded on its Consolidated Balance Sheet, the Company is still evaluating the overall impact on its consolidated financial statements.

In August 2016, FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, or ASU 2016-15. The updated guidance clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. Adoption of ASU 2016-15 is required for fiscal reporting periods beginning after December 15, 2017, including interim reporting periods within those fiscal years with early adoption being permitted. The Company does not expect the adoption of ASU 2016-15 to have a material impact on its consolidated financial statements.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

In November 2016, FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, or ASU 2016-18, which amends ASC 230 to add or clarify guidance on the classification and presentation of restricted cash in the statement of cash flows. The amended guidance requires that amounts that are deemed to be restricted cash and restricted cash equivalents be included in the cash and cash-equivalent balances in the statement of cash flows. A reconciliation between the consolidated balance sheet and the statement of cash flows must be disclosed when the consolidated balance sheet includes more than one-line item for cash, cash equivalents, restricted cash, and restricted cash equivalents. The guidance also requires that changes in restricted cash and restricted cash equivalents that result from transfers between cash, cash equivalents, and restricted cash and restricted cash equivalents should not be presented as cash flow activities in the statement of cash flows. An entity with a material balance of amounts generally described as restricted cash and restricted cash equivalents must disclose information about the nature of the restrictions. Adoption of ASU 2016-18 is required for fiscal reporting periods beginning after December 15, 2017, including interim reporting periods within those fiscal years with early adoption being permitted. The Company does not expect the adoption of ASU 2016-18 to have a material impact on its consolidated financial statements.

Any new accounting standards, not disclosed above, that have been issued or proposed by FASB that do not require adoption until a future date are not expected to have a material impact on the financial statements upon adoption.

3. Going Concern

As a result of the historically low charter rates for drybulk vessels which have been affecting the Company for over eight years, and the resulting material adverse impact on the Company’s results from operations, the accompanying consolidated financial statements have been prepared on a going concern basis. The Company has incurred net losses of $7,121, $20,511and $52,949 during the years ended December 31, 2017, 2016 and 2015, respectively. The Company’s cash flow projections for 2018, indicate that cash on hand will not be sufficient to cover debt repayment as of December 31, 2017, and operating expenses and capital expenditure requirements for at least twelve months from the balance sheet date. As of December 31, 2017, and 2016, the Company had working capital deficits of $40,216 and $35,715, respectively. All of the above raises substantial doubt regarding the Company’s ability to continue as a going concern. Management plans to continue to provide for its capital requirements by issuing additional equity securities and debt in addition to executing their business plan. The Company’s ability to continue as a going concern is dependent upon its ability to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal course of business operations when they come due and to generate profitable operations in the future.

On February 22, 2014, the Company and certain of its subsidiaries entered into terms with the National Bank of Greece ("NBG") for settlement of its obligations arising from the loan agreement with NBG. Pursuant to the terms, NBG agreed to accept a cash payment of $22,000 no later than December 31, 2014, in full and final settlement of all of the Company's obligations to NBG and NBG would forgive the remaining outstanding balance of approximately $4,700. On September 17, 2014, the Company made a payment of $2,700 to reduce outstanding indebtedness with NBG. On September 24, 2014, the Company sold the M/V Free Impala, a 1997-built, 24,111 dwt Handysize dry bulk carrier for a gross sale price of $3,600 and the vessel was delivered to her new owners. Subsequently, the amount of $3,300 had been used to reduce outstanding indebtedness with NBG, which had a mortgage on the vessel. The agreed settlement of the Company's obligations, arising from the loan agreement with NBG mentioned above, was not realized and negotiations have resumed for a new agreement. On June 18, 2015, the Company received from NBG a reservation of rights letter stating that the Bank may take any actions and may exercise all of their rights and remedies referred in the security documents. In December 2017, the Company received notification from NBG that the Company has not paid the aggregate amount of $25,788 constituting repayment installments, accrued loan and default interest due on December 15, 2017.

If the Company is not able to reach an agreement with NBG, its standalone lender, this could lead to the acceleration of the outstanding debt under its debt agreement. The Company's failure to satisfy its covenants under its debt agreement and any consequent acceleration of its outstanding indebtedness would have a material adverse effect on the Company's business operations, financial condition and liquidity.

Generally accepted accounting principles require that long-term debt be classified as a current liability when a covenant violation gives the lender the right to call the debt at the balance sheet date, absent a waiver. As a result of the actual breach existing under the Company's credit facility with NBG (Note 9) acceleration of such debt by its lender could result. Accordingly, as of December 31, 2017, the Company is required to reclassify its long-term debt as current liability on its consolidated balance sheet since the Company has not received waiver in respect to the breach discussed above.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

The Company is currently exploring several alternatives aiming to manage its working capital requirements and other commitments, including offerings of securities through structured financing agreements (Note 8), disposition of certain vessels in its current fleet (Note 5) and additional reductions in operating and other costs.

The consolidated financial statements as of December 31, 2017, were prepared assuming that the Company would continue as a going concern despite its significant losses and working capital deficit. Accordingly, the financial statements did not include any adjustments relating to the recoverability and classification of recorded asset amounts, the amounts and classification of liabilities, or any other adjustments that might result in the event the Company is unable to continue as a going concern, except for the classification of all debt as current.

4. Related Party Transactions

Managers

The vessels owned and the vessels sold and leased back by the Company receive management services from the pursuant to ship management agreements between each of the subsidiaries and Free Bulkers S.A. and OpenSeas Maritime S.A., “the Managers”.

Each of the Company’s subsidiaries pays, as per its ship management agreement with Free Bulkers and OpenSeas Maritime, a monthly management fee of $19 (on the basis that the $/Euro exchange rate is 1.30 or lower; if on the first business day of each month the $/Euro exchange rate exceeds 1.30 then the management fee payable will be increased for the month in question, so that the amount payable in $ will be the equivalent in Euro based on 1.30 $/Euro exchange rate) plus a fee of $400 per day (not expressed in thousands) for superintendent attendance and other direct expenses.

The Company also pays the Managers a fee equal to 1.25% of the gross freight or hire from the employment of the Company’s vessels. In addition, the Company pays a 1% commission on the gross purchase price of any new vessel acquired or the gross sale price of any vessel sold by the Company with the assistance of the Managers.

The Company also pays, as per its services agreement with Free Bulkers, a monthly fee of $136 until May 31, 2017 (on the basis that the $/Euro exchange rate is 1.35 or lower; if on the last business day of each month the $/Euro exchange rate exceeds 1.35 then the service fee payable will be adjusted for the following month in question, so that the amount payable in dollars will be the equivalent in Euro based on 1.35 $/Euro exchange rate) as compensation for services related to accounting, financial reporting, implementation of Sarbanes-Oxley internal control over financial reporting procedures and general administrative and management services plus expenses.

On June 1, 2017, the Company entered into a management services agreement with Prodigy Inc., “the Manager”, for the provision of financial services, including all of our accounting, financial reporting and internal controls, and other back-office services, as well as the provision of use of space for the Company’s offices at 20, Amerikis St., 10671, Athens, Greece. Our Chairman, Chief Executive Officer and President, Ion G. Varouxakis, is a shareholder of Prodigy Inc.

As of June 1, 2017, Free Bulkers is no longer required to provide any of the management services, except for those concerning the ship management agreement with M/V Free Neptune and the Company is no longer required to pay any remuneration, fees, bonuses or premises fee as of June 1, 2017 and beyond.

On September 26, 2016, the Company sold to unrelated third parties the M/V Free Maverick, a 1998-built, 23,994 dwt Handysize dry bulk carrier for a gross sale price of $1,925. As a result of the sale the Company recognized a loss of $277 (Note 5). In this respect, the Company paid Free Bulkers $19 relating to the sale of the M/V Free Maverick during the year ended December 31, 2016. In addition, the Company has incurred commission expenses relating to its commercial agreement with the Managers amounting to $nil, $6 and $35 for the year ended December 31, 2017, 2016 and 2015, respectively, included in “Commissions” in the accompanying consolidated statements of operations.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

On May 20, 2015, the M/V Free Hero, 1995-built, 24,318 dwt Handysize dry bulk carrier and the M/V Free Goddess, 1995-built, 22,051 dwt Handysize dry bulk carrier, were sold for a gross sale price of $5,500 each, and the Company's subsidiaries have entered into long-term bareboat agreements for such vessels with purchase options at a daily hire rate of $1,100 per vessel. The vessels have been renamed to Fiorello and Figaro, respectively.

On June 15, 2016, the bareboat hire agreement in connection with the M/V Fiorello was terminated. Subsequent to the termination of the hire, the vessel was sold for a gross sale price of $1,490 with the sale proceeds being applied towards obligations to the Bareboat Owners of the vessel and trade creditors (Note 6).

On September 30, 2017, the bareboat hire agreement in connection with the M/V Figaro was terminated. Subsequent to the termination of the hire, the vessel was sold to unrelated third parties. The Company realized the amount of $1,924 as gain on settlement of liability in the accompanying consolidated statement of operations for the year ended December 31, 2017, (Note 6).

Fees and expenses charged by the Managers and the Manager are included in the Company's consolidated financial statements in "Management and other fees to a related party," "General and administrative expenses," "Operating expenses," and "Gain on sale of vessel". The total amounts charged for the year ended December 31, 2017, 2016, and 2015 amounted to $1,431 ($398 of management fees, $1,031 of services fees, $nil of superintendent fees and $2 for other expenses), $2,344 ($702 of management fees, $1,635 of services fees, $0 of superintendent fees and $7 for other expenses) and $2,800 ($1,070 of management fees, $1,635 of services fees, $88 of superintendent fees and $7 for other expenses), respectively.

The balance due from the Managers and the Manager as of December 31, 2017 and December 31, 2016 was $nil. The amount paid to the Managers and Manager for office space during the year ended December 31, 2017, 2016 and 2015 was $51, $139 and $140, respectively, and is included in "General and administrative expenses" in the consolidated statements of operations. The balance due to the Managers and the Manager as December 31, 2017 and December 31, 2016 was $3,280 and $2,107, respectively, and is included in the "Management and other fees to a related party" in the consolidated statements of operations.

5. Vessels, net

	Vessels Cost	Accumulated Depreciation	Net Book Value
December 31, 2014	$88,078	$ (25,768)	$62,310
Depreciation	—	(3,585)	(3,585)
Disposal of vessels	(42,674)	13,145	(29,529)
Leased vessels	7,000	—	7,000
Vessel impairment charge	(18,891)	—	(18,891)
December 31, 2015	$33,513	$ (16,208)	$17,305
Depreciation	—	(1,938)	(1,939)
Disposal of vessels	(18,915)	16,956	(1,959)
Leased vessels	(7,000)	—	(7,000)
Vessel impairment charge	(4,286)		(4,286)
December 31, 2016	$3,312	$ (1,190)	$2,122
Depreciation	—	(113)	(113)
December 31, 2017	$3,312	$ (1,303)	$2,009

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

Vessels disposed during the year ended December 31, 2015.

On May 20, 2015, the M/V *Free Hero*, 1995-built, 24,318 dwt Handysize dry bulk carrier and the M/V *Free Goddess*, 1995-built, 22,051 dwt Handysize dry bulk carrier, have been sold for a gross sale price of $5,500 each, and the Company's subsidiaries have entered into long-term bareboat agreements for such vessels with purchase options at a daily hire rate of $1,100 per vessel. The vessels have been renamed to M/V *Fiorello* and M/V *Figaro*, respectively (Note 6). As a result of the sale of the M/V *Free Hero* and the M/V *Free Goddess* the Company recognized a gain of $950 and a loss of $8,571 in the accompanying consolidated statement of operations for the year ended December 31, 2015, respectively.

As of December 31, 2015, the Company performed an impairment assessment of its long-lived assets (M/V *Free Maverick* and M/V *Free Neptune*) by comparing the undiscounted net operating cash flows for each vessel to its respective carrying value. The significant factors and assumptions the Company used in each future undiscounted net operating cash flow analysis included, among others, operating revenues, commissions, off-hire days, dry-docking costs, operating expenses and management fee estimates. Revenue assumptions were based on contracted time charter rates up to the end of life of the current contract of each vessel as well as the ten-year historical average time charter rates for the remaining life of the vessel after the completion of the current contracts. In addition, the Company used an annual operating expenses escalation factor and an estimate of off hire days. All estimates used and assumptions made were in accordance with the Company's internal budgets and historical experience of the shipping industry. The Company, as a result of the unprecedented adverse market conditions the dry bulk industry faced and the substantial decline in the vessel market values, concluded to recognize an impairment charge of $18,891 for the M/V Free Maverick during the year ended December 31, 2015, in the accompanying consolidated statement of operations.

Vessels disposed during the year ended December 31, 2016.

On September 26, 2016, the Company sold to unrelated third parties the M/V Free Maverick, a 1998-built, 23,994 dwt Handysize dry bulk carrier for a gross sale price of $1,925. As a result of the sale the Company recognized a loss of $277. In this respect, the Company paid the Managers $19 relating to the sale of the M/V Free Maverick during the year ended December 31, 2016.

As of December 31, 2016, the Company performed an impairment assessment of its long-lived asset M/V Free Neptune by comparing the undiscounted net operating cash flows for the vessel to its respective carrying value. The significant factors and assumptions the Company used in each future undiscounted net operating cash flow analysis included, among others, operating revenues, commissions, off-hire days, dry-docking costs, operating expenses and management fee estimates. Revenue assumptions were based on contracted time charter rates up to the end of life of the current contract of each vessel as well as the ten-year historical average time charter rates for the remaining life of the vessel after the completion of the current contracts. In addition, the Company used an annual operating expenses escalation factor and an estimate of off hire days. All estimates used and assumptions made were in accordance with the Company’s internal budgets and historical experience of the shipping industry. The Company, as a result of the adverse market conditions the dry bulk industry faces and the substantial decline in the vessel market values, recognized an impairment charge of $4,286 for the M/V Free Neptune during the year ended December 31, 2016, in the accompanying consolidated statement of operations.

Vessels disposed during the year ended December 31, 2017.

During the year ended December 31, 2017, there were no vessel disposals.

As of December 31, 2017, the Company did not perform an impairment assessment of its long-lived asset, M/V Free Neptune since the vessel’s carrying value (Note 5) was below her scrap value of $2,756.

6. Options Advance Payments- Purchase of Leased Vessels

On May 20, 2015, the M/V Free Hero, (1995-built, 24,318 dwt) and the M/V Free Goddess, (1995-built, 22,051 dwt) both Handysize dry bulk carriers, were sold for a gross sale price of $5,500 each payable in tranches, with certain conditions precedent, and a seller’s credit of $4,500 per vessel. An amount of $725 of the sales price remains payable by the new owners. The vessels have been renamed M/V Fiorello and M/V Figaro, respectively. Concurrently, two of the Company’s subsidiaries entered five-year bareboat charter agreements with the new owners of these two vessels at a daily hire rate of $1,100 per vessel (not expressed in thousands) with purchase options at any time up to May 20, 2020. The sellers’ credit of $ 9,000 in the aggregate was agreed to be an Options Advance Payment of $ 4,500 per vessel to be netted against any of the Company’s options’ purchase prices under the bareboat charter agreement and any rightful claim of the owners in case of default or breach by the Company of the bareboat agreements’ terms. On November 22, 2015, the owners of these two vessels exercised their put-option rights, pursuant to the terms of the bareboat charters. Consequently, the Company recognized, as a contractual obligation, an expense of additional $3,300 as part of the put-option price. As of December 31, 2015, the Company was in default as regards the execution of such put- option as well as the charter hire payments due to the Owners for November and December 2015. Additionally, in accordance with U.S. GAAP, the Company, as of December 31, 2015, recognized a contingency loss of $2,000 on the repurchase commitment in the Options Advance Payment.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

On March 1, 2016, the Company received default notices from Fiorello Norge AS and Figaro Norge AS, owners of the M/V Fiorello and M/V Figaro, respectively, for the non-execution of the put option and the charter hires due in November, December 2015 and January, February 2016 under bareboat charters dated May 20, 2015. The Company started negotiations with the owners in order to find an amicable solution.

On June 15, 2016, the bareboat hire agreement in connection with the M/V Fiorello was terminated. Subsequent to the termination of the hire, the vessel was sold for a gross sale price of $1,490 with the sale proceeds being applied towards obligations to the bareboat Owners of the vessel and trade creditors.

On September 30, 2017, the bareboat hire agreement in connection with the M/V Figaro was terminated. Subsequent to the termination of the hire, the vessel was sold to unrelated third parties. The Company realized the amount of $1,924 as gain on settlement of liability in the accompanying consolidated statement of operations for the year ended December 31, 2017.

7. Accrued Liabilities

As of December 31, 2017, the amount of $9,985 in the consolidated balance sheet, includes the NBG loan accrued interest of $8,189 (Note 9). The balance amount of $1,796 relates to operating accruals.

8. Convertible Notes Payable/Derivative Liability

On January 6, 2016, the Company sold to Alpha Capital Anstalt, an accredited investor, a $250 convertible promissory note, which matures a year from issuance and accrues interest at the rate of 8% per annum. The investor is subject to the restrictions of Rule 144 promulgated under the 1933 Act and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is 60% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the Investor in cash, for 127.5% of any outstanding principal and interest remaining on the note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $153 plus accrued interest.

On May 9, 2016, the Company issued to Sichenzia Ross Friedman Ference LLP, a $137 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which note matures a year from issuance and accrues interest at the rate of 8% per annum. The holder, subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lower of (i) $3,000 and (ii) 60% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the holder in cash, for 127.5% of any outstanding principal and interest remaining on the note. On April 6, 2017, upon full conversion of the $137 convertible promissory note to Sichenzia Ross Friedman Ference LLP, dated May 9, 2016, plus accrued interest, the Company has issued in aggregate 822 shares of common stock to the note holder.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

On May 25, 2016, the Company sold to CROWN BRIDGE PARTNERS, LLC, a $55 convertible promissory note, which contained a $5 OID and matures a year from issuance and accrues interest at the rate of 6% per annum. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is 60% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior tr ading days. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 120% of principal plus interest (during days 1-60) to 145% of principal plus interest (during days 121-180). On September 14, 2017, upon full conversion of the $55 convertible promissory note to CROWN BRIDGE PARTNERS, LLC, dated May 25, 2016, plus accrued interest, the Company has issued in aggregate 2,079 shares of common stock to the note holder.

On June 27, 2016, the Company sold to MARINE PLUS S.A., a non-U.S. creditor, a $60 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which matures a year from issuance and accrues interest at the rate of 8% per annum. The note holder is subject to the restrictions of Regulation S promulgated under the 1933 Act, and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the investor in cash, for 127.5% of any outstanding principal and interest remaining on the note. On February 22, 2017, a debt purchase agreement was executed between APG Capital Holdings, LLC, a US investor, the buyer and Marine Plus S.A a non-US creditor, the seller of the outstanding $45 convertible promissory note issued on June 27, 2016. A replacement note was issued for the amount of the outstanding convertible promissory note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $18 plus accrued interest.

On July 11, 2016, the Company issued to Sichenzia Ross Ference Kesner LLP, a $100 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which note matures a year from issuance and accrues interest at the rate of 8% per annum. The holder, subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lower of (i) $100 and (ii) 60% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the holder in cash, for 127.5% of any outstanding principal and interest remaining on the note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $71 plus accrued interest.

On August 16, 2016, the Company sold to ANYLAND TRAVEL LTD, a non-U.S. creditor, a $30 convertible promissory note in connection with a debt settlement agjreement entered into, of the same aggregate amount of outstanding invoices, which matures a year from issuance and accrues interest at the rate of 8% per annum. The note holder is subject to the restrictions of Regulation S promulgated under the 1933 Act and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the investor in cash, for 127.5% of any outstanding principal and interest remaining on the note. On February 16, 2017, upon full conversion of the $30 convertible promissory note in connection with a debt settlement agreement entered into with ANYLAND TRAVEL LTD, plus accrued interest, the Company has issued in aggregate 3 shares of common stock to the note holder.

On August 16, 2016, the Company sold to M. DALAKOS - I. FASSOLIS - N. THEOFANOPOULOS & PARTNERS LAW FIRM, a non-U.S. creditor, a $108 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which matures a year from issuance and accrues interest at the rate of 8% per annum. The note holder is subject to the restrictions of Regulation S promulgated under the 1933 Act and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lower of (i) $232.5 and (ii) 75% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the holder in cash, for 127.5% of any outstanding principal and interest remaining on the note. On January and March 20, 2017, debt purchase agreements were executed between LG Capital Funding, LLC, a US investor, the buyer and M. DALAKOS - I. FASSOLIS - N. THEOFANOPOULOS & PARTNERS LAW FIRM, a non-US creditor, the seller of the $108 Reg. S convertible promissory note plus accrued interest, issued on August 16, 2016. Two replacement notes were issued on January and March 20, 2017, respectively, aggregating the total amount of the convertible promissory note outstanding plus accrued interest. As of December 31, 2017, the outstanding principal of the convertible promissory note is $2.6 plus accrued interest.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

On August 16, 2016, the Company sold to YES Properties Inc., a non-U.S. investor, a $35 convertible promissory note which matures a year from issuance and accrues interest at the rate of 8% per annum. The investor is subject to the restrictions of Regulation S promulgated under the 1933 Act, and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 60% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the fifteen prior trading days. Upon written notice, during the first 39 days the Company may prepay the note to 125% of principal plus interest. On March 15, 2017, a debt purchase agreement was executed between Yoshar Trading LLC, a US investor, the buyer and YES Properties Inc the seller of the $35 convertible promissory note, issued on August 16, 2016. As of December 31, 2017, the outstanding principal of the convertible promissory note is $31 plus accrued interest.

On November 21, 2016, the Company sold to APG Capital Holdings, LLC, a $32 convertible promissory note, which contained a 12% OID and matures a year from issuance and accrues interest at the rate of 12% per annum. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 65% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior trading days. Upon written notice, during the first six months the Company may prepay the note to 150% of principal plus interest. As of December 31, 2017, the outstanding principal of the convertible promissory note is $32 plus accrued interest.

On November 21, 2016, the Company sold to Crede CG III, Ltd, a $50 convertible promissory note, which matures a year from issuance and accrues interest at the rate of 8% per annum. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 65% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior trading days. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 118% of principal plus interest (during days 1-30) to 148% of principal plus interest (during days 151-180). As of December 31, 2017, the outstanding principal of the convertible promissory note is $50 plus accrued interest.

On November 30, 2016, the Company sold to, ADAR BAYS, LLC four 8% convertible notes of the Company, in the aggregate principal amount of $100 (with the First Note being in the amount of $25 and each of the following notes being in the amount of $25, which mature a year from issuance. The Company may reject the closing of the back-end financing by giving the buyer written notice at least 30 days prior to the 6-month anniversary of the First Note of its intent to reject the funding of the Back-End Notes. In such case the Buyer Notes and the Back-End Notes shall be terminated. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 58% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior trading days. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 118% of principal plus interest (during days 1-30) to 148% of principal plus interest (during days 151-180). On October 23, 2017, upon full conversion of the $25 convertible promissory note issued to ADAR BAYS, LLC, plus accrued interest, the Company has issued in aggregate 28,099 shares of common stock to the note holder. As of December 31, 2017, the outstanding principal of the second back end note is $18 plus accrued interest.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

On December 30, 2016, the Company sold to MTR3S Holding Ltd., a non-U.S. person, a $100 convertible promissory note, which matures a year from issuance and accrues interest at the rate of 8% per annum. The investor is subject to the restrictions of Regulation S promulgated under the 1933 Act, and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lesser of (i) $199,500 and (ii) 60% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion, provided, however, that the total number of shares of Common Stock issuable upon conversion of the note shall not exceed 225,225. Upon prior notice, the Company may prepay the Investor in cash, for 127.5% of any outstanding principal and interest remaining on the note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $85 plus accrued interest.

On January 20, 2017, the Company sold to LG CAPITAL FUNDING, LLC, a $45 convertible promissory note, which matures a year from issuance and accrues interest at the rate of 8% per annum. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 65% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company’s shares are traded, for the twenty prior trading days. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 118% of principal plus interest (during days 1-30) to 148% of principal plus interest (during days 151-180). As of December 31, 2017, the outstanding principal of the convertible promissory note is $45 plus accrued interest.

On January and March 20, 2017, debt purchase agreements were executed between LG Capital Funding, LLC, a US investor, the buyer and M. DALAKOS - I. FASSOLIS - N. THEOFANOPOULOS & PARTNERS LAW FIRM, a non-US creditor, the seller of the $108 Reg. S convertible promissory note plus accrued interest, issued on August 16, 2016. Two replacement notes were issued on January and March 20, 2017, respectively, aggregating the total amount of the convertible promissory note outstanding plus accrued interest.

On February 13, 2017, the Company sold to Jabro Funding Corp., a $93 12% interest bearing convertible note due in nine months subject to the restrictions of Rule 144 promulgated under the 1933 Act. One hundred eighty days following the date of this note, the holder has the right to convert all or any part of the outstanding and unpaid principal amount and accrued interest of the note into Company’s common stock, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the 58% of the average of the lowest three trading prices of the Company’s common stock on any trading day during the ten trading days prior to the conversion. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 115% of principal plus interest (during days 1-30) to 140% of principal plus interest (during days 151-180). As of December 31, 2017, the outstanding principal of the convertible promissory note is $8 plus accrued interest.

On February 16, 2017, the Company sold to CROWN BRIDGE PARTNERS, LLC, a $45 convertible promissory note, which contained a $5 original issue discount (OID) and matures a year from issuance and accrues interest at the rate of 6% per annum. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is 60% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company’s shares are traded, for the twenty prior trading days. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 120% of principal plus interest (during days 1-60) to 145% of principal plus interest (during days 121-180). On November 27, 2017, upon full conversion of the $45 convertible promissory note issued to CROWN BRIDGE PARTNERS, LLC, plus accrued interest, the Company has issued in aggregate 224,941shares of common stock to the note holder.

On February 16, 2017, upon full conversion of the $30 convertible promissory note in connection with a debt settlement agreement entered into with ANYLAND TRAVEL LTD, plus accrued interest, the Company has issued in aggregate 3 shares of common stock to the note holder.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

On February 17, 2017, the Company issued to Brighton Capital Ltd., a $68 convertible promissory note in connection with a debt settlement agreement entered into, of the same amount of outstanding invoice, which note matures a year from issuance and accrues interest at the rate of 8% per annum. The holder, subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lower of (i) $0.02 and (ii) 65% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the holder in cash, for 127.5% of any outstanding principal and interest remaining on the note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $68 plus accrued interest.

On February 22, 2017, a debt purchase agreement was executed between APG Capital Holdings, LLC, a US investor, the buyer and Marine Plus S.A a non-US creditor, the seller of the outstanding $45 convertible promissory note issued on June 27, 2016. A replacement note was issued for the amount of the outstanding convertible promissory note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $18 plus accrued interest.

On February 22, 2017, the Company sold to APG Capital Holdings, LLC, a $37 convertible promissory note, which contained a $3.6 original issue discount (OID) and matures a year from issuance and accrues interest at the rate of 10% per annum. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 46% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company’s shares are traded, for the twenty prior trading days. Upon written notice, during the first six months the Company may prepay the note to 150% of principal plus interest. As of December 31, 2017, the outstanding principal of the convertible promissory note is $15 plus accrued interest.

On February 24, 2017, the Company sold to OAKMORE OPPORUTNITY FUND I, LP, a $50 convertible promissory note, which matures a year from issuance and accrues interest at the rate of 8% per annum. The investor is subject to the restrictions of Rule 144 promulgated under the 1933 Act and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the 60% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the investor in cash, for 127.5% of any outstanding principal and interest remaining on the note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $36 plus accrued interest.

On March 14, 2017, the Company issued to SICHENZIA ROSS FERENCE KESNER LLP, a $47 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which note matures a year from issuance and accrues interest at the rate of 8% per annum. The holder, subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lower of (i) $0.06 and (ii) 60% of the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the holder in cash, for 127.5% of any outstanding principal and interest remaining on the note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $47 plus accrued interest.

On March 15, 2017, the Company sold to MARINE PLUS S.A., a non-U.S. investor, an $72 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which matures a year from issuance and accrues interest at the rate of 8% per annum. The note holder is subject to the restrictions of Regulation S promulgated under the 1933 Act, and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lower of (i) $0.403 (as adjusted for stock splits, stock dividends, stock combinations or other similar transactions) and (ii) the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the investor in cash, for 127.5% of any outstanding principal and interest remaining on the note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $72 plus accrued interest.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

On March 15, 2017, a debt purchase agreement was executed between Yoshar Trading LLC, a US investor, the buyer and YES Properties Inc the seller of the $35 convertible promissory note, issued on August 16, 2016. The purchase price for the note was the Buyer's payment of $40 to the seller. As of December 31, 2017, the outstanding principal of the convertible promissory note is $31 plus accrued interest.

On March 20, 2017, the Company sold to LG CAPITAL FUNDING, LLC, a $45 convertible promissory note, which matures a year from issuance and accrues interest at the rate of 8% per annum. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 65% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior trading days. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 118% of principal plus interest (during days 1-30) to 148% of principal plus interest (during days 151-180). As of December 31, 2017, the outstanding principal of the convertible promissory note is $45 plus accrued interest.

On March 22, 2017, the Company sold to E. STAVROPOULOS & CO O.E. "Hydra Travel", a non-U.S. investor, a $22 convertible promissory note in connection with a debt settlement agreement entered into, of the same aggregate amount of outstanding invoices, which matures a year from issuance and accrues interest at the rate of 8% per annum. The note holder is subject to the restrictions of Regulation S promulgated under the 1933 Act, and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the lower of (i) $0.2394 (as adjusted for stock splits, stock dividends, stock combinations or other similar transactions) and (ii) the lowest daily VWAP on any trading day during the twenty-one consecutive trading days prior to conversion. Upon prior notice, the Company may prepay the investor in cash, for 127.5% of any outstanding principal and interest remaining on the note. On June 8, 2017, upon full conversion of the $22 convertible promissory note issued to E. STAVROPOULOS & CO O.E. "Hydra Travel", plus accrued interest, the Company has issued in aggregate 1,220 shares of common stock to the note holder.

On March 28, 2017, the Company sold to CERBERUS FINANCE GROUP LTD, a non-U.S. investor, a $25 convertible promissory note which matures a year from issuance and accrues interest at the rate of 8% per annum. The investor is subject to the restrictions of Regulation S promulgated under the 1933 Act, and is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 60% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the fifteen prior trading days. Upon written notice, during the first 39 days the Company may prepay the investor in cash, for 125% of any outstanding principal and interest remaining on the note. As of December 31, 2017, the outstanding principal of the convertible promissory note is $25 plus accrued interest.

On April 6, 2017, upon full conversion of the $137 convertible promissory note to SICHENZIA ROSS FERENCE KESNER LLP, dated May 9, 2016, plus accrued interest, the Company has issued in aggregate 822 shares of common stock to the note holder.

On April 7, 2017, the Company sold to GS Capital Partners, a $30 convertible promissory note, which matures a year from issuance and accrues interest at the rate of 10% per annum. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price is 60% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior trading days. Upon written notice, during the first six months the Company may prepay the note at 150% of principal plus interest. On November 14, 2017, upon full conversion of the $30 convertible promissory note issued to GS Capital Partners, plus accrued interest, the Company has issued in aggregate 100,777 shares of common stock to the note holder.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

On July 21, 2017, the Company sold to L.G. CAPITAL FUNDING, LLC two 8% convertible notes of the Company, in the aggregate principal amount of $79 (each Note being in the amount of $39.5) which mature a year from issuance. The second such Note is initially paid by a same amount and maturity note collateralized by liquid assets of equal value, it is not repayable, except that if the first Note is redeemed within 6 months from issuance then the second note and its collateral note are automatically cancelled, and it can only be converted when the collateral is liquidated by the Company. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price for both Notes is 65% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior trading days. The second back end note has been cancelled. As of December 31, 2017, the outstanding principal of the convertible promissory note is $39.5 plus accrued interest.

On July 24, 2017 , the Company sold to, ADAR BAYS, LLC a 8% convertible note of the Company in the principal amount of $39.5 which matures a year from issuance paid for by a same amount and maturity note collateralized by liquid assets of equal value, it is not repayable, and it can only be converted when the collateral is liquidated by the Company. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time after 6 months from issuance to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price for both Notes is 65% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior trading days. As of December 31, 2017, the outstanding principal of the convertible promissory note is $39.5 plus accrued interest.

On August 17, 2017, the Company sold to L.G. CAPITAL FUNDING, LLC two 8% convertible notes of the Company, in the aggregate principal amount of $75 (each Note being in the amount of $37.5) which mature a year from issuance. The second such Note is initially paid by a same amount and maturity note collateralized by liquid assets of equal value, it is not repayable, except that if the first Note is redeemed within 6 months from issuance then the second note and its collateral note are automatically cancelled, and it can only be converted when the collateral is liquidated by the Company. The investor subject to the restrictions of Rule 144 promulgated under the 1933 Act, is entitled at any time to convert into common stock any portion of the outstanding and unpaid principal and accrued interest, provided that such conversion does not cause it to own more than 9.9% of the common stock of the Company, into shares of Common Stock. The conversion price for both Notes is 65% of the lowest trading price of the Common Stock as reported by the Trading Market on which the Company's shares are traded, for the twenty prior trading days. The second back end note has been cancelled. As of December 31, 2017, the outstanding principal of the convertible promissory note is $37.5 plus accrued interest.

On October 30, 2017, the Company sold to Power Up Lending Group, a $5 12% interest bearing convertible note due in nine months subject to the restrictions of Rule 144 promulgated under the 1933 Act. One hundred eighty days following the date of this note, the holder has the right to convert all or any part of the outstanding and unpaid principal amount and accrued interest of the note into Company’s common stock, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the 50% of the lowest one trading price of the Company’s common stock on any trading day during the twenty trading days prior to the conversion. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 115% of principal plus interest (during days 1-30) to 140% of principal plus interest (during days 151-180). As of December 31, 2017, the outstanding principal of the convertible promissory note is $5 plus accrued interest.

On November 1, 2017, the Company sold to Power Up Lending Group, a $58 12% interest bearing convertible note due in nine months subject to the restrictions of Rule 144 promulgated under the 1933 Act. One hundred eighty days following the date of this note, the holder has the right to convert all or any part of the outstanding and unpaid principal amount and accrued interest of the note into Company’s common stock, provided that such conversion does not cause it to own more than 4.99% of the common stock of the Company, into shares of Common Stock. The conversion price is the 58% of the average of the lowest three trading prices of the Company’s common stock on any trading day during the ten trading days prior to the conversion. Upon written notice, during the first six months the Company may prepay the note with amounts ranging from 115% of principal plus interest (during days 1-30) to 140% of principal plus interest (during days 151-180). As of December 31, 2017, the outstanding principal of the convertible promissory note is $58 plus accrued interest.

In connection with the issuance of the convertible instruments, the Company has recorded a derivative liability amounting to $1,624 and $nil as of December 31, 2017 and December 31, 2016, respectively.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

9. Bank Loan – current portion

As of December 31, 2016, and 2017, the Company's bank debt is as follows:

	NBG
December 31, 2015	$17,598
Additions	$—
Payments	$—
December 31, 2016	$17,598
Additions	$—
Payments	$—
December 31, 2017	$17,598

Lender	Vessel	Remaining Repayment Terms
National Bank of Greece	*M/V Free Neptune*	The loan matured on December 16, 2016.

The indicated vessel in the above table is pledged as collateral for the respective loan.

The Company's credit facility with NBG bears interest at LIBOR plus a margin of 4% and is secured by mortgage on the financed vessel (M/V *Free Neptune*) and assignments of vessel's earnings and insurance coverage proceeds. It also includes affirmative and negative financial covenants of the borrower, including maintenance of operating accounts, average cash balances to be maintained with the lending bank and minimum ratios for the fair value of the collateral vessel compared to the outstanding loan balance. The borrower is restricted under its respective loan agreement from incurring additional indebtedness, changing the vessel's flag without the lender's consent or distributing earnings.

The weighted average interest rate for the year ended December 31, 2017 and 2016 was 4%. Interest expense incurred under the above loan agreement amounted to $1,935, $1,467 and $1,237 for the years ended December 31, 2017, 2016 and 2015, respectively, and is included in "Interest and Finance Costs" in the accompanying consolidated statements of operations.

On February 22, 2014, the Company and certain of its subsidiaries entered into terms with the National Bank of Greece ("NBG") for settlement of its obligations arising from the loan agreement with NBG. Pursuant to the terms, NBG agreed to accept a cash payment of $22,000 no later than December 31, 2014, in full and final settlement of all of the Company's obligations to NBG and NBG would forgive the remaining outstanding balance of approximately $4,700. On September 17, 2014, the Company made a payment of $2,700 to reduce outstanding indebtedness with NBG. On September 24, 2014, the Company sold the M/V Free Impala, a 1997-built, 24,111 dwt Handysize dry bulk carrier for a gross sale price of $3,600 and the vessel was delivered to her new owners. Subsequently, the amount of $3,300 had been used to reduce outstanding indebtedness with NBG, which had a mortgage on the vessel. The agreed settlement of the Company's obligations, arising from the loan agreement with NBG mentioned above, was not realized and negotiations have resumed for a new agreement. On June 18, 2015, the Company received from NBG a reservation of rights letter stating that the Bank may take any actions and may exercise all of their rights and remedies referred in the security documents. In December 2017, the Company received notification from NBG that the Company has not paid the aggregate amount of $25,788 constituting repayment installments, accrued loan and default interest due on December 15, 2017.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

Loan Covenants

As of December 31, 2016, and December 31, 2017, the Company was in breach of certain of its financial covenants for its loan agreement with NBG, including the loan-to-value ratio, interest cover ratio, minimum liquidity requirements and leverage ratio. Thus, in accordance with guidance related to classification of obligations that are callable by the creditor, the Company has classified all of the related long-term debt amounting to $17,598 as current at December 31, 2017.

NBG loan agreement:

Average corporate liquidity: the Company is required to maintain an average corporate liquidity of at least $3,000;

Leverage ratio: the corporate guarantor's leverage ratio shall not at any time exceed 55%;

Ratio of EBITDA to net interest expense shall not be less than 3; and

Value to loan ratio: the fair market value of the financed vessels shall be at least (a) 115% for the period July 1, 2010 to June 30, 2011 and (b) 125% thereafter.

The covenants described above are tested annually on December 31st.

10. Commitments and Contingencies

The following table summarizes our contractually committed obligations and their maturity dates as of December 31, 2017:

(Dollars in thousands)	Payments Due by Period Total	Less than 1 year	2-year	3-year	4-year	5-year	More than 5 years
	(U.S. dollars in thousands)						
Services fees to the Manager	3,000	600	600	600	600	600	They will be renewed each anniversary date
Management fees to the Managers	1,595	228	228	228	228	228	455
Total obligations	$4,595	$828	$ 828	$ 828	$ 828	$ 828	$455

F-27

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

Claims

Various claims, suits, and complaints, including those involving government regulations and product liability, arise in the ordinary course of the shipping business. In addition, losses may arise from disputes with charterers, agents, insurance and other claims with suppliers relating to the operations of the Company's vessels. Currently, management is not aware of any such claims or contingent liabilities, which should be disclosed, or for which a provision should be established in the accompanying consolidated financial statements. The Company is a member of a protection and indemnity association, or P&I Club that is a member of the International Group of P&I Clubs, which covers its third party liabilities in connection with its shipping activities. A member of a P&I Club that is a member of the International Group is typically subject to possible supplemental amounts or calls, payable to its P&I Club based on its claim records as well as the claim records of all other members of the individual associations, and members of the International Group. Although there is no cap on its liability exposure under this arrangement, historically supplemental calls have ranged from 25%-40% of the Company's annual insurance premiums, and in no year have exceeded $1 million. The Company accrues for the cost of environmental liabilities when management becomes aware that a liability is probable and is able to reasonably estimate the probable exposure. Currently, management is not aware of any such claims or contingent liabilities, which should be disclosed, or for which a provision should be established in the accompanying consolidated financial statements. The Company's protection and indemnity (P&I) insurance coverage for pollution is $1 billion per vessel.

The M/V Free Goddess was hijacked by Somali pirates on February 7, 2012 while transiting the Indian Ocean eastbound. On October 11, 2012, we announced that all 21 crew members of the M/V *Free Goddess* were reported safe and well after the vessel's release by the pirates. At the time of the hijacking the vessel was on time charter in laden condition. Since the release from the pirates, the ex M/V Free Goddess, renamed to M/V Figaro, has been laying at the port of Salalah, Oman, undertaking repairs funded mostly by insurers. The repairs of the vessel were completed and notice of readiness was tendered to her Charterers for the resumption of the voyage. The Charterers repudiated the Charter and the Company accepted Charterers' repudiation and terminated the fixture. Cargo interests commenced proceedings before the local Omani Courts under the Bills of Lading for delivery of the cargo in Oman, which were rejected at the first instance and were appealed by Cargo interests. The appeal by Cargo interests was rejected by the Court. Concurrently with the above proceedings, Cargo interests have obtained favorable arbitration decisions and a UK High Court order against the former owner Adventure Five S.A. to deliver the cargo at the port of Salalah, Oman. Griffin Underwriting, The Kidnap and Ransom insurers of the M/V Free Goddess, have commenced action before the High Court in the UK against Adventure Five, Free Bulkers S.A. and the Company's CEO alleging damages. Those proceedings have been frozen by mutual agreement between the parties pending the conclusion of the ongoing settlement negotiations.

The Company is no longer the Bareboat Charterers of the M/V Figaro. On September 30, 2017, the bareboat hire agreement in connection with the M/V Figaro was terminated. Subsequent to the termination of the hire, the vessel was sold to unrelated third parties.

The outstanding balance of the Company's claims as of December 31, 2017, stands at $nil related to Company's insurance claims for vessel incidents arising in the ordinary course of business.

11. Loss per Share and Series A, B & C Warrants

The computation of basic earnings/loss per share is based on the weighted average number of common shares outstanding during the period, as adjusted to reflect the 60-to-1 reverse stock split, the 200-to-1 reverse stock split, the 5,000-to-1 reverse stock split and the 5,000-to-1 reverse split, effective on January 15, 2016, April 14, 2016, February 7, 2017 and February 6, 2018, respectively, on its issued and outstanding common stock.

The computation of the dilutive common shares outstanding does not include the 0.0000002908 Series C Warrants (adjusted to reflect the recent reverse split) outstanding as of December 31, 2017, as the average stock price during the year ended December 31, 2017 was less than their exercise price, thus resulting in an antidilutive effect.

FREESEAS INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(All amounts in thousands of United States Dollars, except for share and per share data)

Presented below is a table reflecting the activity in the Series A Warrants, Series B Warrants and Series C Warrants from January 1, 2015 through December 31, 2017:

	Series A Warrants	**Series B Warrants**	**Series C Warrants**	Total	**Exercise Price**
December 31, 2014	0.0000000444	0.0000000088	0.00000032	0.0000003732	
Warrants cashlessexercised	(0.0000000444)	(0.0000000088)	(0.0000000024)	(0.0000000556)	$58,500,000,000,000 (Series A&B)
December 31, 2015	—	—	0.0000003176	0.0000003176	$159,750,000,000,000 (Series C)
Warrants cashless exercised	—	—	(0.0000000268)	(0.0000000268)	
December 31, 2016	—	—	0.0000002908	0.0000002908	
Warrants cashless exercised	—	—	—	—	
December 31, 2017	—	—	0.0000002908	0.0000002908	

During the year ended December 31, 2017, there were no warrants cashless exercised.

The components of the denominator for the calculation of basic loss per share and diluted loss per share for the years ended December 31, 2017, 2016 and 2015, respectively, are as follows:

	For the year ended December 31, 2017	**For the year ended December 31, 2016**	**For the year ended December 31, 2015**

Numerator			
Net loss - basic and diluted	$ (7,121)	$ (20,511)	$ (52,949)
Basic earnings per share denominator:			
Weighted average common shares outstanding	144,922	5	—
Diluted earnings per share denominator:			
Weighted average common shares outstanding	144,922	5	—
Dilutive common shares:			
Options	—	—	—
Warrants	—	—	—
Restricted shares	—	—	—

Dilutive effect	Deferred income taxes	(734)	(93)	7
	Changes in operating assets and liabilities:			
	Accounts receivable	775	(1,751)	26
	Inventories	(14)	(198)	(88)
	Prepaid expenses and other current assets	(958)	(1,168)	(118)
	Other assets	1,293	(2,461)	(1,109)
	Accounts payable	201	1,210	1,219
	Accrued expenses	2,548	3,349	(713)
	Accrued wages and related liabilities	3,394	416	866
	Other current liabilities	257	420	31
	Deferred rent	4,363	5,206	1,742
	Other long-term liabilities	(184)	265	1,942
NET CASH PROVIDED BY OPERATING ACTIVITIES		41,258	13,584	12,924
INVESTING ACTIVITIES				
Purchases of marketable securities		(2,397)	—	—
Purchases of property and equipment		(32,117)	(28,515)	(16,194)
NET CASH USED IN INVESTING ACTIVITIES		(34,514)	(28,515)	(16,194)
FINANCING ACTIVITIES				
Promissory note		—	—	313
Proceeds from revolving credit facility		4,000	32,000	—
Payments on revolving credit facility		(36,000)	—	—
Deferred financing costs		(103)	(398)	—
		109,262	—	—

Proceeds from issuance of Class A common stock sold in initial public offering, net of underwriting discounts, commissions and offering costs			
Proceeds from issuance of Class B common stock	30	—	—
Member distributions	(11,125)	(27,070)	—
Employee withholding taxes related to net settled equity awards	(4,636)	—	—
NET CASH PROVIDED BY FINANCING ACTIVITIES	61,428	4,532	313
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	68,172	(10,399)	(2,957)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	2,677	13,076	16,033
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 70,849	$ 2,677	$ 13,076

Supplemental cash flow information and non-cash investing and financing activities are further described in the accompany notes.

See accompanying Notes to Consolidated Financial Statements.

Table of Contents

SHAKE SHACK INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except share and per share amounts)

Table of Contents

NOTE 1: NATURE OF OPERATIONS

Shake Shack Inc. was formed on September 23, 2014 as a Delaware corporation for the purpose of facilitating an initial public offering and other related transactions in order to carry on the business of SSE Holdings, LLC and its subsidiaries. Unless the context otherwise requires, references to "we," "us," "our," "Shake Shack" and the "Company" refer to Shake Shack Inc. and its subsidiaries, including SSE Holdings, LLC, which we refer to as "SSE Holdings." We operate and license Shake Shack restaurants ("Shacks"), which serve hamburgers, hot dogs, crinkle-cut fries, shakes, frozen custard, beer, wine and more. As of December 30, 2015, there were 84 Shacks in operation, system-wide, of which 44 were domestic company-operated Shacks, five were domestic licensed Shacks and 35 were international licensed Shacks.

Initial Public Offering

On February 4, 2015, we completed an initial public offering ("IPO") of 5,750,000 shares of our Class A common stock at a public offering price of $21.00 per share, which includes 750,000 shares issued pursuant to the underwriters' over-allotment option. We received $112,298 in proceeds, net of underwriting discounts and commissions, which we used to purchase newly-issued membership interests from SSE Holdings at a price per interest equal to the initial public offering price of our Class A common stock.

Organizational Transactions

In connection with the IPO, we completed the following transactions (the "Organizational Transactions"):

We amended and restated the limited liability company agreement of SSE Holdings ("LLC Agreement") to, among other things, (i) provide for a new single class of common membership interests in SSE Holdings ("LLC Interests"), (ii) exchange all of the membership interests of the then-existing holders of SSE Holdings' membership interests ("Original SSE Equity Owners") for LLC Interests and (iii) appoint Shake Shack as the sole managing member of SSE Holdings. See Note 11.

We amended and restated our certificate of incorporation to, among other things, (i) provide for Class B common stock with voting rights but no economic interests (where "economic interests" means the right to receive any distributions or dividends, whether cash or stock, in connection with common stock) and (ii) issue shares of Class B common stock to the Original SSE Equity Owners on a one -to-one basis with the number of LLC Interests they own. See Note 11.

We acquired, by merger, two entities that were owned by former indirect members of SSE Holdings ("Former SSE Equity Owners"), for which we issued 5,968,841 shares of Class A common stock as merger consideration (the "Mergers"). The only assets held by the two merged entities prior to the merger were 5,968,841 LLC Interests and a corresponding number of shares of Class B common stock. Upon consummation of the Mergers, we canceled the 5,968,841 shares of Class B common stock and recognized the 5,968,841 of LLC Interests at carrying value, as the Mergers are considered to be transactions between entities under common control.

Following the completion of the Organizational Transactions, we owned 33.3% of SSE Holdings. The SSE Holdings members subsequent to the Merger (the "Continuing SSE Equity Owners") owned the remaining 66.7% of SSE Holdings. As a result of the Organizational Transactions, we became the sole managing member of SSE Holdings and, although we had a minority economic interest in SSE Holdings, we had the sole voting power in, and control the management of, SSE Holdings. Accordingly, we consolidated the financial results of SSE Holdings and reported a non-controlling interest in our consolidated financial statements.

As the Organizational Transactions are considered transactions between entities under common control, the financial statements for periods prior to the IPO and Organizational Transactions have been adjusted to combine the previously separate entities for presentation purposes.

Table of Contents

Secondary Offering

In August 2015, we completed a secondary offering of 4,000,000 shares of our Class A common stock at a price of $60.00 per share. All of the shares sold in the offering were offered by affiliates of the Former SSE Equity Owners and certain of the Continuing SSE Equity Owners (the "Selling Stockholders"). We did not receive any proceeds from the sale of shares of Class A common stock offered by the Selling Stockholders. The shares sold in the offering consisted of (i) 844,727 existing shares of Class A common stock held by the Former SSE Equity Owners and (ii) 3,155,273 newly-issued shares of Class A common stock issued in connection with the redemption of 3,155,273 LLC Interests by the Continuing SSE Equity Owners that participated in the offering. Simultaneously, and in connection with the redemption, 3,155,273 shares of Class B common stock were surrendered by the Continuing SSE Equity Owners and canceled. Additionally, in connection with the redemption, we received 3,155,273 LLC Interests, increasing our total ownership interest in SSE Holdings.

USC Merger

Pursuant to a Stockholders Agreement, dated as of February 4, 2015, as amended, by and among Daniel H. Meyer and his affiliates (the "Meyer Group") and other parties thereto, the Meyer Group has the right to cause all of the stock of Union Square Cafe Corp. ("USC") and Gramercy Tavern Corp. ('GT') to be converted into and exchanged for shares of our Class A common stock pursuant to a tax-free reorganization (each, a "Reorganization"). In December 2015, the Meyer Group exercised their right with respect to USC. The Reorganization was structured as a two-step merger, whereby (i) a newly-formed wholly-owned subsidiary of the Company merged with and into USC, then (ii) USC merged with and into the Company (the foregoing transactions are collectively referred to as the "USC Merger"). Prior to the USC Merger, USC owned 1,727,804 LLC Interests and an equivalent number of shares of our Class B common stock. In the USC Merger, (i) 1,727,804 shares of Class A common stock were issued to the stockholders of USC, with each stockholder receiving newly-issued shares of Class A common stock in an amount equivalent to the number of shares of USC held by such stockholders; (ii) 1,727,804 shares of Class B common stock held by USC were cancelled; and (iii) 1,727,804 LLC Interests held by USC were transferred to us.

As of December 30, 2015, we owned 54.6% of SSE Holdings and the Continuing SSE Equity Owners own the remaining 45.4% of SSE Holdings.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and include our accounts and the accounts of our subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to prior period amounts to conform to the current year presentation.

Fiscal Year

We operate on a 52/53 week fiscal year ending on the last Wednesday in December. Fiscal year 2015 contained 52 weeks and ended on December 30, 2015. Fiscal year 2014 contained 53 weeks and ended on December 31, 2014. Fiscal year 2013 contained 52 weeks ended on and December 25, 2013. Unless otherwise stated, references to years in this report relate to fiscal years.

Use of Estimates

The preparation of these consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates.

Table of Contents

Segment Reporting

We own and operate Shacks in the United States. We also have domestic and international licensed operations. Our chief operating decision maker (the "CODM") is our Chief Executive Officer. As the CODM reviews financial performance and allocates resources at a consolidated level on a recurring basis, we have one operating segment and one reportable segment.

Fair Value Measurements

We apply fair value accounting for all financial assets and liabilities and non-financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities that are required to be recorded at fair value, we assume the highest and best use of the asset by market participants in which we would transact and the market-based risk measurements or assumptions that market participants would use in pricing the asset or liability, such as inherent risk, transfer restrictions, and credit risk.

Assets and liabilities are classified using a fair value hierarchy, which prioritizes the inputs used to measure fair value into three levels, and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

* Level 1 - Quoted prices in active markets for identical assets or liabilities
* Level 2 - Observable inputs other than quoted prices in active markets for identical assets or liabilities, quoted prices for identical assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities
* Level 3 - Inputs that are both unobservable and significant to the overall fair value measurements reflecting an entity's estimates of assumptions that market participants would use in pricing the asset or liability

Cash and Cash Equivalents

Cash and cash equivalents consist primarily of cash on hand, deposits with banks, and short-term, highly liquid investments that have original maturities of three months or less. Cash equivalents are stated at cost, which approximates fair value. Cash equivalents consist primarily of money market funds.

Accounts Receivable

Accounts receivable consist primarily of receivables from landlords for tenant improvement allowances, receivables from our licensees for licensing revenue and related reimbursements, credit card receivables and vendor rebates. We evaluate the collectibility of our accounts receivable based on a variety of factors, including historical experience, current economic conditions and other factors.

Inventories

Inventories, which consist of food, beer, wine, other beverages and retail merchandise, are stated at the lower of cost or market with cost determined on a first-in, first-out basis. No adjustment is deemed necessary to reduce inventory to the lower of cost or market value due to the rapid turnover and high utilization of inventory.

Property and Equipment

Property and equipment is stated at historical cost less accumulated depreciation. Property and equipment is depreciated based on the straight-line method over the estimated useful lives of the assets, generally ranging from three to seven years for equipment, furniture and fixtures, and computer equipment and software. Leasehold improvements are depreciated over the shorter of their estimated useful life or the related lease life, generally ranging from 10 to 20 years. For leases with renewal periods at our option, we use the original lease term, excluding renewal option periods, to determine estimated useful lives.

Costs incurred when constructing Shacks are capitalized. The cost of repairs and maintenance are expensed when incurred. Costs for refurbishments and improvements that significantly increase the productive capacity or extend the useful life of the asset are capitalized. When assets are disposed of, the resulting gain or loss is recognized on the Consolidated Statements of Income (Loss).

We assess potential impairments to our long-lived assets, which includes property and equipment, whenever events or circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of an asset is measured by a comparison of the carrying amount of an asset group to its estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset group exceeds its estimated undiscounted future cash flows, an impairment charge is recognized as the amount by which the carrying amount of the asset exceeds the fair value of the asset. There were no impairment charges recorded in fiscal 2015, 2014 and 2013.

Deferred Financing Costs

Deferred financing costs incurred in connection with the issuance of long-term debt and establishing credit facilities are capitalized and amortized to interest expense based on the related debt agreements. Deferred financing costs are included in other assets on the Consolidated Balance Sheets.

Other Assets

Other assets consist primarily of long-term marketable securities, security deposits, transferable liquor licenses and certain custom furniture pre-ordered for future Shacks and yet to be placed in service.

The costs of obtaining non-transferable liquor licenses that are directly issued by local government agencies for nominal fees are expensed as incurred. The costs of purchasing transferable liquor licenses through open markets in jurisdictions with a limited number of authorized liquor licenses are capitalized as indefinite-lived intangible assets. Annual liquor license renewal fees are expensed over the renewal term. As of December 30, 2015 and December 31, 2014, indefinite-lived intangible assets relating to transferable liquor licenses totaled $701. We evaluate our indefinite-lived intangible assets for impairment annually during our fiscal fourth quarter, and whenever events or changes in circumstances indicate that an impairment may exist. When evaluating other intangible assets for impairment, we may first perform a qualitative assessment to determine whether it is more likely than not that an intangible asset group is impaired. If we do not perform the qualitative assessment, or if we determine that it is not more likely than not that the fair value of the intangible asset group exceeds its carrying amount, we calculate the estimated fair value of the intangible asset group. If the carrying amount of the intangible asset group exceeds the estimated fair value, an impairment charge is recorded to reduce the carrying value to the estimated fair value. In addition, we continuously monitor and may revise our intangible asset useful lives if and when facts and circumstances change.

Equity-based Compensation

Equity-based compensation expense is measured based on fair value. We recognize compensation expense on a straight-line basis over the requisite service period. For awards with graded-vesting features and service conditions only, compensation expense is recognized on a straight-line basis over the total requisite service period for the entire award. Equity-based compensation expense is included within general and administrative expenses on the Consolidated Statements of Income (Loss).

Leases

We lease all of our domestic company-operated Shacks, our home office and certain equipment under various non-cancelable lease agreements that expire on various dates through 2032. Generally, our real estate leases have initial terms ranging from 10 to 20 years and typically include two five-year renewal options. At the inception of each lease, we determine its classification as an operating or capital lease. All of our leases are classified as operating leases and typically provide for fixed minimum rent payments and/or contingent rent payments based upon sales in excess of specified thresholds. When the achievement of such sales thresholds are deemed to be probable, contingent rent is accrued in proportion to the sales recognized during the period. For operating leases that include rent holidays and rent escalation clauses, we recognize rent expense on a straight-line basis over the lease term from the date we take possession of the leased property. The difference between the straight-line rent amounts and amounts payable under the lease agreements is recorded as deferred rent and is included as rent expense in occupancy and related expenses on the Consolidated Statements of Income (Loss). Rent expense incurred before a Shack opens is recorded in pre-opening costs.

Once a domestic company-operated Shack opens, we record the straight-line rent expense and any contingent rent, if applicable, in occupancy and related expenses on the Consolidated Statements of Income (Loss).

Many of our leases also require us to pay real estate taxes, common area maintenance costs and other occupancy costs which are included in occupancy and related expenses on the Consolidated Statements of Income (Loss).

We expend cash for leasehold improvements to build out and equip our leased premises. We may also expend cash for structural additions made to leased premises. Generally, a portion of the leasehold improvements and building costs are reimbursed by our landlords as landlord incentives pursuant to agreed-upon terms in our lease agreements. If obtained, landlord incentives usually take the form of up-front cash, full or partial credits against our future minimum or contingent rents otherwise payable by us, or a combination thereof. When contractually due, we classify landlord incentives as deferred rent on the Consolidated Balance Sheets and amortize the landlord incentives on a straight-line basis over the lease term as a reduction of occupancy costs and related expenses or pre-opening costs on the Consolidated Statements of Income (Loss).

Revenue Recognition

Revenue consists of Shack sales and licensing revenue. Revenue from Shack sales are presented net of discounts and recognized when food and beverage products are sold. Sales tax collected from customers is excluded from Shack sales and the obligation is included in sales tax payable until the taxes are remitted to the appropriate taxing authorities. Revenue from our gift cards are deferred and recognized upon redemption. Licensing revenues include initial territory fees and ongoing licensing fees from all licensed Shacks. Initial territory fees are recorded as deferred revenue when received and proportionate amounts are recognized as revenue when a licensed Shack is opened and all material services and conditions related to the fee have been substantially performed. Ongoing licensing fees from these Shacks are based on a percentage of sales and are recognized as revenue as the fees are earned and become receivable from the licensee.

Income Taxes

We account for income taxes pursuant to the asset and liability method which requires the recognition of deferred income tax assets and liabilities related to the expected future tax consequences arising from temporary differences between the carrying amounts and tax bases of assets and liabilities based on enacted statutory tax rates applicable to the periods in which the temporary differences are expected to reverse. Any effects of changes in income tax rates or laws are included in income tax expense in the period of enactment. A valuation allowance is recognized if we determine it is more likely than not that all or a portion of a deferred tax asset will not be recognized.

Pre-Opening Costs

Pre-opening costs are expensed as incurred and consist primarily of legal fees, occupancy, manager and employee wages, travel and related training costs incurred prior to the opening of a Shack.

Advertising

The cost of advertising and promotions are expensed as incurred. Advertising and promotions costs amounted to $1,646, $1,166 and $794 in fiscal 2015, 2014 and 2013, respectively, and are included in general and administrative expense and other operating expenses on the Consolidated Statements of Income (Loss).

Recently Adopted Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2015-17, Balance Classification of Deferred Taxes ("ASU 2015-17"). ASU 2015-17 requires deferred tax liabilities and assets be classified as non-current in a classified statement of financial position. ASU 2015-17 is effective for reporting periods after December 15, 2016 and may be adopted either retrospectively or prospectively. Early adoption is permitted and we elected to early adopt this guidance as of December 30, 2015 and to apply the guidance retrospectively to all periods presented. Accordingly, we reclassified the prior period amount of $20 related to our deferred tax asset from current to non-current, resulting in an increase to the non-current deferred

Table of Contents

income tax asset for the same amount for that period. The application of this guidance affects classification only, and did not have a material effect on our consolidated financial position or results of operations.

Recently Issued Accounting Pronouncements

In March 2016, the FASB issued Accounting Standards Update No. 2016-04, Recognition of Breakage for Certain Prepaid Stored-Value Products ("ASU 2016-04"). ASU 2016-04 entitles a company to derecognize amounts related to expected breakage in proportion to the pattern of rights expected to be exercised by the product holder to the extent that it is probable a significant reversal of the recognized breakage amount will not subsequently occur. ASU 2016-04 is effective for reporting periods beginning after December 15, 2017 and is to be applied retrospectively. Early adoption is permitted. We are currently evaluating the impact ASU 2016-04 will have on our consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, Leases ("ASU 2016-02"). ASU 2016-02 establishes a new lease accounting model, that, for many companies, eliminates the concept of operating leases and requires entities to record assets and liabilities related to leases on the balance sheet for certain types of leases. ASU 2016-02 is effective for reporting periods beginning after December 15, 2018. Early adoption will be permitted for all entities. We are currently evaluating the impact that this new standard will have on our consolidated financial statements.

In January 2016, the FASB issued Accounting Standards Update No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities ("ASU 2016-01"). ASU 2016-01 requires: (i) equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (ii) simplification of the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (iii) elimination of the requirement for public entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (iv) public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (v) an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments; (vi) separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (vii) clarification that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets. ASU 2016-01 is effective for reporting periods beginning after December 15, 2017 and amendments should be applied by means of a cumulative-effect adjustment to the balance sheet at the beginning of the fiscal year of adoption. Early adoption is permitted, subject to certain conditions. We are currently evaluating the impact ASU 2016-01 will have on our consolidated financial statements.

In July 2015, the FASB issued Accounting Standards Update No. 2015-11, Simplifying the Measurement of Inventory ("ASU 2015-11"). Under ASU 2015-11 entities should measure inventory that is not measured using last-in, first-out (LIFO) or the retail inventory method, including inventory that is measured using first-in, first-out (FIFO) or average cost, at the lower of cost or net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. ASU 2015-11 is effective for reporting periods beginning after December 15, 2016 and is to be applied prospectively. The adoption of ASU 2015-11 is not expected to have a material effect on our consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update No. 2015-05, Customers' Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU 2015-05"). ASU 2015-05 provides guidance in evaluating whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the software license element of the arrangement should be accounted for as an acquisition of a software license. If the arrangement does not contain a software license, it should be accounted for as a service contract. ASU 2015-05 is effective for reporting periods beginning after December 15, 2015 and may be adopted either retrospectively or prospectively. The adoption of ASU 2015-05 will not have a significant impact on our consolidated financial statements.

Table of Contents

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU 2015-03"). ASU 2015-03 requires that debt issuance costs related to a recognized liability be presented on the balance sheet as a direct reduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected. ASU 2015-03 is effective for reporting periods beginning after December 15, 2015. The adoption of ASU 2015-03 will not have a significant impact on its consolidated financial statements.

In February 2015, the FASB issued Accounting Standards Update No. 2015-02, Consolidation ("ASU 2015-02"). ASU 2015-02 amends the existing guidance to: (i) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities; (ii) eliminate the presumption that a general partner should consolidate a limited partnership; (iii) affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships and (iv) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with requirements that are similar to those in Rule 2a-7 of the Investment Company Act of 1940 for registered money market funds. ASU 2015-02 is effective for reporting periods beginning after December 15, 2015. The adoption of ASU 2015-02 will not have a significant impact on its consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). ASU 2014-09 supersedes the existing revenue recognition guidance and clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. In August 2015, the FASB issued an update to ASU 2014-09 deferring the effective date for public entities, on a retrospective basis, to annual reporting periods beginning after December 15, 2017. Early adoption is permitted, subject to certain conditions. We are currently evaluating the impact ASU 2014-09 will have on our consolidated financial statements.

NOTE 3: FAIR VALUE MEASUREMENTS

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following tables present information about our financial assets and liabilities measured at fair value on a recurring basis as of December 30, 2015 and December 31, 2014, and indicate the classification within the fair value hierarchy. Refer to Note 2 for further information.

Cash, Cash Equivalents and Marketable Securities

The following tables summarize our cash, cash equivalents and marketable securities by significant investment categories as of December 30, 2015:

	December 30, 2015					
	Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Cash and Cash Equivalents	Marketable Securities
Cash	$70,816	$—	$—	$70,816	$70,816	$—
Level 1:						
Money market funds	33	—	—	33	33	—
Level 2:						
Corporate debt securities[1]	2,397	1	(12)	2,386	—	2,386
Total	$73,246	$1	$(12)	$73,235	$70,849	$2,386

(1) Corporate debt securities were measured at fair value using a market approach utilizing observable prices for identical securities or securities with similar characteristics and inputs that are observable or can be corroborated by observable market data.

Table of Contents

All investments that were in an unrealized loss position as of December 30, 2015 have been in a continuous loss position for less than 12 months. There were no investments in marketable securities as of December 31, 2014. Interest income related to our available-for-sale securities of $7 was included in interest expense, net on the Consolidated Statement of Income (Loss) for fiscal 2015. There were no realized gains or losses on available-for-sale securities for fiscal 2015. Net unrealized losses on available-for-sale securities totaling $11 for fiscal 2015 were included in other comprehensive loss on the Consolidated Statement of Comprehensive Income.

The following table summarizes the estimated fair value of our investments in marketable debt securities, accounted for as available-for-sale securities and classified by the contractual maturity date of the securities:

	December 30 2015
Due within one year	$ 275
Due after one year through 5 years	2,111
Due after 5 years through 10 years	—
Due after 10 years	—
Total	$ 2,386

We periodically review our marketable debt securities for other-than-temporary impairment. We consider factors such as the duration, severity and the reason for the decline in value, the potential recovery period and our intent to sell. We also consider whether (i) it is more likely than not that we will be required to sell the debt securities before recovery of their amortized cost basis, and (ii) the amortized cost basis cannot be recovered as a result of credit losses. As of December 30, 2015, the declines in the market value of our marketable securities investment portfolio are considered to be temporary in nature.

Other Financial Instruments

The carrying value of our financial instruments, including accounts receivable, accounts payable, and accrued expenses as of December 30, 2015 and December 31, 2014 approximated their fair value due to the short-term nature of these financial instruments.

Assets and Liabilities Measured at Fair Value on a Non-Recurring Basis

Assets and liabilities that are measured at fair value on a non-recurring basis include our long-lived assets and indefinite-lived intangible assets. There were no impairments recognized during 2015, 2014 and 2013.

Table of Contents

NOTE 4: ACCOUNTS RECEIVABLE

The components of accounts receivable as of December 30, 2015 and December 31, 2014 are as follows:

	December 30 2015	December 31 2014
Landlord receivables	$ 1,380	$ 1,088
Licensing receivables	1,669	822
Credit card receivables	1,023	660
Other receivables	145	708
Accounts receivable	$ 4,217	$ 3,278

As of December 30, 2015 and December 31, 2014, no allowance for doubtful accounts was recorded based on our evaluation of collectibility.

NOTE 5: INVENTORIES

Inventories consisted of the following:

	December 30 2015	December 31 2014
Food	$ 328	$ 354
Wine	30	28
Beer	46	33
Beverages	57	42
Retail merchandise	82	72
Inventories	$ 543	$ 529

Table of Contents

NOTE 6: PROPERTY AND EQUIPMENT

Property and equipment consisted of the following:

	December 30 2015	December 31 2014
Leasehold improvements	$ 82,904	$ 58,272
Equipment	16,903	12,108
Furniture and fixtures	4,965	3,249
Computer equipment and software	5,197	3,529
Construction in progress	6,591	6,309
Property and equipment, gross	116,560	83,467
Less: accumulated depreciation	(23,519)	(13,343)
Property and equipment, net	$ 93,041	$ 70,124

Depreciation expense was $10,222, $5,809 and $3,541 for fiscal 2015, 2014 and 2013, respectively.

NOTE 7: SUPPLEMENTAL BALANCE SHEET INFORMATION

The components of other current liabilities as of December 30, 2015 and December 31, 2014 are as follows:

	December 30 2015	December 31 2014
Sales tax payable	$ 1,073	$ 736
Current portion of liabilities under tax receivable agreement	2,157	—
Gift card liability	833	625
Other	551	388
Other current liabilities	$ 4,614	$ 1,749

NOTE 8: DEBT

In January 2015, we executed a Third Amended and Restated Credit Agreement, which became effective on February 4, 2015 (together with the prior agreements and amendments, the "Revolving Credit Facility"), that provides for a total revolving commitment of $20,000, which can be increased to $50,000 at our election. The Revolving Credit Facility will mature and all amounts outstanding will be due and payable five years from the effective date. The Revolving Credit Facility permits the issuance of letters of credit upon our request of up to $10,000. Borrowings under the Revolving Credit Facility bear interest at either: (i) LIBOR plus a percentage ranging from 2.5% to 3.5% or (ii) the prime rate plus a percentage ranging from 0.0% to 1.0%, depending on the type of borrowing made under the Revolving Credit Facility. As of December 31, 2014, amounts outstanding under the Revolving Credit Facility totaled $32,000, and were classified as short-term borrowings on the Consolidated Balance Sheet. During the fiscal year ended December 30, 2015, we borrowed an additional $4,000 in principal under the Revolving Credit Facility. In February 2015, we repaid the entire outstanding balance of $36,000 using a portion of the proceeds we received from our IPO and, as of December 30, 2015,

Table of Contents

there were no amounts outstanding under the Revolving Credit Facility. We had $19,920 of availability as of December 30, 2015, after giving effect to $80 in outstanding letters of credit.

The Revolving Credit Facility is secured by a first-priority security interest in substantially all of the assets of SSE Holdings and the guarantors. The obligations under the Revolving Credit Facility are guaranteed by each of SSE Holdings' wholly-owned domestic subsidiaries (with certain exceptions).

The Revolving Credit Facility contains a number of covenants that, among other things, limit our ability to, subject to specified exceptions, incur additional debt; incur additional liens and contingent liabilities; sell or dispose of assets; merge with or acquire other companies; liquidate or dissolve ourselves; pay dividends or make distributions; engage in businesses that are not in a related line of business; make loans, advances or guarantees; engage in transactions with affiliates; and make investments. In addition, the Revolving Credit Facility contains certain cross-default provisions. We are required to maintain a specified consolidated fixed-charge coverage ratio and a specified funded net debt to adjusted EBITDA ratio, both as defined under the Revolving Credit Facility. As of December 30, 2015, we were in compliance with all covenants.

In March 2013, we entered into a promissory note in the amount of $313 in connection with the purchase of a liquor license. Interest on the outstanding principal balance of this note is due and payable on a monthly basis from the effective date at a rate of 5.0% per year. The entire principal balance and interest is due and payable on the earlier of the maturity date, which is the expiration of the lease in June 2023, or the date of the sale of the license. As of December 30, 2015 and December 31, 2014, the outstanding balance of the promissory note was $313.

Total interest costs incurred were $440, $365 and $56 in fiscal 2015, 2014 and 2013, respectively. During fiscal 2015, $108 was capitalized into property and equipment. No amounts were capitalized during fiscal 2014 and 2013.

NOTE 9: LEASES

A summary of rent expense under operating lease agreements is as follows:

	2015	2014	2013
Minimum rent	$10,796	$6,497	$4,507
Deferred rent	1,482	2,830	975
Contingent rent	2,959	1,883	1,626
Total rent expense	$15,237	$11,210	$7,108

The rent expense above does not include common area maintenance costs, real estate taxes and other occupancy costs, which were $2,119, $1,111 and $758 in fiscal 2015, 2014 and 2013, respectively.

As of December 30, 2015, future minimum lease payments under non-cancelable operating leases consisted of the following:

2016	$14,199
2017	15,664
2018	16,329
2019	16,507
2020	15,982
Thereafter	97,415
Total minimum lease payments	$176,096

Table of Contents

NOTE 10: EMPLOYEE BENEFIT PLANS

Deferred Compensation

During fiscal 2013, we entered into an incentive bonus agreement with one of our executives, whereby the executive is entitled to receive a deferred compensation award in the amount of $2,450, payable by us in March 2018. In fiscal 2013, we recorded $2,054 of deferred compensation expense to recognize the present value of the incentive bonus liability, which is included in other long-term liabilities on the Consolidated Balance Sheet. The deferred compensation expense is included within general and administrative expense on the Consolidated Statement of Income (Loss). There was no such expense in fiscal 2015 or fiscal 2014. The difference between the present value of the bonus liability and the amount payable is accreted to interest expense over the remaining term until the incentive bonus becomes payable. In September 2015, we established a grantor trust, commonly referred to as a "rabbi trust," for the purpose of funding our deferred compensation obligation. We contributed $2,450 to the trust in October 2015. Assets held by the trust are subject to creditor claims in the event of insolvency, but are not available for general corporate purposes. As of December 30, 2015, amounts held by the trust were invested in various marketable securities classified as available-for-sale and recognized at fair value in prepaid expenses and other current assets and other assets on the Consolidated Balance Sheet. See Note 3.

Defined Contribution Plan

Our employees are eligible to participate in a defined contribution savings plan maintained by Union Square Hospitality Group, LLC, a related party. The plan is funded by employee and employer contributions. We pay our share of the employer contributions directly to the third party trustee. Employer contributions to the plan are at our discretion. Effective January 2014, we began making contributions matching a portion of participants' contributions. We match 100% of participants' contributions for the first 3% of eligible compensation contributed and 50% of contributions made in excess of 3% of eligible compensation up to 5% of eligible compensation. Employer contributions totaled $238 and $132 for fiscal 2015 and 2014, respectively. There were no contributions in fiscal 2013.

NOTE 11: STOCKHOLDERS' EQUITY

Amendment and Restatement of Certificate of Incorporation

On February 4, 2015, we amended and restated our certificate of incorporation to, among other things, provide for the (i) authorization of 200,000,000 shares of Class A common stock with a par value of $0.001 per share; (ii) authorization of 35,000,000 shares of Class B common stock with a par value of $0.001 per share; (iii) authorization of 10,000,000 shares of undesignated preferred stock that may be issued from time to time by our Board of Directors in one or more series; and (iv) establishment of a classified board of directors, divided into three classes, each of whose members will serve for staggered three-year terms.

Holders of our Class A and Class B common stock are entitled to one vote per share and, except as otherwise required, will vote together as a single class on all matters on which stockholders generally are entitled to vote. Holders of our Class B common stock are not entitled to receive dividends and will not be entitled to receive any distributions upon the liquidation, dissolution or winding up of the Company. Shares of Class B common stock may only be issued to the extent necessary to maintain the one-to-one ratio between the number of LLC Interests held by the Continuing SSE Equity Owners and the number of shares of Class B common stock held by the Continuing SSE Equity Owners. Shares of Class B common stock are transferable only together with an equal number of LLC Interests. Shares of Class B common stock will be canceled on a one-for-one basis upon the redemption or exchange any of the outstanding LLC Interests.

We must, at all times, maintain a one-to-one ratio between the number of outstanding shares of Class A common stock and the number of LLC Interests owned by us (subject to certain exceptions for treasury shares and shares underlying certain convertible or exchangeable securities).

Table of Contents

Initial Public Offering
As described in Note 1, on February 4, 2015, we completed an IPO of 5,750,000 shares of our Class A common stock at a public offering price of $21.00 per share, which includes 750,000 shares issued pursuant to the underwriters' over-allotment option. We received $112,298 in proceeds, net of underwriting discounts and commissions, which we used to purchase newly-issued LLC Interests from SSE Holdings at a price per interest equal to the initial public offering price of our Class A common stock.
In connection with our IPO, we issued 30,160,694 shares of Class B common stock to the Original SSE Equity Owners.
SSE Holdings Recapitalization
As described in Note 1, on February 4, 2015, we amended the SSE Holdings LLC Agreement to, among other things, (i) provide for a new single class of common membership interests in SSE Holdings, the LLC Interests, and (ii) exchange all of the then-existing membership interests of the Original SSE Equity Owners for LLC Interests.
The LLC Agreement also provides that holders of LLC Interests may, from time to time, require SSE Holdings to redeem all or a portion of their LLC Interests for newly-issued shares of Class A common stock on a one-for-one basis. Upon receipt of a redemption request, we may, instead, elect to effect a direct exchange of LLC Interests directly with the holder. Additionally, we may elect to settle any such redemption or exchange in shares of Class A common stock or in cash. In the event of cash settlement, we would issue new shares of Class A common stock and use the proceeds from the sale of these newly-issued shares of Class A common stock to fund the cash settlement, which, in effect, limits the amount of the cash payment to the redeeming member. In connection with any redemption or exchange, we will receive a corresponding number of LLC Interests, increasing our total ownership interest in SSE Holdings. Additionally, an equivalent number of shares of Class B common stock will be surrendered and canceled.
The amendment also requires that SSE Holdings, at all times, maintain (i) a one-to-one ratio between the number of outstanding shares of Class A common stock and the number of LLC Interests owned by us and (ii) a one-to-one ratio between the number of shares of Class B common stock owned by the Continuing SSE Equity Owners and the number of LLC Interests owned by the Continuing SSE Equity Owners.
Secondary Offering
As described in Note 1, in August 2015, we completed a secondary offering of 4,000,000 shares of our Class A common stock at a price of $60.00 per share. All of the shares sold in the offering were offered by the Selling Stockholders. We did not receive any proceeds from the sale of shares of Class A common stock offered by the Selling Stockholders. The shares sold in the offering consisted of (i) 844,727 existing shares of Class A common stock and (ii) 3,155,273 newly-issued shares of Class A common stock issued in connection with the redemption of 3,155,273 LLC Interests. Simultaneously, and in connection with the secondary offering, 3,155,273 shares of Class B common stock were surrendered and cancelled.
Redemptions of LLC Interests
Subsequent to the secondary offering, an aggregate of 2,848,035 LLC Interests were redeemed by the Continuing SSE Equity Owners. Pursuant to the SSE Holdings LLC Agreement, we issued 2,848,035 shares of Class A common stock in connection with these redemptions and received 2,848,035 LLC Interests, increasing our ownership interest in SSE Holdings. Simultaneously, and in connection with these redemptions, 2,848,035 shares of Class B common stock were surrendered and cancelled.
Mergers
As described in Note 1, we acquired, by merger, the Former SSE Equity Owners, for which we issued d 5,968,841 shares of Class A common stock as merger consideration. In connection with these mergers, 5,968,841 shares of Class B common stock were canceled and we received 5,968,841 of LLC Interests. Additionally, in December 2015, the Meyer Group exercised their right to effect of tax-free reorganization of USC pursuant to the Stockholders Agreement. Prior to the USC Merger, USC owned 1,727,804 LLC Interests and an equivalent number of shares of our Class B common stock. In connection with the USC Merger, (i) 1,727,804 shares of Class A common stock were issued to the stockholders of USC, with each stockholder receiving newly-issued shares of Class A common stock in an amount equivalent to the number of shares of USC held by such stockholders; (ii) 1,727,804 shares of Class B common stock held by USC were cancelled; and (iii) 1,727,804 LLC Interests held by USC were transferred to us.

Table of Contents

Member Distributions

On December 15, 2014, the Board of Directors of SSE Holdings approved a special distribution to its members, to the extent the gross proceeds from the IPO exceeded the anticipated gross proceeds (including as a result of the exercise by the underwriters of their option to purchase additional shares of Class A common stock), in an amount equal to the product of (i) the increased gross proceeds and (ii) 0.273, to be paid from the proceeds of the IPO (the "Special Distribution"). On February 4, 2015, SSE Holdings paid the Additional Distribution to certain of the Original SSE Equity Owners in the amount of $11,125.

Dividend Restrictions

We are a holding company with no direct operations. As a result, our ability to pay cash dividends on our common stock, if any, is dependent upon cash dividends, distributions or other transfers from SSE Holdings. The amounts available to us to pay cash dividends are subject to certain covenants and restrictions set forth in the Revolving Credit Facility. As of December 30, 2015, essentially all of the net assets of SSE Holdings were restricted. See Note 8 for more information regarding the covenants and restrictions set forth in the Revolving Credit Facility.

NOTE 12: NON-CONTROLLING INTERESTS

In connection with the Organizational Transactions described in Note 1, we became the sole managing member of SSE Holdings and, as a result, consolidate the financial results of SSE Holdings. We report a non-controlling interest representing the LLC Interests in SSE Holdings held by Continuing SSE Equity Owners. Changes in our ownership interest in SSE Holdings while we retain our controlling interest in SSE Holdings will be accounted for as equity transactions. As such, future redemptions or direct exchanges of LLC Interests in SSE Holdings by the Continuing SSE Equity Owners will result in a change in ownership and reduce the amount recorded as non-controlling interest and increase additional paid-in capital.

On February 4, 2015, we used the net proceeds from our IPO to purchase 5,750,000 newly-issued LLC Interests. Additionally, in connection with the Organizational Transactions, we acquired 5,968,841 LLC Interests. Pursuant to the LLC Agreement, we received 339,306 LLC Interests as a result of the issuance of 339,306 shares of Class A common stock in settlement of the outstanding UARs.

During fiscal 2015, an aggregate of 6,003,308 LLC Interests were redeemed by the Continuing SSE Equity Owners (including 3,155,273 LLC Interests redeemed in connection with the secondary offering) for newly-issued shares of Class A common stock, and we received 6,003,308 LLC Interests, increasing our total ownership interest in SSE Holdings.

In December 2015, we received 1,727,804 LLC Interests in connection with the USC Merger in exchange for an equivalent number of newly-issued shares of Class A common stock. See Note 1 for more information.

As of December 30, 2015, there were 36,250,000 LLC Interests outstanding, of which we owned 19,789,259 LLC Interests, representing a 54.6% ownership interest in SSE Holdings.

Table of Contents

The following table summarizes the effects of changes in ownership in SSE Holdings on our equity:

	2015	2014	2013
Net income attributable to Shake Shack Inc.	$(8,776)	$2,118	$5,423
Transfers (to) from non-controlling interests:			
Increase in additional paid-in capital as a result of settlement of unit appreciation rights	987	—	—
Decrease in additional paid-in as a result of the Organizational Transactions	(75,182)	—	—
Increase in additional paid-in capital as a result of the redemption of LLC Interests	19,934	—	—
Increase in additional paid-in capital as a result of the USC Merger	$5,908	$—	$—
Change from net income attributable to Shake Shack Inc. and transfers (to) from non-controlling interest	$(57,129)	$2,118	$5,423

In the fourth quarter of fiscal 2015, we corrected certain immaterial errors relating to non-controlling interest amounts in prior 2015 fiscal interim periods, after determining that our initial investment in SSE Holdings, made at the time of our IPO, was not correctly accounted for as a change in a parent's ownership interest in a subsidiary while retaining control. As a result, in the fourth quarter of 2015, we recognized a $63,407 increase to non-controlling interests, a $64,785 decrease to additional paid-in capital and a $1,278 increase to retained earnings relating to these errors from prior interim periods. The corrections had no impact on our Consolidated Statements of Income or Cash Flows for the affected interim periods.

NOTE 13: EQUITY-BASED COMPENSATION

A summary of equity-based compensation expense recognized during fiscal 2015, 2014 and 2013 is as follows:

	2015	2014	2013
Unit appreciation rights	$11,762	$—	$—
Restricted Class B units	605	165	93
Stock options	4,314	—	—
Equity-based compensation expense	$16,681	$165	$93
Total income tax benefit recognized related to equity-based compensation	$482	$4	$2

Amounts are included in general and administrative expense on the Consolidated Statements of Income (Loss).

Unit Appreciation Rights

Prior to the IPO, we maintained a Unit Appreciation Rights Plan (the "UAR Plan"), effective in fiscal 2012, and as amended, whereby we had the authority to grant up to 31,303 unit appreciation rights ("UARs") to employees. The UARs granted were subject to continued employment and were only exercisable upon a qualifying transaction, which was either a change of control or an initial public offering, each as defined in the UAR Plan. Upon the occurrence of a qualifying transaction, each UAR entitled the holder to receive a payment from us. Such payment and related compensation expense was determined by multiplying (i) the excess, if any, of the qualifying transaction price over the base amount of the UAR, by (ii) the stated number of Class B units deemed covered by the UAR. Effective October 30, 2014, the UAR Plan was amended to provide that the payment to which UAR holders were entitled upon the occurrence of a qualifying transaction would be in the form of securities of the Company or one of its affiliates or such other form of payment as we determined in our sole discretion. The UARs would have terminated on the tenth anniversary of the grant date or upon termination of employment, if earlier.

Table of Contents

A summary of UAR activity for fiscal 2015 is as follows:

	UARs	Weighted Average Base Price
Outstanding at beginning of period	22,554	$193.51
Granted	—	—
Forfeited	—	—
Vested and settled	(22,554)	(193.51)
Outstanding at end of period	—	$—

No compensation expense was recorded during fiscal 2014 and 2013 related to the outstanding UARs because we determined that, as of the period end, it was not probable that a qualifying transaction would occur.

As described in Note 1, on February 4, 2015, we amended and restated the SSE Holdings LLC Agreement to, among other things, (i) provide for a new single class of common membership interests, the LLC Interests, and (ii) exchange all of the then-existing membership interests of the Original SSE Equity Owners for LLC Interests (together, the "Recapitalization Transaction"). The 22,554 outstanding UARs that were settled in connection with the IPO equate to 767,947 LLC Interests with a weighted average base price of $5.68, after giving effect to the Recapitalization Transaction.

Our IPO constituted a qualifying transaction under the terms of the UAR Plan, resulting in a qualifying transaction price of $715.02. 339,306 shares of Class A common stock were issued upon the settlement of the 22,554 outstanding UARs, net of employee withholding taxes. We recognized compensation expense of $11,762 during the fiscal 2015 upon settlement of the outstanding UARs.

Restricted Class B Units

Prior to the IPO, we granted restricted Class B units to certain of our executive officers. These awards were to vest in equal installments over periods ranging from three to five years. If not already fully vested, these units would fully vest (i) upon the occurrence of a change in control event or (ii) upon the occurrence of an initial public offering, each as defined in the grant agreement, and any unrecognized compensation expense related to these non-vested units would be subject to acceleration.

A summary of restricted Class B unit activity for fiscal year ended December 30, 2015 is as follows:

	Units	Weighted Average Grant Date Fair Value
Outstanding at beginning of period	7,227	$92.31
Granted	—	—
Vested	(7,227)	(92.31)
Forfeited	—	—
Outstanding at end of period	—	$—

The weighted average grant date fair value of restricted Class B units granted in fiscal 2013 was $92.31. There were no restricted Class B units granted in fiscal 2015 or fiscal 2014.

The IPO constituted a transaction under the terms of the restricted Class B unit awards that resulted in the accelerated vesting of all then-outstanding awards, and recognition of the unrecognized compensation expense related to those awards. During fiscal 2015, we recognized $605 of equity-based compensation expense upon the vesting of these awards. The total fair value of restricted

Table of Contents

Class B units that vested during fiscal 2015, 2014 and 2013 was $667, $167, $450, respectively. After giving effect to the Recapitalization Transaction, the 7,227 restricted Class B units that vested in connection with our IPO equate to 158,251 LLC Interests with a weighted-average grant date fair value of $4.22.

Stock Options

In January 2015, we adopted the 2015 Incentive Award Plan (the "2015 Plan") under which we may grant up to 5,865,522 stock options and other types of equity-based awards to employees, directors and officers. We do not use cash to settle any of our equity-based awards, and we issue new shares upon the exercise of stock options. In connection with the IPO, we granted 2,622,281 stock options to our directors and certain employees. The stock options were granted with an exercise price of $21.00 per share and vest equally over periods ranging from one to five years.

The fair value of stock option awards was determined on the grant date using the Black-Scholes valuation model based on the following weighted-average assumptions:

	2015	
Expected term (years)(1)	7.5	
Expected volatility(2)	35.1	%
Risk-free interest rate(3)	1.6	%
Dividend yield(4)	—	%

(1) Expected term represents the estimated period of time until an award is exercised and was determined using the simplified method.

(2) Expected volatility is based on the historical volatility of a selected peer group over a period equivalent to the expected term.

(3) The risk-free rate rate is an interpolation of yields on U.S. Treasury securities with maturities equivalent to the expected term.

(4) We have assumed a dividend yield of zero as we have no plans to declare dividends in the foreseeable future.

A summary of stock option activity for fiscal 2015 is as follows:

	Stock Options	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted Average Remaining Contractual Life (Years)
Outstanding at beginning of period	—	$—		
Granted	2,622,281	21.00		
Exercised	—	—		
Forfeited	(47,300)	(21.00)		
Expired	—	—		
Outstanding at end of period	2,574,981	$21.00	$48,822	9.1
Options exercisable at end of period	—	$—	$—	—
Options expected to vest	2,469,372	$21.00	$46,819	9.1

The weighted-average grant date fair value of stock options granted during fiscal 2015 was $8.53. No stock options were granted in fiscal 2014 and fiscal 2013. As of December 30, 2015, there were 2,574,981 stock options outstanding, of which none were exercisable. As of December 30, 2015, total unrecognized compensation expense related to unvested stock options, including an estimate for pre-vesting forfeitures, was $17,937, which is expected to be recognized over a weighted-average period of 4.1 years.

Table of Contents

The following table summarizes information about stock options outstanding and exercisable as December 30, 2015:

	Options Outstanding			Options Exercisable		
Range of Exercise Price	Number Outstanding at December 30, 2015	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable at December 30, 2015	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price
$21.00	2,574,981	9.1	$21.00	—	—	$—

NOTE 14: INCOME TAXES

As a result of the IPO and Organizational Transactions, we became the sole managing member of SSE Holdings, and as a result, began consolidating the financial results of SSE Holdings. SSE Holdings is treated as a partnership for U.S. federal and most applicable state and local income tax purposes. As a partnership, SSE Holdings is not subject to U.S. federal and certain state and local income taxes. Any taxable income or loss generated by SSE Holdings is passed through to and included in the taxable income or loss of its members, including us, on a pro rata basis. We are subject to U.S. federal income taxes, in addition to state and local income taxes with respect to our allocable share of any taxable income or loss of SSE Holdings, as well as any stand-alone income or loss generated by Shake Shack Inc. We are also subject to withholding taxes in foreign jurisdictions.

Income Tax Expense

The components of income before income taxes are follows:

	2015	2014	2013
Domestic	$244	$(3,007)	$2,364
Foreign	6,184	5,787	3,519
Income before income taxes	$6,428	$2,780	$5,883

The components of income tax expense are as follows:

	2015	2014	2013
Current income taxes:			
Federal	$2,474	$—	$—
State and local	1,131	194	266
Foreign	433	561	187
Total current income taxes	4,038	755	453
Deferred income taxes:			
Federal	(267)	—	—
State and local	(467)	(93)	7
Total deferred income taxes	(734)	(93)	7
Income tax expense	$3,304	$662	$460

Table of Contents

A reconciliation of income tax expense computed at the U.S. federal statutory income tax rate to the recognized income tax expense is as follows:

	2015	2014	2013
Expected U.S. federal income taxes at statutory rate (34%)	$2,186	$945	$2,000
State and local income taxes, net of federal benefit	663	101	176
Foreign withholding taxes	433	561	188
Non-deductible expenses	653	—	—
Tax credits	(141)	—	—
Non-controlling interest	(490)	—	—
LLC flow-through structure	—	(976)	(1,904)
Other	—	31	—
Income tax expense	$3,304	$662	$460

Our effective income tax rates for fiscal 2015, 2014 and 2013 were 51.4%, 23.8% and 7.8%, respectively. The significant increase in both the amount of income tax expense and our effective income tax rate from fiscal 2014 to fiscal 2015 is primarily due to the IPO and Organizational Transactions. In fiscal 2014, we were only subject to certain LLC entity-level taxes and foreign withholding taxes, whereas in fiscal 2015 we were also subject to U.S. federal, state and local income taxes on our allocable share of any taxable income or loss generated by SSE Holdings subsequent to the IPO and Organizational Transactions. Additionally, as the non-recurring compensation expenses and other IPO-related expenses were incurred in the period prior to the Organizational Transactions, we are not entitled to any tax benefits related to those expenses. This resulted in a high effective income tax rate when compared to the amount of our consolidated income before income taxes for fiscal 2015. The increase in our effective income tax rate from fiscal 2013 to fiscal 2014 was primarily due to increased foreign withholding taxes resulting from increased licensing revenue.

Deferred Tax Assets and Liabilities

The components of deferred tax assets and liabilities are as follows:

	December 30 2015	December 31 2014
Deferred tax assets:		
Investment in partnership	$154,649	$—
Tax Receivable Agreement	69,513	—
Deferred rent	492	448
Deferred revenue	63	66
Stock-based compensation	218	—
Net operating loss carryforwards	334	—
Other assets	159	26
Total gross deferred tax assets	225,428	540
Valuation allowance	(23,155)	—
Total deferred tax assets, net of valuation allowance	202,273	540
Deferred tax liabilities:		
Property and equipment	(316)	(379)
Total gross deferred tax liabilities	(316)	(379)
Net deferred tax assets	$201,957	$161

Table of Contents

As of December 30, 2015, our federal net operating loss carryforwards for income tax purposes was $334. If not utilized, the federal net operating loss carryforward will begin to expire in 2035.

As described in Notes 1 and 11, we acquired an aggregate of 19,789,259 LLC Interests during fiscal 2015 in connection with the IPO, Organizational Transactions, settlement of outstanding UARs, redemptions of LLC Interests and the USC Merger. We recognized a deferred tax asset in the amount of $154,649 associated with the basis difference in our investment in SSE Holdings upon acquiring these LLC Interests. However, a portion of the basis difference will only reverse upon the eventual sale of our interest in SSE Holdings, which we expect would result in a capital loss. As such, we established a valuation allowance in the amount of $23,155 against the deferred tax asset to which this portion relates.

During fiscal 2015, we also recognized $69,513 of deferred tax assets related to additional tax basis increases generated from expected future payments under the Tax Receivable Agreement and related deductions for imputed interest on such payments. See "—Tax Receivable Agreement" for more information.

We evaluate the realizability of our deferred tax assets on a quarterly basis and establish valuation allowances when it is more likely than not that all or a portion of a deferred tax asset may not be realized. As of December 30, 2015, we concluded, based on the weight of all available positive and negative evidence, that all of our deferred tax assets (except for those deferred tax assets described above relating to basis differences that are expected to result in a capital loss upon the eventual sale of our interest in SSE Holdings) are more likely than not to be realized. As such, no additional valuation allowance was recognized. The net change in valuation allowance for fiscal 2015 was $23,155. There was no net change in valuation allowance in fiscal 2014.

In the fourth quarter of fiscal 2015, we corrected certain immaterial errors relating to prior fiscal 2015 interim periods for our deferred income taxes and liabilities under the Tax Receivable Agreement after determining that our prior computations of our liabilities under the Tax Receivable Agreement utilized inappropriate assumptions and incorrectly applied certain provisions of the Tax Receivable Agreement. Additionally, we did not recognize certain deferred tax assets related to historical tax attributes we acquired upon our acquisition of the Former SSE Equity Owners. As a result, in fiscal 2015, we recognized a $15,043 increase in deferred income taxes, a $12,045 increase to liabilities under tax receivable agreement and a $4,026 increase to additional paid-in capital relating to these errors from prior interim periods. The corrections had no impact on our Consolidated Statements of Income or Cash Flows for the affected interim periods.

Uncertain Tax Positions

No uncertain tax positions existed as of December 30, 2015 and December 31, 2014. Shake Shack Inc. was formed in September 2014 and did not engage in any operations prior to the IPO and Organizational Transactions. Shake Shack Inc. first filed tax returns for tax year 2014, which is the first tax year subject to examination by taxing authorities for U.S. federal and state income tax purposes. Additionally, although SSE Holdings is treated as a partnership for U.S. federal and state income taxes purposes, it is still required to file an annual U.S. Return of Partnership Income, which is subject to examination by the Internal Revenue Service ("IRS"). The statute of limitations has expired for tax years through 2011 for SSE Holdings.

Tax Receivable Agreement

Pursuant to our election under Section 754 of the Internal Revenue Code (the "Code"), we expect to obtain an increase in our share of the tax basis in the net assets of SSE Holdings when LLC Interests are redeemed or exchanged by the Continuing SSE Equity Owners and other qualifying transactions. We plan to make an election under Section 754 of Code for each taxable year in which a redemption or exchange of LLC Interest occurs. We intend to treat any redemptions and exchanges of LLC Interests by the Continuing SSE Equity Owners as direct purchases of LLC Interests for U.S. federal income tax purposes. These increases in tax basis may reduce the amounts that we would otherwise pay in the future to various tax authorities. They may also decrease gains (or increase losses) on future dispositions of certain capital assets to the extent tax basis is allocated to those capital assets.

On February 4, 2015, we entered into a tax receivable agreement with the Continuing SSE Equity Owners (the "Tax Receivable Agreement") that provides for the payment by us to the Continuing SSE Equity Owners of 85% of the amount of any tax benefits that we actually realize, or in some cases are deemed to realize, as a result of (i) increases in our share of the tax basis in the net assets of SSE Holdings resulting from any redemptions or exchanges of LLC

Interests, (ii) tax basis increases attributable to payments made under the Tax Receivable Agreement, and (iii) deductions attributable to imputed interest pursuant to the Tax

Table of Contents

Receivable Agreement (the "TRA Payments"). We expect to benefit from the remaining 15% of any tax benefits that we may actually realize. The TRA Payments are not conditioned upon any continued ownership interest in SSE Holdings or us. The rights of each Continuing SSE Equity Owner under the Tax Receivable Agreement are assignable to transferees of its LLC Interests.

During fiscal 2015, SSE Holdings paid a distribution in the amount of $11,125 to certain of the Original SSE Equity Owners (the "Special Distribution"). The Special Distribution was considered a direct purchase of LLC Interests for U.S. federal income tax purposes and resulted in an increase in the tax basis of the net assets of SSE Holdings subject to the provisions of the Tax Receivable Agreement. Additionally, during fiscal 2015, an aggregate of 6,003,308 LLC Interests were redeemed by the Continuing SSE Equity Owners (including 3,155,273 LLC Interests redeemed in connection with the secondary offering) for newly-issued shares of Class A common stock. In connection with these redemptions, we received 6,003,308 LLC Interests, which resulted in an increase in the tax basis of our investment in SSE Holdings subject to the provisions of the Tax Receivable Agreement. We recognized a liability for the TRA Payments due to the Continuing SSE Equity Owners, representing 85% of the aggregate tax benefits we expect to realize from the tax basis increases related to the Special Distribution and redemptions of LLC Interests, after concluding it was probable that such TRA Payments would be paid based on our estimates of future taxable income. As of December 30, 2015, the total amount of TRA Payments due to the Continuing SSE Equity Owners under the Tax Receivable Agreement was $173,090, of which $2,157 was included in other current liabilities on the Consolidated Balance Sheet. See Note 17 for more information relating to our liabilities under the Tax Receivable Agreement.

Pro Forma Financial Information

For periods prior to the IPO and Organizational Transactions, our income taxes represent those of SSE Holdings, our predecessor, and relate solely to foreign withholding taxes and certain LLC entity-level taxes. As a result of the IPO and Organizational Transactions that occurred on February 4, 2015, we became subject to U.S. federal and certain state and local income taxes with respect to our allocable share of any taxable income or loss generated by SSE Holdings. The pro forma financial information presented on the Consolidated Statements of Income (Loss) for fiscal 2015 has been computed to reflect income tax expense at an effective tax rate of 27.8%. The amounts were calculated assuming the Organizational Transactions occurred on January 1, 2015 and were based on the statutory rates in effect during the period.

NOTE 15: EARNINGS PER SHARE

Basic earnings per share of Class A common stock is computed by dividing net income available to Shake Shack Inc. by the weighted-average number of shares of Class A common stock outstanding during the period. Diluted earnings per share of Class A common stock is computed by dividing net income available to Shake Shack Inc. by the weighted-average number of shares of Class A common stock outstanding adjusted to give effect to potentially dilutive securities.

As described in Note 1, on February 4, 2015, the SSE Holdings LLC Agreement was amended and restated to, among other things, (i) provide for a new single class of common membership interests, the LLC Interests, and (ii) exchange all of the then-existing membership interests of the Original SSE Equity Owners for LLC Interests. For purposes of calculating earnings per share, the prior period amounts have been retroactively adjusted to give effect to the above-mentioned amendment and resulting recapitalization. The computations of earnings per share for periods prior to our IPO do not consider the 5,750,000 shares of Class A common stock issued to investors in our IPO or the 339,306 shares of Class A common stock issued upon settlement of outstanding UARs in connection with the IPO.

Table of Contents

The following table sets forth reconciliations of the numerators and denominators used to compute basic and diluted earnings per share of Class A common stock for fiscal 2015, 2014 and 2013.

	2015	2014	2013
Numerator:			
Net income	$3,124	$2,118	$5,423
Less: net income attributable to non-controlling interests	11,900	—	—
Net income (loss) attributable to Shake Shack Inc.	$(8,776)	$2,118	$5,423
Denominator:			
Weighted-average shares of Class A common stock outstanding—basic	13,588	29,977	29,934
Effect of dilutive securities:			
Restricted Class B units	—	145	84
Weighted-average shares of Class A common stock outstanding—diluted	13,588	30,122	30,018
Earnings per share of Class A common stock—basic	$(0.65)	$0.07	$0.18
Earnings per share of Class A common stock—diluted	$(0.65)	$0.07	$0.18

2,574,981 stock options were excluded from the computation of diluted earnings per share of Class A common stock for fiscal 2015 because the effect would have been anti-dilutive as we recorded a net loss for the period.

Shares of our Class B common stock do not share in the earnings or losses of Shake Shack and are therefore not participating securities. As such, separate presentation of basic and diluted earnings per share of Class B common stock under the two-class method has not been presented. Shares of our Class B common stock are, however, considered potentially dilutive shares of Class A common stock. After evaluating the potential dilutive effect under the if-converted and two-class methods, the 16,460,741 shares of Class B common stock outstanding as of December 30, 2015 were determined to be anti-dilutive and have therefore been excluded from the computations of diluted earnings per share of Class A common stock.

Table of Contents

NOTE 16: SUPPLEMENTAL CASH FLOW INFORMATION

The following table sets forth supplemental cash flow information for fiscal 2015, 2014 and 2013:

	2015	2014	2013
Cash paid for:			
Income taxes, net of refunds	$416	$836	$639
Interest, net of amounts capitalized	92	123	19
Non-cash investing activities:			
Accrued purchases of property and equipment	4,904	3,577	234
Property and equipment acquired through landlord incentives	—	6,000	—
Class A common stock issued in connection with the acquisition of the Former SSE Equity Owners	6	—	—
Class A common stock issued in connection with the USC Merger	2	—	—
Non-cash financing activities:			
Cancellation of Class B common stock in connection with the Organizational Transactions	(6)	—	—
Class A common stock issued in connection with the redemption of LLC Interests	6	—	—
Cancellation of Class B common stock in connection with the redemption of LLC Interests	(6)	—	—
Cancellation of Class B common stock in connection with the USC Merger	(2)	—	—
Establishment of liabilities under tax receivable agreement	173,090	—	—

NOTE 17: COMMITMENTS AND CONTINGENCIES

Lease Commitments

We are obligated under various operating leases for Shacks and our home office space, expiring in various years through 2032. Under certain of these leases, we are liable for contingent rent based on a percentage of sales in excess of a specified threshold and are responsible for our proportionate share of real estate taxes and utilities. See Note 9, Leases.

As security under the terms of several of our leases, we are obligated under letters of credit totaling $160 as of December 30, 2015. The letters of credit expire on April 23, 2016 and February 28, 2026. In addition, in December 2013, we entered into an irrevocable standby letter of credit in conjunction with our home office lease in the amount of $80. The letter of credit expires in September 2016 and renews automatically for one-year periods through September 30, 2019.

Purchase Commitments

Purchase obligations include legally binding contracts, including commitments for the purchase, construction or remodeling of real estate and facilities, firm minimum commitments for inventory purchases, equipment purchases, marketing-related contracts, software acquisition/license commitments and service contracts. These obligations are generally short-term in nature and are recorded as liabilities when the related goods are received or services rendered. We also enter into long-term, exclusive contracts with certain vendors to supply us with food, beverages and paper goods, obligating us to purchase specified quantities. These volume commitments are not subject to any time limit and there are no material financial penalties associated with these agreements in the event of early termination.

Table of Contents

Legal Contingencies

In November 2015, we met with a law firm representing two former Shake Shack managers who alleged that Shake Shack improperly classified its restaurant managers as exempt. Although we have always believed that our managers are properly classified as exempt under both federal and state laws, and have always intended to defend any such lawsuits vigorously, we agreed to mediate the matter. At the conclusion of the meeting, the parties entered into a Memorandum of Understanding, and the Company agreed to create a fund of $750 to settle the matter. In exchange, all participating managers (former and current), including the two former managers, will release Shake Shack from all federal and/or state wage and hour claims that may exist through the settlement date. As part of the settlement process, the law firm filed a Complaint on March 17, 2016 with the Supreme Court of the State of New York (the “Court”), and within the coming weeks will file the final settlement agreement with the Court as well as a motion seeking the Court’s preliminary approval of the settlement. As of December 30, 2015, we recognized a liability of $770 for this matter and related expenses.

We are subject to various legal proceedings, claims and liabilities, such as employment-related claims and slip and fall cases, which arise in the ordinary course of business and are generally covered by insurance. As of December 30, 2015, the amount of ultimate liability with respect to these matters was not material.

Liabilities under Tax Receivable Agreement

As described in Note 14, we are a party to the Tax Receivable Agreement under which we are contractually committed to pay the Continuing SSE Equity Owners 85% of the amount of any tax benefits that we actually realize, or in some cases are deemed to realize, as a result of certain transactions. We are not obligated to make any payments under the Tax Receivable Agreement until the tax benefits associated the transaction that gave rise to the payment are realized. Amounts payable under the Tax Receivable Agreement are contingent upon, among other things, (i) generation of future taxable income over the term of the Tax Receivable Agreement and (ii) future changes in tax laws. If we do not generate sufficient taxable income in the aggregate over the term of the Tax Receivable Agreement to utilize the tax benefits, then we would not be required to make the related TRA Payments. During fiscal 2015, as a result of the Special Distribution and redemptions of LLC Interests, we recognized liabilities totaling $173,090 relating to our obligations under the Tax Receivable Agreement, after concluding that it was probable that we would have sufficient future taxable income to utilize the related tax benefits. There were no transactions subject to the Tax Receivable Agreement for which we did not recognize the related liability, as we concluded that we would have sufficient future taxable income to utilize all of the related tax benefits generated by all transactions that occurred in fiscal 2015.

NOTE 18: RELATED PARTY TRANSACTIONS

Union Square Hospitality Group

Union Square Hospitality Group, LLC is a stockholder and a party to the Stockholders Agreement we entered into in connection with our IPO. The Chairman of our Board of Directors serves as the Chief Executive Officer of Union Square Hospitality Group, LLC. As a result, Union Square Hospitality Group, LLC and its subsidiaries (collectively, "USHG") are considered related parties.

Under the terms of the management agreement with USHG, as amended, in fiscal 2014, we paid a 2.5% management fee to USHG based on Shack sales and licensing revenue generated from license agreements with unaffiliated entities. Total management fees, which are included in general and administrative expenses, amounted to $2,927 and $2,455 for fiscal 2014 and 2013, respectively. Effective January 1, 2015, the management agreement was amended and restated. As a result, we are no longer obligated to pay management fees to USHG. Therefore, no management fees were paid to USHG for fiscal 2015.

Previously, we sub-leased office space from USHG on a month-to-month basis. Amounts paid to USHG as rent totaled $38 and $236 for fiscal 2014 and 2013, respectively. These amounts are included in general and administrative expense on the Consolidated Statements of Income (Loss). No amounts were paid during fiscal 2015.

Previously, our employees were included in USHG's self-insurance health plan and we paid our portion of the plan costs on a monthly basis to USHG. Amounts paid to the USHG for these health insurance costs were $1,306 and $865 for fiscal 2014 and 2013,

respectively. In February 2015, we established our own self-funded health insurance plan for our employees and ceased payments to USHG. The total amount paid to USHG for these health insurance costs for fiscal 2015 was $146. These amounts are included in labor and related expenses and general and administrative expenses on the Consolidated Statements of Income (Loss). Additionally, our employees are eligible participants under USHG's 401(k) plan. We pay our share of the employer's matching contributions directly to the third-party plan trustee.
We also pay USHG for certain miscellaneous general operating expenses incurred by them on our behalf. Total amounts paid to USHG for general corporate expenses were $157, $490 and $473 for fiscal 2015. 2014 and 2013, respectively, and are included in general and administrative expenses on the Consolidated Statements of Income (Loss).
Total amounts payable to USHG as of December 30, 2015 and December 31, 2014 were $2 and $238, respectively, and are included in other current liabilities on the Consolidated Balance Sheets. No amounts were due from USHG as of December 30, 2015 and December 31, 2014.

Hudson Yards Sports and Entertainment

In fiscal 2011, we entered into a Master License Agreement (an "MLA") with Hudson Yards Sports and Entertainment LLC ("HYSE"), a subsidiary of USHG and a related party, to operate Shake Shack branded limited menu concession stands in sports and entertainment venues within the United States. The agreement expires on December 31, 2027 and includes five consecutive five-year renewal options at HYSE's option. As consideration for these rights, HYSE pays us a license fee based on a percentage of net food sales, as defined in the MLA. HYSE also pays us a percentage of profits on sales of branded beverages, as defined in the MLA. Amounts paid to us by HYSE for fiscal 2015, 2014 and 2013 were $282, $218 and $215, respectively, and are included in licensing revenue on the Consolidated Statements of Income (Loss). No amounts were due from HYSE as of December 30, 2015 and December 31, 2014.

Madison Square Park Conservancy

The Chairman of our Board of Directors serves as a director of the Madison Square Park Conservancy ("MSP Conservancy"), with which we have a license agreement and pay license fees to operate our Madison Square Park Shack. Amounts paid to Madison Square Park Conservancy as rent amounted to $692, $528 and $607 for fiscal 2015, 2014 and 2013, respectively. These amounts are included in occupancy and related expenses on the Consolidated Statements of Income (Loss). Total amounts due to the MSP Conservancy as of December 30, 2015 were $17. No amounts were due to the MSP Conservancy as of December 31, 2014 as our Madison Square Park Shack was closed for renovations.

Share Our Strength

The Chairman of our Board of Directors serves as a director of Share Our Strength, for which Shake Shack hold the "Great American Shake Sale" every year during the month of May to raise money and awareness for childhood hunger. During the Great American Shake Sale, we encourage guests to donate money to Share Our Strength's No Kid Hungry campaign in exchange for a coupon for a free cake-themed shake. All of the guest donations we collect go directly to Share Our Strength. We raised a total of $504, $338 and $286 in fiscal 2015, 2014 and 2013, respectively, and the proceeds were remitted to Share Our Strength in the respective years. We incurred costs of approximately $109, $69 and $53 for fiscal 2015, 2014 and 2013, respectively, representing the cost of the free shakes redeemed. These costs are included in general and administrative expense and other operating expenses on the Consolidated Statements of Income (Loss).

Tax Receivable Agreement

In connection with our IPO, we entered into a tax receivable agreement with the Continuing SSE Equity Owners that provides for the payment by us to the Continuing SSE Equity Owners of 85% of the amount of any tax benefits that Shake Shack actually realizes or in some cases is deemed to realize as a result of (i) increases in the tax basis of the net assets of SSE Holdings resulting from any redemptions or exchanges of LLC Interests and (ii) certain other tax benefits related to our making payments under the Tax Receivable Agreement. See Note 14 for further information.
There were no amounts paid under the Tax Receivable Agreement to the Continuing SSE Equity Owners during fiscal 2015. Total amounts due to the Continuing SSE Equity Owners as of December 30, 2015 under the Tax Receivable Agreement were $173,090. As the Tax Receivable Agreement went into effect in January 2015, no

Table of Contents

amounts were due to the Continuing SSE Equity Owners under the Tax Receivable Agreement as of December 31, 2014, and no amounts were paid in fiscal 2014 and 2013.

NOTE 19: GEOGRAPHIC INFORMATION

Revenue by geographic area for fiscal 2015, 2014 and 2013 is as follows:

	2015	2014	2013
United States	$184,408	$112,743	$78,937
Other countries	6,184	5,787	3,519
Total revenue	$190,592	$118,530	$82,456

Revenues are shown based on the geographic location of our customers and licensees. All of our assets are located in the United States.

NOTE 20: SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table sets forth certain unaudited financial information for each quarter of fiscal 2015 and fiscal 2014. The unaudited quarterly information includes all adjustments (consisting of normal recurring adjustments) that, in the opinion of management, are necessary for the fair presentation of the information presented. Operating results for interim periods are not necessarily indicative of the results that may be expected for a full fiscal year.

	2015			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Total revenue	$37,808	$48,450	$53,273	$51,061
Operating income (loss)	(10,949)	6,244	7,804	3,654
Net income (loss)	(11,260)	5,145	6,193	3,046
Net income (loss) attributable to Shake Shack Inc.	(12,668)	1,118	1,528	1,246
Earnings (loss) per share[(1)]:				
Basic	$(1.06)	$0.09	$0.11	$0.08
Diluted	$(1.06)	$0.08	$0.10	$0.07

Table of Contents

	2014 First Quarter	Second Quarter	Third Quarter	Fourth Quarter[2]
Total revenue	$24,196	$27,737	$31,825	$34,772
Operating income (loss)	1,229	2,142	759	(987)
Net income (loss)	1,092	1,949	504	(1,427)
Net income (loss) attributable to Shake Shack Inc.	1,092	1,949	504	(1,427)
Earnings (loss) per share[1]:				
Basic	$0.04	$0.07	$0.02	$(0.05)
Diluted	$0.04	$0.07	$0.02	$(0.05)

(1) Basic and diluted earnings per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted earnings per share amounts may not equal annual basic and diluted earnings per share amounts.

(2) We operate on a 52/53 week fiscal year that ends on the last Wednesday of the calendar year. Fiscal 2014 was a 53-week year with the extra operating week falling in our fiscal fourth quarter. Fiscal 2015 contained 52 weeks.

Table of Contents

Schedule I: Condensed Financial Information of Registrant

SHAKE SHACK INC.
CONDENSED BALANCE SHEETS
(PARENT COMPANY ONLY)
(in thousands, except share and per share amounts)

	December 30 2015	December 31 2014
ASSETS		
Current assets:		
Cash	$422	$—
Prepaid expenses	628	—
Total current assets	1,050	—
Due form SSE Holdings	3,979	—
Deferred income taxes, net	201,614	—
Investment in subsidiaries	67,810	—
TOTAL ASSETS	$274,453	$—
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Income taxes payable	$689	$—
Accrued expenses	59	—
Current portion of liabilities under tax receivable agreement	2,157	—
Total current liabilities	2,905	—
Liabilities under tax receivable agreement, net of current portion	170,933	—
Total liabilities	173,838	—
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, no par value—10,000,000 shares authorized; none issued and outstanding as of December 30, 2015	—	—
Common stock, $0.01 par value—100 shares authorized; none issued and outstanding as of December 31, 2014	—	—
Class A common stock, $0.001 par value—200,000,000 shares authorized; 19,789,259 shares issued and outstanding as of December 30, 2015	20	—
Class B common stock, $0.001 par value—35,000,000 shares authorized; 16,460,741 shares issued and outstanding as of December 30, 2015	16	—
Additional paid-in capital	96,311	—
Retained earnings	4,273	—
Accumulated other comprehensive loss	(5)	—
Total stockholders' equity	100,615	—
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$274,453	$—

See accompanying Notes to Condensed Financial Statements.

Table of Contents

Schedule I: Condensed Financial Information of Registrant (continued)

SHAKE SHACK INC.
CONDENSED STATEMENTS OF INCOME
(PARENT COMPANY ONLY)
(in thousands)

	Fiscal Year Ended	
	December 30 2015	December 31 2014
Intercompany revenue	$1,336	$—
TOTAL REVENUE	1,336	—
General and administrative expenses	1,336	—
TOTAL EXPENSES	1,336	—
OPERATING INCOME	—	—
Equity in net income of subsidiaries	6,906	—
INCOME BEFORE INCOME TAXES	6,906	—
Income tax expense	2,633	—
NET INCOME	$4,273	$—

See accompanying Notes to Condensed Financial Statements.

Table of Contents

Schedule I: Condensed Financial Information of Registrant (continued)

SHAKE SHACK INC.
CONDENSED STATEMENTS OF COMPREHENSIVE INCOME
(PARENT COMPANY ONLY)
(in thousands)

	Fiscal Year Ended	
	December 30 2015	December 31 2014
Net income	$4,273	$—
Other comprehensive loss:		
Unrealized holding losses on available-for-sale securities	(5)	—
Income tax benefit	—	—
OTHER COMPREHENSIVE LOSS, NET OF TAX	(5)	—
COMPREHENSIVE INCOME	$4,268	$—

See accompanying Notes to Condensed Financial Statements.

Table of Contents

Schedule I: Condensed Financial Information of Registrant (continued)

SHAKE SHACK INC.
CONDENSED STATEMENTS OF CASH FLOWS
(PARENT COMPANY ONLY)
(in thousands)

	Fiscal Year Ended December 30 2015	December 31 2014
OPERATING ACTIVITIES		
Net income	$4,273	$—
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in net income of subsidiaries	(6,906)	—
Equity-based compensation	330	—
Deferred income taxes	(551)	—
Changes in operating assets and liabilities:		
Due from SSE Holdings	4	—
Accrued expenses	58	—
Income taxes payable	3,184	—
NET CASH PROVIDED BY OPERATING ACTIVITIES	392	—
INVESTING ACTIVITIES		
Purchases of LLC Interests from SSE Holdings	(112,298)	—
NET CASH USED IN INVESTING ACTIVITIES	(112,298)	—
FINANCING ACTIVITIES		
Proceeds from issuance of Class A common stock sold in initial public offering, net of underwriting discounts and commissions	112,298	—
Proceeds from issuance of Class B common stock	30	—
NET CASH PROVIDED BY FINANCING ACTIVITIES	112,328	—
INCREASE IN CASH	422	—
CASH AT BEGINNING OF PERIOD	—	—
CASH AT END OF PERIOD	$422	$—
Non-cash investing activities:		
Class A common stock issued in connection with the acquisition of the Former SSE Equity Owners	$6	$—
Class A common stock issued in connection with the USC Merger	2	—
Class A common stock issued in connection with the acquisition of LLC Interests upon redemption by the Continuing SSE Equity Owners	19,933	—
Non-cash financing activities:		
Cancellation of Class B common stock in connection with the Organizational Transactions	(6)	—
Cancellation of Class B common stock in connection with the redemption of LLC Interests	(6)	—
Cancellation of Class B common stock in connection with the USC Merger	(2)	—
Establishment of liabilities under tax receivable agreement	173,090	—

See accompanying Notes to Condensed Financial Statements.

Table of Contents

Schedule I: Condensed Financial Information of Registrant (continued)

SHAKE SHACK INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
(PARENT COMPANY ONLY)
(in thousands, except share and per share amounts)

NOTE 1: ORGANIZATION

Shake Shack Inc. (the "Parent Company") was formed on September 23, 2014 as a Delaware corporation and is a holding company with no direct operations. The Parent Company's assets consist primarily of its equity interest in SSE Holdings, LLC ("SSE Holdings") and certain deferred tax assets.

On February 4, 2015, the Parent Company completed an initial public offering ("IPO") of 5,750,000 shares of its Class A common stock at a public offering price of $21.00 per share, which includes 750,000 shares issued pursuant to the underwriters' over-allotment option. The Parent Company received $112,298 in proceeds, net of underwriting discounts and commissions, which it used to purchase newly-issued membership interests from SSE Holdings at a price per interest equal to the initial public offering price of its Class A common stock.

The Parent Company's cash inflows are primarily from cash dividends or distributions and other transfers from SSE Holdings. The amounts available to the Parent Company to fulfill cash commitments and pay cash dividends on its common stock are subject to certain restrictions in SSE Holdings' revolving credit agreement. See Note 8 to the consolidated financial statements.

NOTE 2: BASIS OF PRESENTATION

These condensed parent company financial statements should be read in conjunction with the consolidated financial statements of Shake Shack Inc. and the accompanying notes thereto, included in this Annual Report on Form 10-K. For purposes of these condensed financial statements, the Parent Company's interest in SSE Holdings is recorded based upon its proportionate share of SSE Holdings' net assets (similar to presenting them on the equity method).

The Parent Company is the sole managing member of SSE Holdings, and pursuant to the Third Amended and Restated LLC Agreement of SSE Holdings (the “LLC Agreement”), receives compensation in the form of reimbursements for all costs associated with being a public company. Intercompany revenue consists of these reimbursement payments and is recognized when the corresponding expense to which it relates is recognized.

Certain intercompany balances presented in these condensed parent company financial statements are eliminated in the consolidated financial statements. $3,979 of payables were eliminated in consolidation as of December 30, 2015. $1,336 and $6,906 of intercompany revenue and equity in net income of subsidiaries was eliminated in consolidation for fiscal 2015. Related party amounts that were not eliminated in the consolidated financial statements include the Parent Company's liabilities under the tax receivable agreement, which totaled $173,090 as of December 30, 2015.

NOTE 3: COMMITMENTS AND CONTINGENCIES

On February 4, 2015, the Parent Company entered into a tax receivable agreement with certain members of SSE Holdings (the "Continuing SSE Equity Owners") that provides for the payment by us to the Continuing SSE Equity Owners of 85% of the amount of any tax benefits that we actually realize, or in some cases are deemed to realize, as a result of certain transactions. See Note 14 to the consolidated financial statements for more information regarding the Parent Company's tax receivable agreement. As described in Note 17 to the consolidated financial statements, amounts payable under the tax receivable agreement are contingent upon, among other things, (i) generation of future taxable income of Shake Shack Inc. over the term of the tax receivable agreement and (ii) future changes in tax laws. As of December 30, 2015, liabilities under the tax receivable agreement totaled $173,090.

Table of Contents

Schedule II: Valuation and Qualifying Accounts

(in thousands)	Balance at beginning of period	Additions Charged to costs and expenses	Charged to other accounts	Reductions	Balance at end of period
Deferred tax asset valuation allowance:					
Fiscal year ended December 25, 2013	$—	$—	$—	$—	$—
Fiscal year ended December 31, 2014	$—	$—	$—	$—	$—
Fiscal year ended December 30, 2015	$—	$—	$39,700 (1)	$(16,545)	$23,155

(1) Amount relates to a valuation allowance established on deferred tax assets related to our investment in SSE Holdings.

Table of Contents

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.
None.
Item 9A. Controls and Procedures.
DISCLOSURE CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of such date. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.
MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

For the Management's Report on Internal Control over Financial Reporting, see Item 8, Financial Statements and Supplementary Data.
CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

We have enhanced our controls related to accounting for complex transactions, including engaging third-party experts to advise us on the technical aspects of complex transactions. There were no changes to our internal control over financial reporting that occurred during the quarter ended December 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.
Item 9B. Other Information.
Not applicable.

Table of Contents

PART III
Item 10. Directors, Executive Officers and Corporate Governance.
The information required by this item with respect to our directors is incorporated by reference to the sections entitled “Nominees for Election as Class I Directors” and "Continuing Directors" in our Proxy Statement to be filed in connection with our 2016 Annual Meeting of Shareholders (the “Proxy Statement”). The information required by this item with respect to our Code of Business Conduct and Audit Committee (including our “audit committee financial expert”) is incorporated by reference to the sections entitled “Code of Ethics” and “Audit Committee Report.”
The information required by this item with respect to our executive officers is set forth under the section entitled “Executive Officers of the Registrant” in Part I, Item 1 of this Annual Report on Form 10-K.
The information required by this item with respect to Section 16(a) of the Exchange Act is incorporated by reference to the section of the Proxy Statement entitled “Section 16(a) Beneficial Ownership Reporting Compliance.”
Item 11. Executive Compensation.
The information required by this item with respect to director and executive officer compensation is incorporated by reference to the section entitled “Executive Compensation” in our Proxy Statement.
Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.
The information required by this item with respect to securities authorized for issuance under equity compensation plans is set forth under the section entitled “Securities Authorized for Issuance under Equity Compensation Plans” in Part II, Item 5 of this Annual Report on Form 10-K.
The information required by this item with respect to security ownership of certain beneficial owners and management is incorporated by reference to the section entitled “Security Ownership of Certain Beneficial Owners and Management” in our Proxy Statement.
Item 13. Certain Relationships and Related Transactions, and Director Independence.
The information required by this item with respect to transactions with related persons and director independence is incorporated by reference to the sections entitled “Certain Relationships and Related Party Transactions” and “Composition of our Board of Directors” in our Proxy Statement.

Table of Contents

Item 14. Principal Accounting Fees and Services.

The information required by this item with respect to principal accountant's fees and services is incorporated by reference to the sections entitled "Audit and Related Fees" and "Audit Committee Report" in our Proxy Statement.

Table of Contents

Part IV
Item 15. Exhibits and Financial Statement Schedules.
(a) The following documents are filed as part of this report:
(1) Financial Statements

(2) Financial Statement Schedules

All other financial statement schedules are omitted since they are not required or are not applicable, or the required information is included in the consolidated financial statements or notes thereto.

(1) Exhibits
The exhibits listed on the accompanying Exhibit Index are filed or incorporated by reference as part of this report and such Exhibit Index is incorporated herein by reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Shake Shack Inc.
(Registrant)

By: /s/ Jeff Uttz
Jeff Uttz
Chief Financial Officer

Date: March 30, 2016

Pursuant to the requirements of the Securities and Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ Randy Garutti Randy Garutti	Chief Executive Officer and Director (Principal Executive Officer)	March 30, 2016
/s/ Jeff Uttz Jeff Uttz	Chief Financial Officer (Principal Financial and Accounting Officer)	March 30, 2016
/s/ Daniel Meyer Daniel Meyer	Chairman of the Board of Directors	March 30, 2016
/s/ Jeff Flug Jeff Flug	Director	March 30, 2016
/s/ Evan Guillemin Evan Guillemin	Director	March 30, 2016
/s/ Jenna Lyons Jenna Lyons	Director	March 30, 2016
/s/ Jonathan D. Sokoloff Jonathan D. Sokoloff	Director	March 30, 2016
/s/ Robert Vivian Robert Vivian	Director	March 30, 2016

Table of Contents

EXHIBIT INDEX

Exhibit Number		Exhibit Description	Incorporated by Reference Form	Exhibit	Filing Date	Filed Herewith
3.1		Amended and Restated Certificate of Incorporation of Shake Shack Inc., effective February 4, 2015	8-K	3.1	2/10/2015	
3.2		Amended and Restated Bylaws of Shack Shake Inc., dated February 4, 2015	8-K	3.2	2/10/2015	
4.1		Form of Class A Common Stock Certificate	S-1/A	4.1	1/28/2015	
10.1		Third Amended and Restated Limited Liability Company Agreement of SSE Holdings, LLC, dated February 4, 2015 by and among SSE Holdings, LLC and its Members	8-K	10.3	2/10/2015	
10.1.1		Amendment No. 1 to Third Amended and Restated Limited Liability Company Agreement of SSE Holding, LLC, dated March 7, 2015, but effective as of February 5, 2015	POSAM	10.1.1	3/10/2016	
10.2		Amended and Restated Management Services Agreement, to be effective as of January 15, 2015, by and between SSE Holdings, LLC and USHG, LLC.	S-1	10.1	12/29/2014	
10.3		Tax Receivable Agreement, dated February 4, 2015, by and among Shake Shack Inc., SSE Holdings, LLC and each of the Members from time to time party thereto	8-K	10.1	2/10/2015	
10.4		Registration Rights Agreement, dated February 4, 2015, by and among Shake Shack Inc. and each other person identified on the schedule of investors attached thereto	8-K	10.2	2/10/2015	
10.4.1		Amendment No. 1 to Registration Rights Agreement, dated and effective as of October 8, 2015, by and among Shake Shack Inc., the Continuing SSE Equity Owners and affiliates of the Former SSE Equity Owners	10-Q	10.2	11/6/2015	
10.5		Stockholders Agreement, dated February 4, 2015, by and among Shake Shack Inc., SSE Holdings, LLC, and the persons and entities listed on the schedules attached thereto	8-K	10.4	2/10/2015	
10.5.1		Amendment No. 1 to Stockholders Agreement, dated and effective as of October 8, 2015, by and among Shake Shack Inc., SSE Holdings, LLC, the Meyer Stockholders, the LGP Stockholders and the SEG Stockholders	10-Q	10.1	11/6/2015	
10.6		Third Amended and Restated Credit Agreement, dated January 28, 2015, among SSE Holdings, LLC, each other loan party signatory thereto and JPMorgan Chase Bank, N.A., as administrative agent	10-K	10.6	3/27/2015	
10.7		Second Amended and Restated Security Agreement, entered into as of February 18, 2014 by and among SSE Holdings, LLC, each other loan party signatory thereto and JPMorgan Chase Bank, N.A., as administrative agent	S-1/A	10.6	1/20/2015	
10.8		Form of Indemnification Agreement entered into between Shake Shack Inc. and each of its directors and officers, effective February 4, 2015	S-1/A	10.21	1/20/2015	
10.9	†	SSE Holdings, LLC Unit Appreciation Rights Plan	S-1	10.7	12/29/2014	
10.9.1	†	Amendment No. 1 to the SSE Holdings, LLC Unit Appreciation Rights Plan	S-1	10.8	12/29/2014	
10.9.2	†		S-1	10.9	12/29/2014	

		Amendment No. 2 to the SSE Holdings, LLC Unit Appreciation Rights Plan			
10.9.3	†	Form of Unit Appreciation Right Agreement	S-1	10.10	12/29/2014
10.10	†	Shake Shack Inc. 2015 Incentive Award Plan	S-8	4.4	1/30/2015
10.10.1	†	Form of employee option agreement under the Shake Shack Inc. 2015 Incentive Award Plan	S-1/A	10.19	1/20/2015
10.10.2	†	Form of director option agreement under the Shake Shack Inc. 2015 Incentive Award Plan	S-1/A	10.20	1/20/2015
10.11	†	2015 Senior Executive Bonus Plan	S-1	10.12	12/29/2014
10.12	†	Employment Agreement, dated as of November 25, 2014, by and between Shake Shack Inc., SSE Holdings, LLC and Randall Garutti	S-1	10.17	12/29/2014
10.13	†	Employment Agreement, dated as of December 1, 2014, by and between Shake Shack Inc., SSE Holdings, LLC and Jeff Uttz.	S-1	10.18	12/29/2014

Table of Contents

10.14	†	Special Bonus Agreement by and between Union Square Hospitality Group, LLC and Randall Garutti, entered into on March 11, 2011.	S-1	10.14	12/29/2014	
10.14.1	†	Amendment to Special Bonus Agreement by and between Union Square Hospitality Group, LLC and Randall Garutti, entered into on March 11, 2011, effective as of July 25, 2013	S-1	10.15	12/29/2014	
10.14.2	†	Assignment and Assumption Agreement, effective as of October 30, 2014, among Union Square Hospitality Group, LLC, Randall Garutti and SSE Holdings, LLC	S-1	10.16	12/29/2014	
10.14.3	†	Assignment and Assumption Agreement, dated as of January 15, 2015, by and among SSE Holdings, LLC and Shake Shack Inc.	S-1/A	10.22	1/20/2015	
21		Subsidiaries of Shake Shack Inc.				*
23.1		Consent of Independent Registered Public Accounting Firm				*
31.1		Certification of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				*
31.2		Certification of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				*
32	#	Certifications of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				*
101.INS		XBRL Instance Document				*
101.SCH		XBRL Taxonomy Extension Schema Document				*
101.CAL		XBRL Taxonomy Extension Calculation Linkbase Document				*
101.DEF		XBRL Taxonomy Extension Definition Linkbase Document				*
101.LAB		XBRL Taxonomy Extension Label Linkbase Document				*
101.PRE		XBRL Taxonomy Extension Presentation Linkbase Document				*

† Indicates a management contract or compensatory plan or arrangement.
# Furnished herewith.