

Edgar Filing: HERCULES OFFSHORE, INC. - Form 10-Q

HERCULES OFFSHORE, INC.

Form 10-Q

October 24, 2013

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2013

or

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

Commission file number: 0-51582

HERCULES OFFSHORE, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

56-2542838

(I.R.S. Employer
Identification No.)

9 Greenway Plaza, Suite 2200

Houston, Texas

(Address of principal executive offices)

(713) 350-5100

(Registrant's telephone number, including area code)

77046

(Zip Code)

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. 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). Yes ☒ No ☐

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input type="checkbox"/>
(Do not check if a smaller reporting company)			

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, par value \$0.01 per share

Outstanding as of October 21, 2013
159,748,613

Table of Contents

TABLE OF CONTENTS

	Page
<u>PART I - FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	<u>1</u>
<u>Consolidated Balance Sheets as of September 30, 2013 and December 31, 2012</u>	<u>1</u>
<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012</u>	<u>2</u>
<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012</u>	<u>3</u>
<u>Notes to Unaudited Consolidated Financial Statements</u>	<u>4</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>23</u>
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>43</u>
Item 4. <u>Controls and Procedures</u>	<u>43</u>
<u>PART II - OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>43</u>
Item 1A. <u>Risk Factors</u>	<u>44</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>44</u>
Item 6. <u>Exhibits</u>	<u>45</u>
Signatures	<u>46</u>

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	September 30, 2013 (Unaudited)	December 31, 2012
ASSETS		
Current Assets:		
Cash and Cash Equivalents	\$365,839	\$259,193
Restricted Cash	2,027	2,027
Accounts Receivable, Net of Allowance for Doubtful Accounts of \$607 and \$788 as of September 30, 2013 and December 31, 2012, Respectively	187,812	167,936
Prepays	30,561	16,135
Current Deferred Tax Asset	—	21,125
Other	12,584	12,191
	598,823	478,607
Property and Equipment, Net	1,772,148	1,462,755
Equity Investment	—	38,191
Other Assets, Net	32,464	37,077
	\$2,403,435	\$2,016,630
LIABILITIES AND EQUITY		
Current Liabilities:		
Short-term Debt and Current Portion of Long-term Debt	\$—	\$67,054
Accounts Payable	83,826	58,615
Accrued Liabilities	75,931	82,781
Interest Payable	43,662	17,367
Insurance Notes Payable	19,175	9,123
Other Current Liabilities	29,179	26,483
	251,773	261,423
Long-term Debt, Net of Current Portion	1,205,800	798,013
Deferred Income Taxes	4,201	56,821
Other Liabilities	19,289	17,611
Commitments and Contingencies		
Stockholders' Equity:		
Common Stock, \$0.01 Par Value; 300,000 Shares Authorized; 162,127 and 160,708 Shares Issued, Respectively; 159,747 and 158,628 Shares Outstanding, Respectively	1,621	1,607
Capital in Excess of Par Value	2,168,309	2,159,744
Treasury Stock, at Cost, 2,380 Shares and 2,080 Shares, Respectively	(55,143)	(53,100)
Retained Deficit	(1,192,415)	(1,225,489)
	922,372	882,762
	\$2,403,435	\$2,016,630

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

Table of ContentsHERCULES OFFSHORE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenue	\$225,308	\$160,157	\$622,959	\$443,490
Costs and Expenses:				
Operating Expenses	122,728	68,523	355,539	266,503
Asset Impairment	—	60,693	—	108,216
Depreciation and Amortization	38,040	34,529	110,906	108,143
General and Administrative	19,284	14,686	59,821	37,555
	180,052	178,431	526,266	520,417
Operating Income (Loss)	45,256	(18,274	) 96,693	(76,927)
Other Income (Expense):				
Interest Expense	(19,360	) (18,249	) (54,495	) (54,915)
Loss on Extinguishment of Debt	—	—	—	(9,156)
Gain on Equity Investment	—	—	14,876	—
Other, Net	(337	) 676	(1,652	) 764
Income (Loss) Before Income Taxes	25,559	(35,847	) 55,422	(140,234)
Income Tax Benefit (Provision)	(8,400	) (1,319	) 18,609	16,829
Income (Loss) from Continuing Operations	17,159	(37,166	) 74,031	(123,405)
Income (Loss) from Discontinued Operations, Net of Taxes	8,093	(692	) (40,996	) (7,866)
Net Income (Loss)	25,252	(37,858	) 33,035	(131,271)
Loss attributable to Noncontrolling Interest	21	—	39	—
Net Income (Loss) attributable to Hercules Offshore, Inc.	\$25,273	\$(37,858	) \$33,074	\$(131,271)
Net Income (Loss) attributable to Hercules Offshore, Inc. Per share:				
Basic:				
Income (Loss) from Continuing Operations	\$0.11	\$(0.23	) \$0.46	\$(0.81)
Income (Loss) from Discontinued Operations	0.05	(0.01	) (0.25	) (0.05)
Net Income (Loss)	\$0.16	\$(0.24	) \$0.21	\$(0.86)
Diluted:				
Income (Loss) from Continuing Operations	\$0.11	\$(0.23	) \$0.46	\$(0.81)
Income (Loss) from Discontinued Operations	0.05	(0.01	) (0.26	) (0.05)
Net Income (Loss)	\$0.16	\$(0.24	) \$0.20	\$(0.86)
Weighted Average Shares Outstanding:				
Basic	159,743	158,573	159,416	152,098
Diluted	161,851	158,573	161,472	152,098

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

Table of ContentsHERCULES OFFSHORE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30,	
	2013	2012
Cash Flows from Operating Activities:		
Net Income (Loss)	\$33,074	\$(131,271)
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities:		
Depreciation and Amortization	121,804	126,178
Stock-Based Compensation Expense	7,464	5,141
Deferred Income Taxes	(29,792)	(33,120)
Provision (Benefit) For Doubtful Accounts Receivable	356	(8,841)
Gain on Equity Investment	(14,876)	—
Asset Impairment	44,370	108,216
Gain on Insurance Settlement	—	(30,668)
Gain on Disposal of Assets, Net	(3,140)	(24,563)
Other	4,667	7,537
(Increase) Decrease in Operating Assets -		
Accounts Receivable	(21,030)	7,992
Prepaid Expenses and Other	10,078	2,033
Increase (Decrease) in Operating Liabilities -		
Accounts Payable	23,165	9,013
Insurance Notes Payable	(21,855)	(17,151)
Other Current Liabilities	20,126	35,821
Other Liabilities	4,992	2,896
Net Cash Provided by Operating Activities	179,403	59,213
Cash Flows from Investing Activities:		
Acquisition of Assets, Net of Cash Acquired	(200,957)	(40,000)
Additions of Property and Equipment	(307,135)	(82,150)
Deferred Drydocking Expenditures	(7,519)	(9,814)
Cash Paid for Equity Investment	—	(4,288)
Insurance Proceeds Received	1,430	54,139
Proceeds from Sale of Assets, Net	107,404	49,854
Other	2,214	1,621
Net Cash Used in Investing Activities	(404,563)	(30,638)
Cash Flows from Financing Activities:		
Long-term Debt Borrowings	400,000	500,000
Long-term Debt Repayments	—	(452,909)
Redemption of 3.375% Convertible Senior Notes	(61,274)	(27,606)
Common Stock Issuance	—	96,696
Payment of Debt Issuance Costs	(8,208)	(7,717)
Other	1,288	160
Net Cash Provided by Financing Activities	331,806	108,624
Net Increase in Cash and Cash Equivalents	106,646	137,199
Cash and Cash Equivalents at Beginning of Period	259,193	134,351
Cash and Cash Equivalents at End of Period	\$365,839	\$271,550

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

3

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 UNAUDITED

1. General

Hercules Offshore, Inc., a Delaware corporation, and its majority owned subsidiaries (the “Company”) provide shallow-water drilling and marine services to the oil and natural gas exploration and production industry globally through its Domestic Offshore, International Offshore and International Liftboats segments (See Notes 5 and 11). At September 30, 2013, the Company owned a fleet of 40 jackup rigs, including Hercules Triumph (Formerly Discovery Triumph) and Hercules Resilience (Formerly Discovery Resilience) acquired from Discovery Offshore (See Note 4), 19 liftboat vessels as well as operated an additional five liftboat vessels owned by a third party (See Notes 5 and 11). The Company’s diverse fleet is capable of providing services such as oil and gas exploration and development drilling, well service, platform inspection, maintenance and decommissioning operations in several key shallow-water provinces around the world.

The consolidated financial statements of the Company are unaudited; however, they include all adjustments of a normal recurring nature which, in the opinion of management, are necessary for a fair presentation. Certain information relating to the Company’s organization and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted in this Form 10-Q pursuant to Securities and Exchange Commission rules and regulations. These financial statements should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2012 and the notes thereto included in the Company’s Annual Report on Form 10-K, as amended by our current report on Form 8-K filed on August 23, 2013. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of the results expected for the full year.

Recast of Financial Information for Discontinued Operations

Due to the current period classification of the Domestic Liftboats and Inland segments as discontinued operations, we have recast the Company's historical information to reflect the results of operations of these two segments as discontinued operations for all periods presented. In addition, the historical results of Domestic Offshore have been recast to include the operating results of the remaining retained Inland assets and the historical results of International Liftboats have also been recast to include the operating results of the Kingfish vessel which was transferred from Domestic Liftboats in 2012 (See Note 11).

Principles of Consolidation

The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries including the accounts of its wholly owned subsidiary Discovery Offshore S.A. (“Discovery”) from the date a majority controlling interest was acquired. All intercompany account balances and transactions have been eliminated.

2. Supplemental Financial Information

Consolidated Balance Sheet Information

Other current liabilities consisted of the following:

	September 30, 2013	December 31, 2012
	(in thousands)	
Other Current Liabilities:		
Deferred Revenue - Current Portion	\$ 19,266	\$ 14,546
Other	9,913	11,937
	\$ 29,179	\$ 26,483

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

Equity

Changes in equity during the nine months ended September 30, 2013 are presented below:

	Stockholders' Equity (in thousands)	Noncontrolling Interest	Total Equity
Balance at December 31, 2012	\$882,762	\$—	\$882,762
Net Income (Loss)	33,074	(39	) 33,035
Acquisition of Interest in Discovery	—	26,448	26,448
Acquisition of Noncontrolling Interest in Discovery	(39	) (26,409	) (26,448
Compensation Expense Recognized	7,464	—	7,464
Repurchase of Common Stock	(2,044	) —	(2,044
Excess Tax Benefit, Net from Stock-Based Arrangements	842	—	842
Other	313	—	313
Balance at September 30, 2013	\$922,372	\$—	\$922,372

Common Stock Offering

In March 2012, the Company raised approximately \$96.7 million in net proceeds from an underwritten public offering of 20.0 million shares of common stock at a price to the public of \$5.10 per share. The Company used a portion of the net proceeds from the share offering to fund a portion of the purchase price for the acquisition of Hercules 266 and used the remaining net proceeds for general corporate purposes as well as the costs associated with the upgrade and mobilization of Hercules 266.

3. Earnings Per Share

The reconciliation of the numerators and denominators used for the computation of basic and diluted earnings per share is as follows:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	2012		2012	
	(in thousands)			
Numerator:				
Income (loss) from continuing operations	\$17,159	\$(37,166)	\$74,031	\$(123,405)
Less: Loss attributable to noncontrolling interest	21	—	39	—
Adjusted income (loss) from continuing operations	17,180	(37,166)	74,070	(123,405)
Income (loss) from discontinued operations, net of taxes	8,093	(692)	(40,996)	(7,866)
Net income (loss) attributable to Hercules Offshore, Inc.	\$25,273	\$(37,858)	\$33,074	\$(131,271)
Denominator:				
Weighted average basic shares	159,743	158,573	159,416	152,098
Add effect of stock equivalents	2,108	—	2,056	—
Weighted average diluted shares	161,851	158,573	161,472	152,098

The Company calculates basic earnings per share by dividing net income by the weighted average number of shares outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the period as adjusted for the dilutive effect of the Company's stock option and restricted stock awards. The effect of stock option and restricted stock awards is not included in the computation for periods in which a net loss occurs, because to do so would be anti-dilutive.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

The Company's diluted earnings per share calculation excludes 0.8 million and 0.9 million stock equivalents for the three and nine month periods ended September 30, 2013, respectively, due to their anti-dilutive effect. The Company's diluted earnings per share calculation for both the three and nine month periods ended September 30, 2012 excludes 6.2 million stock equivalents that would have potentially been included if the Company had generated net income for the period, but are excluded as the Company generated a net loss during the period.

4. Business Combination

As of December 31, 2012, the Company held a \$38.2 million, or 32%, equity investment in Discovery, a development stage company whose purpose was to own new ultra high specification jackup drilling rigs. Historically, we accounted for our investment in Discovery under the equity method of accounting. On June 24, 2013, the Company acquired an additional 52% interest to bring the total interest held to 84%, for cash consideration, net of cash acquired of \$77.7 million ("Discovery Transaction"). The Discovery Transaction allows the Company to enter into the high-specification jackup market and it significantly expands our service offerings to the most demanding drilling customers and opens new international markets that have growing needs for assets of this caliber. The Company began consolidating Discovery's results of operations as of the acquisition date, June 24, 2013 ("Acquisition Date"). As of September 30, 2013, the Company held a 100% interest in Discovery as a result of additional purchases of shares of Discovery common stock subsequent to the Acquisition Date at 15 Norwegian Kroner ("NOK") per share (USD \$26.3 million in total).

The acquisition date fair value of the Company's previously held equity interest in Discovery was \$52.0 million based on the price the Company paid for additional Discovery shares on June 24, 2013 of 15 NOK per share. The Company recognized a \$14.9 million gain as a result of remeasuring the 32% equity interest in Discovery at its fair value as of the Acquisition Date in accordance with Accounting Standards Codification ("ASC") Topic 805, Business Combinations. This gain is included in Gain on Equity Investment on the Consolidated Statements of Operations for the nine month period ended September 30, 2013.

In connection with the Discovery Transaction, the Company settled certain pre-existing relationships including a receivable from Discovery, warrants to purchase 5 million Discovery shares (see Note 7), as well as deferred revenue in the amounts of \$14.3 million, \$3.5 million and \$5.6 million, respectively, at the date of acquisition.

The Company valued the noncontrolling interest at the Acquisition Date at 15 NOK per share or \$26.4 million in total. The components of the consideration transferred were as follows:

	June 24, 2013 (in thousands) (unaudited)
Cash Paid, net of cash acquired	\$77,658
Elimination of related party balances	12,283
Fair value of Discovery equity investment	51,959
Noncontrolling interest	26,448
	\$168,348

The Company accounted for this transaction as a business combination and, accordingly, the total consideration was allocated to Discovery's net tangible assets based on their estimated fair values. The Company is in the process of finalizing valuations of these net tangible assets. Therefore, these valuations are preliminary and are subject to change upon the receipt and management's review of the final valuations. Upon final valuation of the net tangible assets, the excess, if any, of the purchase price over these assets will be recorded as goodwill.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

The preliminary allocation of the consideration is as follows:

	June 24, 2013 (in thousands) (unaudited)
Prepays	\$1,700
Other	1,563
Property and Equipment, Net	334,210
Total Assets	337,473
Accounts Payable	(986)
Accrued Liabilities (a)	(166,953)
Insurance Note Payable	(1,186)
Total Liabilities	(169,125)
Total Preliminary Purchase Price	\$168,348

(a) includes the final shipyard installment for Hercules Triumph of \$166.9 million, which was paid on July 23, 2013.

The following presents the consolidated financial information for the Company on a pro forma basis assuming the Discovery Transaction had occurred as of the beginning of the periods presented. The historical financial information has been adjusted to give effect to pro forma items that are directly attributable to the acquisition and factually supportable. These items include adjustments to eliminate directly related transaction costs, record noncontrolling interest, and eliminate our losses on equity investment.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

The unaudited pro forma financial information set forth below has been compiled from current financial statements and historical financial statements as recast for the Company's discontinued operations and other information, but is not necessarily indicative of the results that actually would have been achieved had the transaction occurred at the beginning of the periods presented or that may be achieved in the future:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(in millions, except per share amounts)			
Revenue	\$224.0	\$158.5	\$615.4	\$438.9
Income (Loss) from Continuing Operations	17.4	(37.4)	) 60.5	(124.3)
Income (Loss) from Discontinued Operations, Net of Taxes	8.1	(0.7)	) (41.0)	) (7.9)
Net Income (Loss)	25.5	(38.1)	) 19.5	(132.2)
Loss Attributable to Noncontrolling Interest	—	—	—	—
Net Income (Loss) Attributable to Hercules Offshore, Inc.	\$25.5	\$(38.1)	) \$19.5	\$(132.2)

Net Income (Loss) Attributable to Hercules Offshore, Inc. Per share:

Basic:

Income (Loss) from Continuing Operations	\$0.11	\$(0.24)	) \$0.38	\$(0.82)
Income (Loss) from Discontinued Operations	0.05	—	(0.26)	) (0.05)
Net Income (Loss)	\$0.16	\$(0.24)	) \$0.12	\$(0.87)

Diluted:

Income (Loss) from Continuing Operations	\$0.11	\$(0.24)	) \$0.37	\$(0.82)
Income (Loss) from Discontinued Operations	0.05	—	(0.25)	) (0.05)
Net Income (Loss)	\$0.16	\$(0.24)	) \$0.12	\$(0.87)

The amount of revenue and net loss of Discovery included in the Consolidated Statements of Operations for the three and nine months ended September 30, 2013 is as follows:

	Three Months Ended September 30, 2013 (in millions)	June 24, 2013 through September 30, 2013
Revenue	\$—	\$—
Net loss	(1.8)	) (1.9)

The Company incurred transaction costs in the amount of \$0.3 million and \$3.3 million for the three and nine months ended September 30, 2013 related to the Discovery Transaction. These transaction costs are included in General and Administrative on the Consolidated Statements of Operations.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

5. Dispositions and Discontinued Operations

From time to time the Company enters into agreements to sell assets. The following table provides information related to the sale of several of the Company's assets, excluding other miscellaneous asset sales that occur in the normal course of business, during the nine months ended September 30, 2013 and 2012:

Asset	Segment	Period of Sale	Proceeds (in thousands)	Gain/(Loss) (a)
2013:				
Various (b)	Domestic Liftboats	July 2013	\$54,447	\$—
Various (c)	Inland	July 2013	44,331	—
Hercules 27	Inland	August 2013	5,149	4,834
			\$103,927	\$4,834
2012:				
Hercules 2501	Domestic Offshore	June 2012	\$7,000	\$5,465
Hercules 29	Inland	July 2012	900	770
Platform Rig 3 (d)	International Offshore	August 2012	35,516	18,350
Hercules 101	Domestic Offshore	September 2012	1,200	—
			\$44,616	\$24,585

(a) Gains (Losses) on the Domestic Liftboats and Inland segments are reflected in the Consolidated Statement of Operations as discontinued operations.

(b) The Company completed the sale of its U.S. Gulf of Mexico liftboats and related assets.

(c) The Company completed the sale of eleven inland barge rigs and related assets.

(d) This represents the gain on the sale of Platform Rig 3 and related legal entities.

Discontinued Operations

In May 2013, the Company entered into an agreement to sell eleven inland barge rigs, comprising the majority of the Inland segment fleet, and related assets for \$45 million, and in July 2013 the Company closed on the sale of these Inland assets. Additionally, in August 2013, the Company sold the Hercules 27 inland barge for approximately \$5.1 million. In the second quarter of 2013, the Company recorded an impairment charge of \$40.9 million (\$40.7 million, net of tax) related to the sale of the Inland barges. The results of operations of the Inland segment are reflected in the Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012 as discontinued operations.

In June 2013, the Company entered into an agreement to sell its U.S. Gulf of Mexico Liftboats and related assets. As a result of this transaction, the Company recorded an impairment charge of \$3.5 million (\$3.5 million, net of tax) in the second quarter of 2013. On July 1, 2013, the Company closed on the sale of the liftboats and related assets and received proceeds of approximately \$54.4 million. The results of operations of the Domestic Liftboats segment are reflected in the Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012 as discontinued operations.

Interest charges have been allocated to the discontinued operations of the Inland and Domestic Liftboat segments in accordance with FASB ASC 205-20, Discontinued Operations. The interest was allocated based on a pro rata calculation of the net assets sold as compared to the Company's consolidated net assets. Interest allocated to discontinued operations of the Inland segment was \$0.1 million and \$1.4 million for the three and nine months ended September 30, 2013, respectively, and \$0.9 million and \$2.8 million for the three and nine months ended September 30, 2012, respectively. Interest allocated to discontinued operations of the Domestic Liftboat segment was \$1.2 million for the nine months ended September 30, 2013 and \$0.7 million and \$2.1 million for the three and nine months ended September 30, 2012, respectively.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

Operating results included in discontinued operations were as follows:

	Three Months Ended September 30, 2013 2012		Nine Months Ended September 30, 2013 2012	
	(in thousands)			
Inland:				
Revenue	\$1,510	\$7,363	\$15,782	\$19,907
Income (Loss) Before Income Taxes	\$5,192	\$(3,168)	\$(39,481)	\$(12,245)
Income Tax Benefit	2,397	1,273	2,571	4,920
Income (Loss) from Discontinued Operations, Net of Taxes	\$7,589	\$(1,895)	\$(36,910)	\$(7,325)
Domestic Liftboats:				
Revenue	\$—	\$17,368	\$29,625	\$43,761
Income (Loss) Before Income Taxes	\$504	\$1,866	\$(4,086)	\$(839)
Income Tax Benefit (Provision)	—	(663)	—	298
Income (Loss) from Discontinued Operations, Net of Taxes	\$504	\$1,203	\$(4,086)	\$(541)
Total:				
Revenue	\$1,510	\$24,731	\$45,407	\$63,668
Income (Loss) Before Income Taxes	\$5,696	\$(1,302)	\$(43,567)	\$(13,084)
Income Tax Benefit	2,397	610	2,571	5,218
Income (Loss) from Discontinued Operations, Net of Taxes	\$8,093	\$(692)	\$(40,996)	\$(7,866)

6. Debt

Debt is comprised of the following:

	September 30, 2013	December 31, 2012
	(in thousands)	
8.75% Senior Notes, due July 2021	\$400,000	\$—
7.125% Senior Secured Notes, due April 2017	300,000	300,000
10.5% Senior Notes, due October 2017	295,184	294,503
10.25% Senior Notes, due April 2019	200,000	200,000
3.375% Convertible Senior Notes, due June 2038	7,106	67,054
7.375% Senior Notes, due April 2018	3,510	3,510
Total Debt	1,205,800	865,067
Less Short-term Debt and Current Portion of Long-term Debt	—	67,054
Total Long-term Debt, Net of Current Portion	\$1,205,800	\$798,013
Senior Secured Credit Agreement		

On April 3, 2012, the Company entered into a credit agreement (the "Credit Agreement"), which governs its senior secured revolving credit facility (the "Credit Facility"). On July 8, 2013, the Company amended its Credit Agreement to increase the senior secured revolving credit facility to \$150.0 million from \$75.0 million and the sublimit for the issuance of letters of credit to \$50.0 million from \$25.0 million. As of September 30, 2013, no amounts were outstanding and \$1.0 million in letters of credit had been issued under the Credit Facility, therefore the remaining availability under this facility was \$149.0 million.

Prior to July 8, 2013, borrowings under the Credit Facility bore interest, at the Company's option, at either (i) the Alternate Base Rate ("ABR") (the highest of the administrative agent's corporate base rate of interest, the federal funds rate plus

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

0.5%, or the one-month Eurodollar rate (as defined in the Credit Agreement) plus 1%), plus an applicable margin that ranged between 3.0% and 4.5%, depending on the Company's leverage ratio, or (ii) the Eurodollar rate plus an applicable margin that ranged between 4.0% and 5.5%, depending on the Company's leverage ratio. The Company paid a per annum fee on all letters of credit issued under the Credit Facility, which fee equaled the applicable margin for loans accruing interest based on the Eurodollar rate, and the Company paid a commitment fee of 0.75% per annum on the unused availability under the Credit Facility.

In addition, during any period of time that outstanding letters of credit under the Credit Facility exceed \$10 million or there are any revolving borrowings outstanding under the Credit Facility, the Company will have to maintain compliance with a maximum secured leverage ratio (as defined in the Credit Agreement, being generally computed as the ratio of secured indebtedness to consolidated cash flow). The maximum secured leverage ratio is 3.50 to 1.00.

The Company's obligations under the Credit Agreement are guaranteed by substantially all of the Company's current domestic subsidiaries (collectively, the "Guarantors"), and the obligations of the Company and the Guarantors are secured by liens on substantially all of the vessels owned by the Company and the Guarantors, together with certain accounts receivable, equity of subsidiaries, equipment and other assets.

July 2013 Credit Amendment

The amendment to the Credit Agreement, among other things:

- increased the senior secured revolving credit facility to \$150.0 million (subject to certain limitations which restrict borrowing to \$75.0 million while the 10.5% Senior Notes due 2017 are outstanding);

- extended the maturity date of the Credit Facility to July 8, 2018;

- increased the sublimit for the issuance of letters of credit to \$50.0 million;

- allowed for an increase in aggregate commitments of up to \$50.0 million;

- reduced the applicable margin for ABR Loans to a range between 1.5% and 3.0% depending on the Company's total leverage ratio;

- reduced the applicable margin for Eurodollar Loans to a range between 2.5% and 4.0% depending on the Company's total leverage ratio; and

- reduced the per annum commitment fee on unused availability under the Credit Facility to 0.50%.

The Company incurred costs of \$1.1 million related to the amendment of its Credit Agreement.

8.75% Senior Notes due 2021

On July 8, 2013, the Company completed the issuance and sale of \$400.0 million aggregate principal amount of senior notes at a coupon rate of 8.75% ("8.75% Senior Notes") with maturity in July 2021. These notes were sold at par and the Company received net proceeds from the offering of the notes of approximately \$393.0 million after deducting the bank fees and estimated offering expenses. Interest on the notes will accrue from and including July 8, 2013 at a rate of 8.75% per year and is payable semi-annually in arrears on January 15 and July 15 of each year, beginning January 15, 2014.

The 8.75% Senior Notes are guaranteed by each of the Guarantors that guarantee the Company's obligations under its Credit Agreement.

Prior to July 15, 2016, the Company may redeem the notes with the net cash proceeds of certain equity offerings, at a redemption price equal to 108.75% of the aggregate principal amount plus accrued and unpaid interest; provided, that (i) after giving effect to any such redemptions, at least 65% of the notes originally issued would remain outstanding immediately after such redemption and (ii) the Company makes such redemption not more than 180 days after consummation of such equity offering. In addition, prior to July 15, 2017, the Company may redeem all or part of the notes at a price equal to 100% of the aggregate principal amount of the notes to be redeemed, plus the applicable premium, as defined in the indenture, and accrued and unpaid interest.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

On or after July 15, 2017, the Company may redeem all or part of the notes at the redemption prices set forth below, together with accrued and unpaid interest, if any, to the redemption date, if redeemed during the 12-month period beginning July 15 of the years indicated:

Year	Optional Redemption Price	
2017	104.375	%
2018	102.188	%
2019 and thereafter	100.000	%

If the Company experiences certain kinds of changes of control, holders of the notes will be entitled to require the Company to purchase all or any portion of the notes for a cash price equal to 101.0% of the principal amount of the applicable notes, plus accrued and unpaid interest, if any, to the date of purchase. Furthermore, in certain circumstances following an asset sale (as defined in the indenture), the Company may be required to use the excess proceeds to offer to repurchase the notes at an offer price in cash equal to 100% of their principal amount, plus accrued and unpaid interest.

7.5% Senior Notes due 2021

On October 1, 2013, the Company completed the issuance and sale of \$300.0 million aggregate principal amount of senior notes at a coupon rate of 7.5% ("7.5% Senior Notes") with maturity in October 2021. These notes were sold at par and the Company received net proceeds from the offering of the notes of approximately \$294.5 million after deducting the bank fees and estimated offering expenses. Interest on the notes will accrue from and including October 1, 2013 at a rate of 7.5% per year and is payable semi-annually in arrears on April 1 and October 1 of each year, beginning April 1, 2014.

The 7.5% Senior Notes are guaranteed by each of the Guarantors that guarantee the Company's obligations under its Credit Agreement.

Prior to October 1, 2016, the Company may redeem the notes with the net cash proceeds of certain equity offerings, at a redemption price equal to 107.5% of the aggregate principal amount plus accrued and unpaid interest; provided, that (i) after giving effect to any such redemptions, at least 65% of the notes originally issued would remain outstanding immediately after such redemption and (ii) the Company makes such redemption not more than 180 days after consummation of such equity offering. In addition, prior to October 1, 2016, the Company may redeem all or part of the notes at a price equal to 100% of the aggregate principal amount of the notes to be redeemed, plus the applicable premium, as defined in the indenture, and accrued and unpaid interest.

On or after October 1, 2016, the Company may redeem all or part of the notes at the redemption prices set forth below, together with accrued and unpaid interest, if any, to the redemption date, if redeemed during the 12-month period beginning October 1 of the years indicated:

Year	Optional Redemption Price	
2016	105.625	%
2017	103.750	%
2018	101.875	%
2019 and thereafter	100.000	%

If the Company experiences certain kinds of changes of control, holders of the notes will be entitled to require the Company to purchase all or any portion of the notes for a cash price equal to 101.0% of the principal amount of the applicable notes, plus accrued and unpaid interest, if any, to the date of purchase. Furthermore, in certain circumstances following an asset sale (as defined in the indenture), the Company may be required to use the excess proceeds to offer to repurchase the notes at an offer price in cash equal to 100% of their principal amount, plus accrued and unpaid interest.

10.5% Senior Notes due 2017

On September 17, 2013, the Company commenced a cash tender offer (the "Tender offer") for any and all of the \$300.0 million outstanding aggregate principal amount of its 10.5% Senior Notes due 2017. Senior notes totaling approximately \$253.6 million were tendered as of September 30, 2013 and were settled on October 1, 2013 for \$268.5 million using a portion of the

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

proceeds from the issuance of the 7.5% Senior Notes due 2021. The Company expects to use the remaining net proceeds from the 7.5% Senior Notes due 2021 offering, together with cash on hand, to redeem the remaining \$46.4 million aggregate principal amount of the 10.5% Senior Notes in November 2013 for approximately \$48.8 million.

3.375% Convertible Senior Notes due 2038

The Company may redeem the 3.375% Convertible Senior Notes at its option and holders of the notes will have the right to require the Company to repurchase the notes on June 1, 2018 and certain dates thereafter or on the occurrence of a fundamental change.

The Company determined that upon maturity or redemption, it has the intent and ability to settle the principal amount of its 3.375% Convertible Senior Notes in cash, and any additional conversion consideration spread (the excess of conversion value over face value) in shares of the Company's Common Stock.

In May 2012, the Company repurchased \$27.6 million aggregate principal amount of the 3.375% Convertible Senior Notes, resulting in a loss of \$1.3 million that is included in Loss on Extinguishment of Debt in the Consolidated Statements of Operations for the nine months ended September 30, 2012. The settlement consideration was allocated to the extinguishment of the liability component in an amount equal to the fair value of that component immediately prior to extinguishment with the difference between this allocation and the net carrying amount of the liability component and unamortized debt issuance costs recognized as a gain or loss on debt extinguishment. If there would have been any remaining settlement consideration, it would have been allocated to the reacquisition of the equity component and recognized as a reduction of stockholders' equity.

On May 1, 2013, the Company made an offer to purchase all of the outstanding notes in accordance with our repurchase obligation under the indenture and on June 1, 2013 repurchased \$61.3 million aggregate principal amount of the 3.375% Convertible Senior Notes pursuant to the terms of the tender offer.

Other Indenture Provisions

The Credit Agreement as well as the indentures governing the 8.75% Senior Notes, 7.5% Senior Notes, 7.125% Senior Secured Notes, 10.25% Senior Notes, 10.5% Senior Notes and 3.375% Convertible Senior Notes contain customary events of default. In addition, the Credit Agreement as well as the indentures governing the 8.75% Senior Notes, 7.5% Senior Notes, 7.125% Senior Secured Notes, 10.25% Senior Notes, 10.5% Senior Notes and 3.375% Convertible Senior Notes also contain a provision under which an event of default by the Company or by any restricted subsidiary on any other indebtedness exceeding \$25.0 million would be considered an event of default under the Credit Agreement and indentures if such default: a) is caused by failure to pay the principal at final maturity, or b) permits the acceleration of such indebtedness prior to maturity.

The Credit Agreement as well as the indentures governing the 8.75% Senior Notes, 7.5% Senior Notes, 7.125% Senior Secured Notes, 10.25% Senior Notes and 10.5% Senior Notes contain covenants that, among other things, limit the Company's ability and the ability of its restricted subsidiaries to:

- incur additional indebtedness or issue certain preferred stock;
- pay dividends or make other distributions;
- make other restricted payments or investments;
- sell assets;
- create liens;
- enter into agreements that restrict dividends and other payments by restricted subsidiaries;
- engage in transactions with affiliates; and
- consolidate, merge or transfer all or substantially all of its assets.

The indenture governing the 10.5% Senior Notes provides that all the liens securing the notes may be released if the Company's total amount of secured indebtedness, other than the 10.5% Senior Notes, does not exceed the lesser of \$375.0 million and 15.0% of its consolidated tangible assets. We refer to such a release as a "collateral suspension." When a collateral suspension is in effect, the 10.5% Senior Notes due 2017 become unsecured. Following the closing

of the 2012 debt issuances and the use of proceeds thereof to repay in full the prior secured credit facility, the liens securing the 10.5% Senior Notes were released on April 3, 2012 and a collateral suspension is currently in effect. The indenture governing the 10.5% Senior Notes also provides that if, after any such collateral suspension, the aggregate principal amount of our total secured indebtedness, other than the 10.5% Senior Notes due 2017, were to exceed the greater of \$375.0 million and 15.0% of our consolidated tangible assets, as defined in such indenture, then the collateral obligations of the Company and guarantors thereunder will be

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

reinstated and must be complied with within 30 days of such event.

Substantially all of the Company's domestic subsidiaries guarantee the obligations under the Credit Agreement, the 8.75% Senior Notes, 7.5% Senior Notes, 7.125% Senior Secured Notes, 10.25% Senior Notes and 10.5% Senior Notes.

The Company's obligations under the Credit Agreement and 7.125% Senior Secured Notes are secured on an equal and ratable first priority basis by liens on a majority of its vessels and substantially all of its other personal property.

7. Derivative Instruments

Warrants

Previously the Company was issued warrants to purchase up to 5.0 million additional shares of Discovery stock at a strike price of 11.50 NOK per share which was exercisable in the event that the Discovery stock price reached an average equal to or higher than 23.00 NOK per share for 30 consecutive trading days. The warrants were being accounted for as a derivative instrument as the underlying security was readily convertible to cash. Subsequent changes in the fair value of the warrants were recognized to other income (expense). The fair value of the Discovery warrants was determined using a Monte Carlo simulation (See Note 8). On June 24, 2013, the derivative asset was adjusted to a fair value of \$3.5 million and included as a purchase adjustment in connection with the purchase of a controlling interest in Discovery (see Note 4).

The following table provides the fair values of the Company's derivatives:

	Fair Value	
Balance Sheet	December 31, 2012	
Classification	(in thousands)	
Derivatives:		
Warrants	\$3,964	
Other Assets, Net	\$3,964	

The following table provides the effect of the Company's derivatives on the Consolidated Statements of Operations:

Derivatives	Three Months Ended September 30,		Nine Months Ended September 30,	
	I.	II.	I.	II.
	(in thousands)		(in thousands)	
Warrants	Other Income (Expense)	\$— \$847	Other Income (Expense)	\$(424) \$1,080

I. Classification of Gain (Loss) Recognized in Income (Loss) on Derivative

II. Amount of Gain (Loss) Recognized in Income (Loss) on Derivative

8. Fair Value Measurements

Fair value measurements are generally based upon observable and unobservable inputs. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's view of market assumptions in the absence of observable market information. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. The Company uses the fair value hierarchy included in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820-10, Fair Value Measurements and Disclosure ("ASC 820-10"), which is intended to increase consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy consists of the following three levels:

Level 1 — Inputs are quoted prices in active markets for identical assets or liabilities.

Level 2 — Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable and market-corroborated inputs which are derived principally from or corroborated by observable market data.

Level 3 — Inputs are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

The fair value of the warrants was determined using a Monte Carlo simulation based on the following assumptions:

	June 24, 2013	December 31, 2012		
Strike Price (NOK)	11.50	11.50		
Target Price (NOK)	23.00	23.00		
Stock Value (NOK)	15.00	13.00		
Expected Volatility (%)	40.0	% 50.0	%	
Risk-Free Interest Rate (%)	1.42	% 1.44	%	
Expected Life of Warrants (5 years at inception)	2.6	3.1		
Number of Warrants	5,000,000	5,000,000		

The Company used the historical volatility of companies similar to that of Discovery to estimate volatility. The risk-free interest rate assumption was based on observed interest rates consistent with the approximate life of the warrants. The stock price represents the closing stock price of Discovery stock at June 24, 2013 and December 31, 2012. The strike price, target price, expected life and number of warrants are all contractual based on the terms of the warrant agreement. On June 24, 2013, the derivative asset was adjusted to a fair value of \$3.5 million, measured using level 2 inputs, and was included as a purchase adjustment in connection with the purchase of a controlling interest in Discovery (see Note 4).

The following table represents the Company's derivative asset measured at fair value on a recurring basis as of December 31, 2012:

	Total Fair Value Measurement (in thousands)	Quoted Prices in Active Markets for Identical Asset or Liability (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Warrants - as of December 31, 2012	\$3,964	\$—	\$3,964	\$—

The carrying value and fair value of the Company's equity investment in Discovery was \$38.2 million and \$49.1 million at December 31, 2012, respectively. The fair value at December 31, 2012 was calculated using the closing price of Discovery shares (Level 1 input), converted to U.S. dollars using the exchange rate. In June 2013, as a result of the acquisition of a controlling interest in Discovery, the Company began consolidating the results of Discovery and discontinued accounting for the investment as an equity investment (See Note 4).

The following table represents the Company's assets measured at fair value on a non-recurring basis for which an impairment measurement was made during the nine months ended September 30, 2013:

	Total Fair Value Measurement (in thousands)	Quoted Prices in Active Markets for Identical Asset or Liability (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gain (Loss)
Property and Equipment, Net (1)	\$98,802	\$ —	\$98,802	\$—	\$(44,370)

(1) This represents a non-recurring fair value measurement made at June 30, 2013 for various assets that were part of the discontinued operations of the Inland and Domestic Liftboats segments.

Long-lived assets held for sale at June 30, 2013 were written down to their fair value less estimated cost to sell, resulting in impairment charges of \$40.9 million (\$40.7 million, net of tax) and \$3.5 million (\$3.5 million, net of tax), for the discontinued operations of the Inland and Domestic Liftboats segments, respectively. The impairment charges are included in Discontinued Operations on the Consolidated Statements of Operations for the nine months ended September 30, 2013 (See Note 5).

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

The following table represents the Company's assets measured at fair value on a non-recurring basis for which an impairment measurement was made during the nine months ended September 30, 2012:

	Total Fair Value Measurement (in thousands)	Quoted Prices in Active Markets for Identical Asset or Liability (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Gain (Loss)
Property and Equipment, Net (1)	\$9,340	\$ —	\$7,840	\$1,500	\$(60,693)
Property and Equipment, Net (2)	\$1,500	\$ —	\$—	\$1,500	\$(42,916)

(1) This represents a non-recurring fair value measurement made at September 30, 2012 for Hercules 252 and Hercules 258.

(2) This represents a non-recurring fair value measurement made at June 30, 2012 for Hercules 185.

Long-lived assets held for sale at September 30, 2012 were written down to their fair value less estimated cost to sell, resulting in an impairment charge of approximately \$25.5 million (\$16.6 million, net of tax), which is included in Asset Impairment on the Consolidated Statements of Operations for the three and nine months ended September 30, 2012, related to Hercules 252. The sale of Hercules 252 was completed in October 2012.

During September 2012, the Company made the decision to cold stack Hercules 258 effective October 1, 2012 and removed it from its marketable assets into its non-marketable assets as the Company does not reasonably expect to market this rig in the foreseeable future. This decision resulted in an impairment charge of approximately \$35.2 million (\$35.2 million, net of tax), which is included in Asset Impairment on the Consolidated Statements of Operations for the three and nine months ended September 30, 2012, to write the rig down to salvage value based on a third party estimate. The financial information for Hercules 258 has been reported as part of the International Offshore segment.

In April 2012, during the return mobilization from the U.S. Gulf of Mexico to Angola, Hercules 185 experienced extensive damage to various portions of the rig's legs. The Company believed it was unfeasible to repair the damage and return the rig to service and recorded an impairment charge of \$42.9 million (\$27.9 million, net of tax) which is included in Asset Impairment on the Consolidated Statements of Operations for the nine months ended September 30, 2012 to write the rig down to salvage value. In addition, the Company incurred \$4.6 million (\$3.0 million, net of tax) related to the write-off of the unamortized deferred costs associated with the Hercules 185 contract which is included in Asset Impairment on the Consolidated Statements of Operations for the nine months ended September 30, 2012.

Fair Value of Financial Instruments

The carrying amounts of the Company's financial instruments, which include cash and cash equivalents, restricted cash, accounts receivable, accounts payable, accrued liabilities and other current liabilities, approximate fair values because of the short-term nature of the instruments. The fair value of the Company's cash equivalents are Level 1. The fair value of the Company's 3.375% Convertible Senior Notes, 8.75% Senior Notes, 10.25% Senior Notes, 10.5% Senior Notes and 7.125% Senior Secured Notes is estimated based on quoted prices in active markets. The fair value of the Company's 7.375% Senior Notes is estimated based on discounted cash flows using inputs from quoted prices in active markets for similar debt instruments. The inputs used to determine fair value are considered Level 2 inputs.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

The following table provides the carrying value and fair value of the Company's long-term debt instruments:

	September 30, 2013		December 31, 2012	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(in millions)			
8.75% Senior Notes, due July 2021	\$400.0	\$427.0	\$—	\$—
7.125% Senior Secured Notes, due April 2017	300.0	320.1	300.0	317.1
10.5% Senior Notes, due October 2017	295.2	317.6	294.5	326.6
10.25% Senior Notes, due April 2019	200.0	224.8	200.0	219.6
3.375% Convertible Senior Notes, due June 2038	7.1	7.1	67.1	68.5
7.375% Senior Notes, due April 2018	3.5	3.5	3.5	3.3

9. Long-Term Incentive Awards

Stock-based Compensation

The Company's 2004 Amended and Restated Long-Term Incentive Plan (the "2004 Plan") provides for the granting of stock options, restricted stock, phantom stock, performance stock awards and other stock-based awards to selected employees and non-employee directors of the Company. At September 30, 2013, approximately 4.3 million shares were available for grant or award under the 2004 Plan.

During the nine months ended September 30, 2013, the Company granted the following equity awards:

Time-based awards The Company granted 0.7 million time-based restricted stock awards to employees which vest 1/3 per year and 0.1 million time-based restricted stock awards to the Company's Directors which vest on the date of the Company's 2014 Annual Meeting of Stockholders. The grant-date fair value per share for these time-based restricted stock awards is equal to the closing price of the Company's stock on the grant date, which was a weighted-average grant date fair value of \$6.81 and a grant date fair value of \$7.13 for the awards granted in the nine months ended September 30, 2013 to employees and the Company's Directors, respectively.

Objective-based awards The Company granted additional compensation awards to employees that are based on the Company's achievement of certain Company-based performance objectives as well as the Company's achievement of certain market-based objectives. These awards, which cliff vest on the third anniversary of the grant date, are payable in shares at target levels when combined and in cash for the amount above target up to maximum, as defined by the agreements. For the CEO's portion of these awards, the portion payable in cash is based on the achievement of certain market-based and Company-based performance objectives being met at levels slightly below target levels when combined. The fair value of all awards requiring share settlement is measured at the fair value on the grant date, while those requiring cash settlement are remeasured at the end of each reporting period.

Objective-based Awards (cash settled)

The Company accounts for awards, or the portion of the awards, requiring cash settlement under stock-compensation principles of accounting as liability instruments. The fair value of all liability instruments are being remeasured based on the awards' estimated fair value at the end of each reporting period and are being recorded to expense over the vesting period.

The awards that are based on the Company's achievement of market-based objectives related to the Company's stock price are valued using a Monte Carlo simulation. The Company uses various assumptions to estimate the fair value of the Company's objective-based awards. The Company uses the historical volatility of its common stock to estimate volatility while the dividend yield assumptions are based on historical and anticipated dividend payouts. The risk-free interest rate assumptions are based on observed interest rates consistent with the approximate vesting periods and the stock price used represents the closing price of the Company's common stock at the valuation date.

10. Income Taxes

The Company, directly or through its subsidiaries, files income tax returns in the United States, and multiple state and foreign jurisdictions. The Company's tax returns for 2006 through 2012 remain open for examination by the taxing authorities in the respective jurisdictions where those returns were filed. Although the Company believes that its estimates are reasonable, the final outcome in the event that the Company is subjected to an audit could be different from that which is reflected in its historical income tax provision and accruals. Such differences could have a material effect on the Company's income tax

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

provision and net income in the period in which such determination is made. In addition, certain tax returns filed by TODCO and its subsidiaries are open for years prior to 2004; however, TODCO tax obligations from periods prior to its initial public offering in 2004 are indemnified by Transocean, the former owner of TODCO, under the tax sharing agreement, except for the Trinidad and Tobago jurisdiction. The Company's Trinidadian and Tobago tax returns are open for examination for the years 2006 through 2012.

Effective April 27, 2011, the Company completed the Seahawk Transaction. The Company's financial statements were historically prepared assuming this transaction should be treated as a purchase of assets for tax purposes. Seahawk is in a Chapter 11 proceeding in the U.S. Bankruptcy Court. In February 2013, at the direction of the Court, Seahawk made certain distributions to its equity holders. These distributions, taken together with other aspects of the acquisition, changed the tax treatment and caused the Seahawk Transaction to be characterized as a reorganization pursuant to IRC §368(a)(1)(G). Therefore, the Company recorded a carryover basis in the Seahawk assets and other tax attributes. Because of the ownership change certain of these carryovers may be subject to specific, and in some cases an annual, limitation on their utilization. The Company recognized a valuation allowance as appropriate. These carryover attributes recognized include net operating losses of \$186.7 million, tax credits of \$17.1 million, and tax basis in assets of \$70.0 million. The Company recorded deferred tax assets, net of a valuation allowance, of approximately \$37.7 million in the first quarter 2013. There can be no assurance that these deferred tax assets will be realized.

From time to time, the Company's tax returns are subject to review and examination by various tax authorities within the jurisdictions in which the Company operates or has operated. The Company is currently contesting tax assessments in Venezuela and may contest future assessments where the Company believes the assessments are meritless.

In January 2008, SENIAT, the national Venezuelan tax authority, commenced an audit for the 2003 calendar year, which was completed in the fourth quarter of 2008. The Company has not yet received any proposed adjustments from SENIAT for that year. In June 2013, the U.S. Internal Revenue Service commenced an audit of the U.S. Corporate Income Tax Return, for the 2010 calendar year. While we cannot predict or provide assurance regarding the outcome of these proceedings, we do not expect the ultimate liability to have a material effect on our consolidated financial statements.

11. Segments

The Company currently reports its business activities in three business segments: (1) Domestic Offshore, (2) International Offshore and (3) International Liftboats. The Company eliminates inter-segment revenue and expenses, if any.

The results of operations of the Domestic Liftboats and Inland segments are reflected in the Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012 as discontinued operations. The financial information of the Company's discontinued operations is not included in the results of operations presented for the Company's reporting segments (See Note 5). The remaining assets of the Inland segment, which included spare equipment, one cold stacked barge and a barge that will be used as a training rig, have been transferred to the Domestic Offshore segment and the historical results of Domestic Offshore have been recast to include the operating results of these assets. In 2012, the Company transferred one vessel, Kingfish, from its Domestic Liftboats segment to its International Liftboats segment. The historical results generated by the Kingfish, that were previously reported in the Domestic Liftboats segment are reported in the International Liftboats segment. As a result of this transfer, the historical results of International Liftboats have also been recast to include the operating results of this asset.

The Company's jackup rigs are used primarily for exploration and development drilling in shallow waters. The Company's liftboats are self-propelled, self-elevating vessels with a large open deck space, which provides a versatile, mobile and stable platform to support a broad range of offshore maintenance and construction services throughout the life of an oil or natural gas well.

In March 2012, the Company acquired an offshore jackup drilling rig, Hercules 266, for \$40.0 million. The Company has entered into a three-year drilling contract with Saudi Aramco for the use of this rig with Saudi Aramco having an option to extend the term for an additional one-year period. This rig completed upgrades and other contract specific refurbishments and commenced work in April 2013.

During November 2012, the decision was made to reactivate one of the Company's previously cold stacked rigs, Hercules 209. This rig underwent repairs and upgrades for reactivation and commenced work in May 2013.

In March 2013, the Company acquired the offshore drilling rig Hercules 267 for \$55.0 million. In addition, the Company signed a three-year rig commitment with Cabinda Gulf Oil Company Limited for the use of Hercules 267. The rig is expected to commence work in the fourth quarter of 2013.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

In March 2013, the Company acquired the liftboat Bull Ray for \$42.0 million. The liftboat commenced work in West Africa in March 2013.

As a result of the Discovery Transaction (See Note 4), Hercules Triumph and Hercules Resilience are included in the Company's International Offshore segment. The Company entered into a contract with Cairn India Limited for use of the Hercules Triumph in the Indian Ocean which is expected to commence in late October 2013. Hercules Resilience was delivered in October 2013 but remains in the shipyard for the installation of additional equipment.

Information regarding the Company's reportable segments is as follows:

	Three Months Ended September 30, 2013			Nine Months Ended September 30, 2013		
	Revenue	Income (Loss) from Operations (in thousands)	Depreciation and Amortization	Revenue	Income (Loss) from Operations (in thousands)	Depreciation and Amortization
Domestic Offshore	\$138,975	\$44,349	\$19,811	\$387,088	\$124,205	\$59,291
International Offshore	46,309	2,507	12,768	126,836	(12,995)	35,555
International Liftboats	40,024	12,804	4,721	109,035	27,893	13,872
	\$225,308	\$59,660	\$37,300	\$622,959	\$139,103	\$108,718
Corporate	—	(14,404)	740	—	(42,410)	2,188
Total Company	\$225,308	\$45,256	\$38,040	\$622,959	\$96,693	\$110,906

	Three Months Ended September 30, 2012			Nine Months Ended September 30, 2012		
	Revenue	Income (Loss) from Operations (in thousands)	Depreciation and Amortization	Revenue	Income (Loss) from Operations (in thousands)	Depreciation and Amortization
Domestic Offshore (a)	\$92,277	\$(16,941)	\$19,678	\$264,663	\$(1,112)	\$57,930
International Offshore (b)	37,090	3,513	10,360	85,210	(68,970)	35,087
International Liftboats	30,790	6,499	3,819	93,617	26,538	13,189
	\$160,157	\$(6,929)	\$33,857	\$443,490	\$(43,544)	\$106,206
Corporate	—	(11,345)	672	—	(33,383)	1,937
Total Company	\$160,157	\$(18,274)	\$34,529	\$443,490	\$(76,927)	\$108,143

(a) Income (Loss) from Operations for the Company's Domestic Offshore segment includes a \$25.5 million asset impairment charge for the three and nine months ended September 30, 2012 (See Note 8).

Income (Loss) from Operations for the Company's International Offshore segment includes \$35.2 million and \$82.7 million in asset impairment charges for the three and nine months ended September 30, 2012, respectively

(b) (See Note 8). In addition, Income (Loss) from Operations for the Company's International Offshore segment includes a gain on the sale of Platform Rig 3 of \$18.4 million (See Note 5) and a gain on the Hercules 185 insurance settlement of \$27.3 million for both the three and nine months ended September 30, 2012.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

	Total Assets	
	September 30, 2013	December 31, 2012
	(in thousands)	
Domestic Offshore	\$1,077,864	\$980,973
International Offshore	1,095,896	649,565
Inland	—	107,349
Domestic Liftboats	—	74,824
International Liftboats	184,418	147,823
Corporate	45,257	56,096
Total Company	\$2,403,435	\$2,016,630

12. Commitments and Contingencies

Legal Proceedings

The Company is involved in various claims and lawsuits in the normal course of business. As of September 30, 2013, management did not believe any accruals were necessary in accordance with FASB ASC 450-20, Contingencies — Loss Contingencies.

Shareholder Derivative Suits

Say-on-Pay Litigation

In June 2011, two separate shareholder derivative actions were filed purportedly on the Company's behalf in response to its failure to receive a majority advisory "say-on-pay" vote in favor of the Company's 2010 executive compensation. On June 8, 2011, the first action was filed in the District Court of Harris County, Texas, and on June 23, 2011, the second action was filed in the United States Court for the District of Delaware. Subsequently, on July 21, 2011, the plaintiff in the Harris County action filed a concurrent action in the United States District Court for the Southern District of Texas. Each action named the Company as a nominal defendant and certain of its officers and directors, as well as the Company's Compensation Committee's consultant, as defendants. Plaintiffs allege that the Company's directors breached their fiduciary duty by approving excessive executive compensation for 2010, that the Compensation Committee consultant aided and abetted that breach of fiduciary duty, that the officer defendants were unjustly enriched by receiving the allegedly excessive compensation, and that the directors violated the federal securities laws by disseminating a materially false and misleading proxy. The plaintiffs seek damages in an unspecified amount on the Company's behalf from the officer and director defendants, certain corporate governance actions, and an award of their costs and attorney's fees. The Company and the other defendants have filed motions to dismiss these cases for failure to make demand upon the Company's board and for failing to state a claim. On June 11, 2012, the plaintiff in the Harris County action voluntarily dismissed his action. On March 14, 2013, the Company's and the other defendants' motions to dismiss the Delaware federal action were granted. The motions to dismiss the Texas federal action are pending.

The Company does not expect the ultimate outcome of the shareholder derivative lawsuit to have a material adverse effect on its consolidated results of operations, financial position or cash flows.

The Company and its subsidiaries are involved in a number of other lawsuits, all of which have arisen in the ordinary course of business. The Company does not believe that the ultimate liability, if any, resulting from any such other pending litigation will have a material adverse effect on its business or consolidated financial statements.

The Company cannot predict with certainty the outcome or effect of any of the litigation matters specifically described above or of any other pending litigation. There can be no assurance that the Company's belief or expectations as to the outcome or effect of any lawsuit or other litigation matter will prove correct, and the eventual outcome of these matters could materially differ from management's current estimates.

Insurance and Indemnity

The Company is self-insured for the deductible portion of its insurance coverage. Management believes adequate accruals have been made on known and estimated exposures up to the deductible portion of the Company's insurance coverage. Management believes that claims and liabilities in excess of the amounts accrued are adequately insured. However, the

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

Company's insurance is subject to exclusions and limitations, and there is no assurance that such coverage will adequately protect the Company against liability from all potential consequences. In addition, there is no assurance of renewal or the ability to obtain coverage acceptable to the Company. The Company maintains insurance coverage that includes coverage for physical damage, third party liability, workers' compensation and employer's liability, general liability, vessel pollution and other coverages.

Effective May 1, 2013, the Company completed the annual renewal of all of its key insurance policies. The Company's primary marine package provides for hull and machinery coverage for substantially all of the Company's rigs and liftboats up to a scheduled value of each asset. The total maximum amount of coverage for these assets is \$1.7 billion. The marine package includes protection and indemnity and maritime employer's liability coverage for marine crew personal injury and death and certain operational liabilities, with primary coverage (or self-insured retention for maritime employer's liability coverage) of \$5.0 million per occurrence with excess liability coverage up to \$200.0 million. The marine package policy also includes coverage for personal injury and death of third parties with primary and excess coverage of \$25.0 million per occurrence with additional excess liability coverage up to \$200.0 million, subject to a \$250,000 per-occurrence deductible. The marine package also provides coverage for cargo and charterer's legal liability. The marine package includes limitations for coverage for losses caused in U.S. Gulf of Mexico named windstorms, including an annual aggregate limit of liability of \$75.0 million for property damage and removal of wreck liability coverage. The Company also procured an additional \$75.0 million excess policy for removal of wreck and certain third-party liabilities incurred in U.S. Gulf of Mexico named windstorms. Deductibles for events that are not caused by a U.S. Gulf of Mexico named windstorm are 12.5% of the insured drilling rig values per occurrence, subject to a minimum of \$1.0 million, and \$1.0 million per occurrence for liftboats. The deductible for drilling rigs in a U.S. Gulf of Mexico named windstorm event is \$25.0 million. Vessel pollution is covered under a Water Quality Insurance Syndicate policy ("WQIS Policy") providing limits as required by applicable law, including the Oil Pollution Act of 1990. The WQIS Policy covers pollution emanating from the Company's vessels and drilling rigs, with primary limits of \$5.0 million (inclusive of a \$3.0 million per-occurrence deductible) and excess liability coverage up to \$200.0 million.

Control-of-well events generally include an unintended flow from the well that cannot be contained by equipment on site (e.g., a blow-out preventer), by increasing the weight of the drilling fluid, or that does not naturally close itself off through what is typically described as "bridging over". The Company carries a contractor's extra expense policy with \$25.0 million primary liability coverage for well control costs, pollution and expenses incurred to redrill wild or lost wells, with excess liability coverage up to \$200.0 million for pollution liability that is covered in the primary policy. The policies are subject to exclusions, limitations, deductibles, self-insured retention and other conditions. In addition to the marine package, the Company has separate policies providing coverage for onshore foreign and domestic general liability, employer's liability, auto liability and non-owned aircraft liability, with customary deductibles and coverage.

The Company's drilling contracts provide for varying levels of indemnification from its customers and in most cases, may require the Company to indemnify its customers for certain liabilities. Under the Company's drilling contracts, liability with respect to personnel and property is customarily assigned on a "knock-for-knock" basis, which means that the Company and its customers assume liability for their respective personnel and property, regardless of how the loss or damage to the personnel and property may be caused. The Company's customers typically assume responsibility for and agree to indemnify the Company from any loss or liability resulting from pollution or contamination, including clean-up and removal and third-party damages arising from operations under the contract and originating below the surface of the water, including as a result of blow-outs or cratering of the well ("Blowout Liability"). The customer's assumption for Blowout Liability may, in certain circumstances, be limited or could be determined to be unenforceable in the event of the Company's gross negligence, willful misconduct or other egregious conduct. In addition, the Company may not be indemnified for statutory penalties and punitive damages relating to such pollution

or contamination events. The Company generally indemnifies the customer for the consequences of spills of industrial waste or other liquids originating solely above the surface of the water and emanating from its rigs or vessels. The Company has a separate primary marine package for Hercules Triumph that provides hull and machinery coverage up to \$250.0 million, subject to a \$2.5 million per-occurrence deductible, which increases to \$5.0 million for losses incurred during delivery voyages. The marine package also provides coverage for cargo, contractor's extra expense and loss of hire coverage. The Company also has operational protection and indemnity coverage up to \$500.0 million, subject to a \$50,000 per-occurrence deductible for claims originating outside the U.S. and a \$250,000 per-occurrence deductible for claims originating in the U.S. Additionally, the Company has coverage for extended contractual liability that includes subsea activities, property and personnel, and clean-up costs up to \$25.0 million and pollution-by-blowout coverage up to \$10.0 million, all subject to certain contractual assumptions and limitations. The Company does not have coverage inclusive of U.S. Gulf of Mexico named windstorms. Upon delivery of the Hercules Resilience, the Company obtained insurance policies for the Hercules Resilience substantially similar to those procured for the Hercules Triumph.

Table of Contents

HERCULES OFFSHORE, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

UNAUDITED

In 2013, in connection with the renewal of certain of its insurance policies, the Company entered into an agreement to finance a portion of its annual insurance premiums. Approximately \$30.7 million was financed through this arrangement with an interest rate of 3.24% and a maturity date of March 2014, of which \$18.5 million was outstanding as of September 30, 2013. There was \$9.1 million outstanding in insurance notes payable at December 31, 2012 which was fully paid by the maturity date of March 2013. Additionally \$0.7 million was outstanding on the \$1.3 million note, related to the 2013 insurance renewal for the Hercules Triumph, with an interest rate of 3.24% and a maturity date of March 2014.

Hercules 265 Incident

On July 23, 2013, the Company's jackup drilling rig Hercules 265, a 250' mat-supported cantilevered unit operating in the U.S. Gulf of Mexico Outer Continental Shelf lease block South Timbalier 220, experienced a well control incident. Natural gas flowing from the well ignited and spread to the rig. On July 25, 2013, the natural gas well apparently bridged over, and the flow of natural gas ceased and the well was thereafter secured by the Company's customer. All 44 personnel aboard the jackup rig were safely evacuated with no reported injuries. Based on the Company's limited survey, the rig sustained substantial damage in the incident. The Company's insurance underwriters have not been able to determine whether the rig will be a constructive total loss. The cause of the incident is unknown but is under investigation. The rig has an insured value of \$50.0 million. The Company also has removal of wreck coverage up to a total amount of \$110.0 million. The deductible under our package policy, which includes physical damage and removal of wreck coverage, is \$5.0 million, but the deductible does not apply in the event the rig is a total loss. In the event any pollution emanated from the Company's rig or equipment as a result of the incident, the Company's vessel pollution policy provides coverage, subject to deductibles and limitations. The rig has a net book value of approximately \$19.0 million at September 30, 2013.

Sales and Use Tax Audits

Certain of the Company's legal entities are under audit by various taxing authorities for several prior-year periods. These audits are ongoing and the Company is working to resolve all relevant issues. The Company has an accrual of \$8.9 million and \$12.0 million related to these sales and use tax matters, which is included in Accrued Liabilities on the Consolidated Balance Sheets as of September 30, 2013 and December 31, 2012, respectively.

13. Accounting Pronouncement

In July 2013, the FASB issued Accounting Standards Update ("ASU") No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists ("ASU 2013-11"). The amendments in this ASU provides guidance on presentation of unrecognized tax benefits and is expected to reduce diversity in practice and better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments in this ASU are effective prospectively for interim and annual periods beginning after December 15, 2013, with early adoption and retrospective application permitted. The Company does not expect the adoption of this standard to have a material impact on its consolidated financial statements.

14. Subsequent Events

Subsequent to September 30, 2013, the Company noted the following:

- On October 1, 2013, the Company issued \$300.0 million aggregate principal amount of 7.5% Senior Notes due 2021 (See Note 6).
- On October 1, 2013, the Company used a portion of the proceeds from the 7.5% Senior Notes due 2021 offering to redeem \$253.6 million of the \$300.0 million aggregate principal amount of 10.5% Senior Notes due 2017 for \$268.5 million. The Company expects to use the remaining net proceeds from the 7.5% Senior Notes due 2021 offering, together with cash on hand, to redeem the remaining \$46.4 million aggregate principal amount of the 10.5% Senior Notes due 2017 in November 2013 for approximately \$48.8 million (See Note 6).

- On October 17, 2013, the final shipyard installment of \$166.9 million was paid on Hercules Resilience.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the accompanying unaudited consolidated financial statements as of September 30, 2013 and for the three and nine months ended September 30, 2013 and September 30, 2012, included elsewhere herein, and with our Annual Report on Form 10-K for the year ended December 31, 2012, as amended by our current report on Form 8-K filed on August 23, 2013. The following discussion and analysis contains forward-looking statements that involve risks and uncertainties. Please read "Forward-Looking Statements" below for a discussion of certain limitations inherent in such statements. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors. Please also read "Risk Factors" in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012 and Item 1A of Part II of our quarterly reports on Form 10-Q for March 31, 2013, June 30, 2013 and this quarterly report for a discussion of certain risks facing our company.

OVERVIEW

We are a leading provider of shallow-water drilling and marine services to the oil and natural gas exploration and production industry globally. We provide these services to national oil and gas companies, major integrated energy companies and independent oil and natural gas operators. As of October 22, 2013, we owned a fleet of 40 jackup rigs, including Hercules Triumph and Hercules Resilience, 19 liftboat vessels and operated an additional five liftboat vessels owned by a third party. Our diverse fleet is capable of providing services such as oil and gas exploration and development drilling, well service, platform inspection, maintenance and decommissioning operations in several key shallow-water provinces around the world.

During November 2012, the decision was made to reactivate one of our previously cold stacked rigs, Hercules 209. We completed the reactivation in May 2013 and the rig commenced on its initial contract shortly thereafter.

Asset Purchases

In March 2012, we acquired an offshore jackup drilling rig, Hercules 266, for \$40.0 million. We entered into a three-year drilling contract with Saudi Aramco for the use of this rig with Saudi Aramco having an option to extend the term for an additional one-year period. This rig completed upgrades and other contract specific refurbishments and commenced work in April 2013.

In March 2013, we acquired the offshore drilling rig Hercules 267 for \$55.0 million. In addition, we signed a three-year rig commitment with Cabinda Gulf Oil Company Limited for use of Hercules 267. We expect the rig to commence work in the fourth quarter of 2013.

In March 2013, we acquired the liftboat Bull Ray for \$42.0 million. The liftboat commenced work in West Africa in March 2013.

On June 24, 2013 ("Acquisition Date"), we acquired an additional 52% interest in Discovery Offshore S.A. ("Discovery") by purchasing additional common stock to bring the total interest held to 84%. We began consolidating Discovery's results of operations as of the Acquisition Date. As of September 30, 2013, we held a 100% interest in Discovery as a result of additional purchases of shares of Discovery common stock subsequent to the Acquisition Date at 15 Norwegian Kroner ("NOK") per share (USD \$26.3 million in total). (See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Business Combinations"). As a result of this transaction, Hercules Triumph and Hercules Resilience are included in our International Offshore segment. We entered into a contract with Cairn India Limited for use of the Hercules Triumph in the Indian Ocean which is expected to commence in late October 2013. Hercules Resilience was delivered in October 2013 but remains in the shipyard for the installation of additional equipment.

Asset Dispositions

In May 2013, we entered into an agreement to sell eleven inland barge rigs, comprising the majority of the Inland segment fleet, and related assets for \$45 million, and in July 2013 we closed on the sale of these Inland assets. Additionally, in August 2013, we sold the Hercules 27 inland barge for approximately \$5.1 million. The remaining assets of the Inland segment, which included spare equipment, one cold stacked barge and a barge that will be used as a training rig, have been transferred to the Domestic Offshore segment. In the second quarter of 2013, we recorded an impairment charge of \$40.9 million (\$40.7 million, net of tax) related to the sale of the Inland barges. The results of

operations of the Inland segment are reflected in the Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012, as discontinued operations. Additionally, the historical results of Domestic Offshore have been recast to include the operating results of the remaining Inland assets.

In June 2013, we entered into an agreement to sell our U.S. Gulf of Mexico Liftboats and related assets. As a result of this transaction, we recorded an impairment charge of \$3.5 million (\$3.5 million net of tax). On July 1, 2013, we closed on the

Table of Contents

sale of the liftboats and related assets and received proceeds of approximately \$54.4 million. In 2012, the Company transferred one vessel, Kingfish, from its Domestic Liftboats segment to its International Liftboats segment. The historical results generated by the Kingfish, that were previously reported in the Domestic Liftboats segment are reported in the International Liftboats segment. The results of operations of the Domestic Liftboats segment are reflected in the Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012, as discontinued operations.

Our drilling rigs are used primarily for exploration and development drilling in shallow waters. Under most of our contracts, we are paid a fixed daily rental rate called a “dayrate,” and we are required to pay all costs associated with our own crews as well as the upkeep and insurance of the rig and equipment.

Our liftboats are self-propelled, self-elevating vessels with a large open deck space, which provides a versatile, mobile and stable platform to support a broad range of offshore maintenance and construction services throughout the life of an oil or natural gas well. Under most of our liftboat contracts, we are paid a fixed dayrate for the rental of the vessel, which typically includes the costs of a small crew of four to eight employees, and we also receive a variable rate for reimbursement of other operating costs such as catering, fuel, rental equipment, crane overtime and other items.

Our backlog at October 22, 2013, totaled approximately \$1.1 billion for our executed contracts. Approximately \$146.7 million of this backlog is expected to be realized during the remainder of 2013. We calculate our contract revenue backlog, or future contracted revenue, as the contract dayrate multiplied by the number of days remaining on the contract, assuming full utilization, less any penalties or reductions in dayrate for late delivery or non-compliance with contractual obligations. Backlog excludes revenue for management agreements, mobilization, demobilization, contract preparation and customer reimbursables. The amount of actual revenue earned and the actual periods during which revenue is earned will be different than the backlog disclosed or expected due to various factors. Downtime due to various operational factors, including unscheduled repairs, maintenance, operational delays, health, safety and environmental incidents, weather events in the Gulf of Mexico and elsewhere and other factors (some of which are beyond our control), may result in lower dayrates than the full contractual operating dayrate. In some of the contracts, our customer has the right to terminate the contract without penalty and in certain instances, with little or no notice.

Regulation

The Coast Guard issued a Policy Letter in July 2011 that provides for more frequent inspections of foreign flagged Mobile Offshore Drilling Units (“MODUs”) that operate on the U.S. Outer Continental Shelf (“OCS”). The Coast Guard will make determinations to conduct more frequent inspections of foreign flagged MODUs in accordance with its Mobile Offshore Drilling Unit Safety and Environmental Protection Compliance Targeting Matrix. We may be subject to increased costs and potential downtime for certain of our rigs operating on the OCS if such rigs are determined by the Coast Guard to need additional oversight and inspection under this Policy Letter.

In addition to this Coast Guard Policy Letter, in November 2011, the Bureau of Safety and Environmental Enforcement (“BSEE”) announced a change in its enforcement policies in the aftermath of the Macondo well blowout in April 2010, pursuant to which the agency has extended its regulatory enforcement reach to include contractors as well as offshore lease operators. Consequently, the BSEE may elect to hold contractors, including drilling contractors, liable for alleged violations of law arising in the BSEE's jurisdictional area. In August 2012, the BSEE issued an Interim Policy Letter that established the parameters by which BSEE will issue incidents of noncompliance to drilling contractors for serious violations of BSEE regulations. Implementation of this announced change in enforcement policy by the BSEE could subject us to added liabilities, including sanctions and penalties, as well as increased costs arising from contractual arrangements in master services agreements that failed to take into account such change in enforcement policy with respect to our operations in the U.S. Gulf of Mexico, which may have an adverse effect on our business and results of operations.

RECENT DEVELOPMENTS

Subsequent to September 30, 2013, we noted the following:

- On October 1, 2013, we issued \$300.0 million aggregate principal amount of 7.5% Senior Notes due 2021 (See Item 2. “Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Cash Requirements and Contractual Obligations”).

- On October 1, 2013, we used a portion of the proceeds from the 7.5% Senior Notes due 2021 offering to redeem \$253.6 million of the \$300.0 million aggregate principal amount of 10.5% Senior Notes due 2017 for \$268.5 million. We expect to use the remaining net proceeds from the 7.5% Senior Notes due 2021 offering, together with cash on hand, to redeem the remaining \$46.4 million aggregate principal amount of the 10.5% Senior Notes due 2017 in November 2013 for approximately \$48.8 million (See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources - Cash Requirements and Contractual Obligations").
- On October 17, 2013, the final shipyard installment of \$166.9 million was paid on Hercules Resilience.

Table of Contents

RESULTS OF OPERATIONS

The following table sets forth financial information by operating segment and other selected information for the periods indicated:

	Three Months Ended September 30,				
	2013	2012	Change	% Change	
	(Dollars in thousands)				
Domestic Offshore:					
Number of rigs (as of end of period)	29	34			
Revenue	\$138,975	\$92,277	\$46,698	50.6	%
Operating expenses	73,577	61,939	11,638	18.8	%
Asset impairment	—	25,502	(25,502	) n/m	
Depreciation and amortization expense	19,811	19,678	133	0.7	%
General and administrative expenses	1,238	2,099	(861	) (41.0)%
Operating income (loss)	\$44,349	\$(16,941	) \$61,290	n/m	
International Offshore:					
Number of rigs (as of end of period)	11	8			
Revenue	\$46,309	\$37,090	\$9,219	24.9	%
Operating expenses	28,191	(13,816	) 42,007	n/m	
Asset impairment	—	35,191	(35,191	) n/m	
Depreciation and amortization expense	12,768	10,360	2,408	23.2	%
General and administrative expenses	2,843	1,842	1,001	54.3	%
Operating income	\$2,507	\$3,513	\$(1,006	) (28.6)%
International Liftboats:					
Number of liftboats (as of end of period)	24	24			
Revenue	\$40,024	\$30,790	\$9,234	30.0	%
Operating expenses	20,960	20,400	560	2.7	%
Depreciation and amortization expense	4,721	3,819	902	23.6	%
General and administrative expenses	1,539	72	1,467	n/m	
Operating income	\$12,804	\$6,499	\$6,305	97.0	%
Total Company:					
Revenue	\$225,308	\$160,157	\$65,151	40.7	%
Operating expenses	122,728	68,523	54,205	79.1	%
Asset impairment	—	60,693	(60,693	) n/m	
Depreciation and amortization expense	38,040	34,529	3,511	10.2	%
General and administrative expenses	19,284	14,686	4,598	31.3	%
Operating income (loss)	45,256	(18,274	) 63,530	n/m	
Interest expense	(19,360	) (18,249	) (1,111	) 6.1	%
Other, net	(337	) 676	(1,013	) n/m	
Income (loss) before income taxes	25,559	(35,847	) 61,406	n/m	
Income tax provision	(8,400	) (1,319	) (7,081	) n/m	
Income (loss) from continuing operations	17,159	(37,166	) 54,325	n/m	
Income (loss) from discontinued operations, net of taxes	8,093	(692	) 8,785	n/m	
Net income (loss)	25,252	(37,858	) 63,110	n/m	
Loss attributable to noncontrolling interest	21	—	21	n/m	
	\$25,273	\$(37,858	) \$63,131	n/m	

Net income (loss) attributable to Hercules Offshore,
Inc.

"n/m" means not meaningful.

25

Table of Contents

The following table sets forth selected operational data by operating segment for the periods indicated:

Three Months Ended September 30, 2013

	Operating Days	Available Days	Utilization(1)	Average Revenue per Day(2)	Average Operating Expense per Day(3)
Domestic Offshore	1,522	1,678	90.7	% \$91,311	\$43,848
International Offshore	426	552	77.2	% 108,707	51,071
International Liftboats	1,578	2,116	74.6	% 25,364	9,905

Three Months Ended September 30, 2012

	Operating Days	Available Days	Utilization(1)	Average Revenue per Day(2)	Average Operating Expense per Day(3)
Domestic Offshore	1,460	1,656	88.2	% \$63,203	\$37,403
International Offshore	393	602	65.3	% 94,377	(22,950)
International Liftboats	1,314	1,932	68.0	% 23,432	10,559

Utilization is defined as the total number of days our rigs or liftboats, as applicable, were under contract, known as operating days, in the period as a percentage of the total number of available days in the period. Days during which our rigs and liftboats were undergoing major refurbishments, upgrades or construction, and days during which our rigs and liftboats are cold stacked, are not counted as available days. Days during which our liftboats are in the shipyard undergoing drydocking or inspection are considered available days for the purposes of calculating utilization.

(1) Average revenue per rig or liftboat per day is defined as revenue earned by our rigs or liftboats, as applicable, in the period divided by the total number of operating days for our rigs or liftboats, as applicable, in the period. Average operating expense per rig or liftboat per day is defined as operating expenses, excluding depreciation and amortization, incurred by our rigs or liftboats, as applicable, in the period divided by the total number of available days in the period. We use available days to calculate average operating expense per rig or liftboat per day rather than operating days, which are used to calculate average revenue per rig or liftboat per day, because we incur operating expenses on our rigs and liftboats even when they are not under contract and earning a dayrate. In addition, the operating expenses we incur on our rigs and liftboats per day when they are not under contract are typically lower than the per day expenses we incur when they are under contract.

For the Three Months Ended September 30, 2013 and 2012

Revenue

Consolidated. The increase in consolidated revenue is described below.

Domestic Offshore. Revenue increased for our Domestic Offshore segment due to higher average dayrates along with additional operating days in the Current Quarter as compared to the Comparable Quarter, which contributed to an increase of approximately \$41 million and \$6 million, respectively. The Hercules 209 contributed \$9.5 million to these increases in revenue in the Current Quarter as it was reactivated and commenced work in May 2013.

International Offshore. The increase in revenue from our International Offshore segment resulted primarily from the following:

- \$13.2 million increase from Hercules 266, as it was acquired in March 2012 and commenced work in April 2013;
- \$1.6 million increase from Hercules 262, as it was preparing for a new contract a portion of the Comparable Quarter;
- \$3.0 million decrease from Hercules 208 resulting from fewer operating days in the Current Quarter as compared to the Comparable Quarter.
- \$2.5 million decrease from Platform Rig 3, as it was sold in August 2012.

Table of Contents

International Liftboats. The increase in revenue from our International Liftboats segment resulted from an increase in operating days and average dayrates, contributing to revenue increases of approximately \$7 million and approximately \$3 million, respectively in the Current Quarter as compared to the Comparable Quarter. These increases in operating days and average dayrates are largely due to the Bull Ray, contributing a \$6.4 million increase to revenue in the Current Quarter, after its purchase in March 2013.

Operating Expenses

Consolidated. The increase in consolidated operating expenses is described below.

Domestic Offshore. The increase in operating expenses for our Domestic Offshore segment related primarily to \$3.1 million in incremental costs for the Hercules 209 operating after its reactivation in May 2013 and \$3.2 million in expenses related to the Hercules 265 insurance claim. Additionally, labor, workers' compensation and insurance costs increased in the Current Quarter as compared to the Comparable Quarter by \$2.0 million, \$1.3 million and \$1.1 million, respectively.

International Offshore. The increase in operating expenses was driven primarily by the following:

- \$24.8 million increase from Hercules 185 due primarily to the \$27.3 gain on insurance settlement in the Comparable Quarter;
- \$18.4 million gain on the sale of Platform Rig 3 in the Comparable Quarter;
- \$4.8 million increase from Hercules 266 which began work in April 2013; and
- \$2.5 million decrease from Hercules 208 primarily due to amortization of deferred mobilization and contract preparation costs in the Comparable Quarter.

International Liftboats. The increase in operating expenses for our International Liftboats segment related primarily to the following:

- \$1.3 million increase due to the Bull Ray operating in the International Liftboats segment in the Current Quarter after its purchase in March 2013;
- \$1.7 million increase in labor costs in the Current Quarter as compared to the Comparable Quarter; and
- \$1.3 million decrease in repair and maintenance costs in the Current Quarter as compared to the Comparable Quarter.

Asset Impairment

In the Comparable Quarter, we recorded an asset impairment charge of \$60.7 million of which \$35.2 million was related to the write-down of Hercules 258 to salvage value and \$25.5 million related to the write down of Hercules 252, which was held for sale at September 30, 2012, to its fair value less estimated cost to sell.

Depreciation and Amortization

The increase in depreciation and amortization is largely due to the additional depreciation for the Hercules 266 and other capital projects, which contributed to increases of \$2.6 million and approximately \$3.8 million, respectively. These increases are partially offset by a reduction in depreciation of \$1.6 million primarily due to rigs sold. Additionally, the Hercules 258 contributed to a \$0.9 million reduction in depreciation after its impairment in 2012.

General and Administrative Expenses

The increase in general and administrative expenses is primarily related to an increase in labor costs in the Current Quarter as compared to the Comparable Quarter of \$2.3 million, primarily in Corporate. Additionally, bad debt expense increased \$1.5 million in the Current Quarter as compared to the Comparable Quarter primarily related to the International Liftboats segment.

Table of Contents

Interest Expense

The increase in interest expense for the Current Quarter is primarily due to \$8.2 million in interest on our 8.75% Senior Notes due 2021, partially offset by higher interest capitalization, \$7.5 million increase, on the Hercules Triumph and Hercules Resilience rigs projects and other upgrade and reactivation projects.

Other, net

The increase in other expense is largely due to the gain on the fair value of the Discovery warrants recorded in the Comparable Period.

Income Tax Provision

During the Current Quarter we generated an income tax provision from continuing operations of \$8.4 million compared to \$1.3 million in the Comparable Quarter. The change is primarily related to generating pretax income from continuing operations in the Current Quarter compared to losses from continuing operations in the Comparable Quarter. Additionally the variation is due to the tax effect of the mix of earnings (losses) from different jurisdictions partially offset by the impact of discrete items.

Discontinued Operations

We had income from our discontinued Inland operations of \$7.6 million during the Current Quarter compared to a loss of \$1.9 million in the Comparable Quarter, primarily due to the \$4.8 million gain recognized on the sale of Hercules 27 in August 2013. The sales of all of the inland assets that were held for sale at June 30, 2013 were completed in July 2013, except for the Hercules 27 which closed in August 2013. For the Domestic liftboats, we had income from discontinued operations of \$0.5 million in the Current Quarter compared with an income from discontinued operations of \$1.2 million in the Comparable Quarter. The sale of the domestic liftboats assets was completed in July 2013.

Table of Contents

The following table sets forth financial information by operating segment and other selected information for the periods indicated:

	Nine Months Ended September 30,				
	2013	2012	Change	% Change	
	(Dollars in thousands)				
Domestic Offshore:					
Number of rigs (as of end of period)	29	34			
Revenue	\$387,088	\$264,663	\$122,425	46.3	%
Operating expenses	198,887	176,407	22,480	12.7	%
Asset Impairment	—	25,502	(25,502)	n/m	
Depreciation and amortization expense	59,291	57,930	1,361	2.3	%
General and administrative expenses	4,705	5,936	(1,231)	(20.7))%
Operating income (loss)	\$124,205	\$(1,112)	) \$125,317	n/m	
International Offshore:					
Number of rigs (as of end of period)	11	8			
Revenue	\$126,836	\$85,210	\$41,626	48.9	%
Operating expenses	93,769	39,061	54,708	140.1	%
Asset Impairment	—	82,714	(82,714)	n/m	
Depreciation and amortization expense	35,555	35,087	468	1.3	%
General and administrative expenses	10,507	(2,682)	) 13,189	n/m	
Operating loss	\$(12,995)	) \$(68,970)	) \$55,975	n/m	
International Liftboats:					
Number of liftboats (as of end of period)	24	24			
Revenue	\$109,035	\$93,617	\$15,418	16.5	%
Operating expenses	62,883	51,035	11,848	23.2	%
Depreciation and amortization expense	13,872	13,189	683	5.2	%
General and administrative expenses	4,387	2,855	1,532	53.7	%
Operating income	\$27,893	\$26,538	\$1,355	5.1	%
Total Company:					
Revenue	\$622,959	\$443,490	\$179,469	40.5	%
Operating expenses	355,539	266,503	89,036	33.4	%
Asset impairment	—	108,216	(108,216)	n/m	
Depreciation and amortization expense	110,906	108,143	2,763	2.6	%
General and administrative expenses	59,821	37,555	22,266	59.3	%
Operating income (loss)	96,693	(76,927)	) 173,620	n/m	
Interest expense	(54,495)	) (54,915)	) 420	(0.8))%
Loss on extinguishment of debt	—	(9,156)	) 9,156	n/m	
Gain on equity investment	14,876	—	14,876	n/m	
Other, net	(1,652)	) 764	(2,416)	n/m	
Income (loss) before income taxes	55,422	(140,234)	) 195,656	n/m	
Income tax benefit	18,609	16,829	1,780	10.6	%
Income (loss) from continuing operations	74,031	(123,405)	) 197,436	n/m	
Loss from discontinued operations, net of taxes	(40,996)	) (7,866)	) (33,130)	n/m	
Net income (loss)	33,035	(131,271)	) 164,306	n/m	
Loss attributable to noncontrolling interests	39	—	39	n/m	
Net income (loss) attributable to Hercules Offshore, Inc.	\$33,074	\$(131,271)	) \$164,345	n/m	

"n/m" means not meaningful.

Table of Contents

The following table sets forth selected operational data by operating segment for the periods indicated:

Nine Months Ended September 30, 2013

	Operating Days	Available Days	Utilization(1)	Average Revenue per Day(2)	Average Operating Expense per Day(3)
Domestic Offshore	4,576	4,993	91.6	% \$84,591	\$39,833
International Offshore	1,115	1,540	72.4	% 113,754	60,889
International Liftboats	4,503	6,220	72.4	% 24,214	10,110

Nine Months Ended September 30, 2012

	Operating Days	Available Days	Utilization(1)	Average Revenue per Day(2)	Average Operating Expense per Day(3)
Domestic Offshore	4,414	4,932	89.5	% \$59,960	\$35,768
International Offshore	969	1,876	51.7	% 87,936	20,821
International Liftboats	3,911	5,702	68.6	% 23,937	8,950

For the Nine Months Ended September 30, 2013 and 2012

Revenue

Consolidated. The increase in consolidated revenue is described below.

Domestic Offshore. Revenue increased for our Domestic Offshore segment due to higher average dayrates as well as additional operating days in the Current Period as compared to the Comparable Period, which contributed an increase of approximately \$108 million and \$14 million, respectively.

International Offshore. The increase in revenue from our International Offshore segment resulted primarily from the following:

- \$24.7 million increase from Hercules 266 as it was acquired in March 2012 and commenced work in April 2013;
- \$14.5 million increase from Hercules 262 as it was in the shipyard preparing for a new contract for a portion of the Comparable Period;
- \$10.8 million increase from Hercules 261 as it was in the shipyard preparing for a new contract for a portion of the Comparable Period; and
- \$11.6 million decrease from Platform Rig 3 as it was sold in August 2012.

International Liftboats. The increase in revenue from our International Liftboats segment resulted primarily from an increase in operating days in the Current Period as compared to the Comparable Period which contributed to an increase of approximately \$14 million. Approximately \$10 million of this increase was contributed by the Bull Ray after its purchase in March 2013.

Operating Expenses

Consolidated. The increase in consolidated operating expenses is discussed below.

Domestic Offshore. The increase in operating expenses for our Domestic Offshore segment related primarily to \$4.8 million in incremental costs for the Hercules 209 operating after its reactivation in May 2013 and \$3.2 million in expenses related to the Hercules 265 insurance claim. Additionally, labor, insurance and repair and maintenance costs increased in the Current Period as compared to the Comparable Period by \$8.3 million, \$1.6 million and \$1.4 million, respectively.

International Offshore. The increase in operating expenses is primarily due to the following:

Table of Contents

- \$27.3 million gain on the Hercules 185 insurance settlement in the Comparable Period, partially offset by costs incurred in the Comparable Period associated with the the additional damage the rig sustained during its return mobilization to Angola;
- \$18.4 million gain on the sale of Platform Rig 3 in the Comparable Period, partially offset by costs incurred in the Comparable Period;
- \$10.0 million increase from Hercules 266 as the rig began working in April 2013;
- \$7.4 million increase from Hercules 262 as the rig was in the shipyard preparing for a new contract a portion of the Comparable Period;
- \$5.2 million increase from Hercules 260 in the Current Period as compared to the Comparable Period primarily due to repair costs related to its spud can damage; and
- \$4.2 million decrease from Hercules 258 as the rig was cold stacked in the fourth Quarter of 2012.

International Liftboats. The increase in operating expenses for our International Liftboats segment resulted from the following:

- \$2.6 million increase related to the write down of the Croaker to fair market value in the Current Period;
- \$3.4 million increase due to the Bull Ray operating in the International Liftboats segment in the Current Period after its purchase in 2013;
- \$4.3 million increase in labor costs in the Current Period as compared to the Comparable Period; and
- \$1.6 million insurance gain recognized on the loss of the Mako in the Comparable Period.

Asset Impairment

During the Comparable Period, we recorded an asset impairment charge of \$108.2 million of which \$42.9 million related to the write-down of Hercules 185 to salvage value and \$4.6 million related to the write off of unamortized deferred costs associated with the rig's contract; \$35.2 million related to the write down of Hercules 258 to salvage value and \$25.5 million related to Hercules 252, which was held for sale at September 30, 2012, to write it down to its fair value less estimated cost to sell.

Depreciation and Amortization

The increase in depreciation and amortization is largely due to the additional depreciation for the Hercules 266 and other capital projects, which contributed to increases of \$5.3 million and approximately \$11.2 million, respectively. These increases are partially offset by a reduction in depreciation of \$9.2 million primarily due to rigs sold. Additionally, the Hercules 258 contributed to a \$2.5 million reduction in depreciation after its impairment in 2012.

General and Administrative Expenses

The increase in general and administrative expenses is primarily related to higher recoveries from one international customer of doubtful accounts receivable in the Comparable Period of \$8.8 million. Additionally, labor cost, primarily in corporate, and professional fees, primarily in our International Offshore segment, increased \$8.8 million and \$2.3 million, respectively in the Current Period as compared to the Comparable Period.

Interest Expense

Interest expense for the Current Period is essentially flat with the Comparable Period. Higher interest expense is offset by higher interest capitalization on upgrade and reactivation projects in addition to the Hercules Triumph and Hercules Resilience projects.

Loss on Extinguishment of Debt

During the Comparable Period, we expensed \$6.4 million related to the April 2012 debt refinancing and wrote off \$1.4 million of unamortized debt issuance costs associated with the April 2012 termination of our prior term loan. Additionally, in May 2012 we repurchased a portion of our 3.375% Convertible Senior Notes, resulting in a loss of \$1.3 million.

Table of Contents

Gain on Equity Investment

During the Current Period, we recognized a gain of \$14.9 million as a result of remeasuring our 32% equity interest in Discovery at its fair value as of the acquisition date of a controlling interest in Discovery in June 2013.

Other, net

The increase in other expense is primarily due to change in the fair value of the Discovery warrants as we recognized a loss of \$0.4 million in the Current Period compared to a gain of \$1.1 million in the Comparable Period.

Additionally, we recognized \$0.7 million of additional equity in losses from Discovery during the Current Period as compared to the Comparable Period.

Income Tax Benefit

During the Current Period we generated an income tax benefit from continuing operations of \$18.6 million compared to an income tax benefit of \$16.8 million during the Comparable Period. The increase is primarily related to the \$37.7 million tax benefit recorded in the Current Period related to the tax attributes received from the Seahawk Transaction as well as the impact of discrete items, which is largely offset by the tax effect of the mix of earnings (losses) from different jurisdictions.

Discontinued Operations

We had a loss from our discontinued Inland operations of \$36.9 million during the Current Period compared to a loss of \$7.3 million in the Comparable Period, primarily due to the \$40.9 million asset impairment charge in the Current Period to write down the assets to fair value less costs to sell, partially offset by the \$4.8 million gain on the sale of Hercules 27 in August 2013. We had a loss from our discontinued Domestic Liftboat operations of \$4.1 million during the Current Period compared to \$0.5 million in the Comparable Period primarily due to the \$3.5 million asset impairment charge in the Current Period to write down the assets to fair value less costs to sell.

Non-GAAP Financial Measures

Regulation G, General Rules Regarding Disclosure of Non-GAAP Financial Measures and other SEC regulations define and prescribe the conditions for use of certain Non-Generally Accepted Accounting Principles ("Non-GAAP") financial measures. We use various Non-GAAP financial measures such as adjusted operating income (loss), adjusted income (loss) from continuing operations, adjusted diluted earnings (loss) per share from continuing operations, EBITDA and Adjusted EBITDA. EBITDA is defined as net income plus interest expense, income taxes, depreciation and amortization. We believe that in addition to GAAP based financial information, Non-GAAP amounts are meaningful disclosures for the following reasons: i) each are components of the measures used by our board of directors and management team to evaluate and analyze our operating performance and historical trends, ii) each are components of the measures used by our management team to make day-to-day operating decisions, iii) under certain scenarios the Credit Agreement requires us to maintain compliance with a maximum secured leverage ratio, which contains Non-GAAP adjustments as components, iv) each are components of the measures used by our management to facilitate internal comparisons to competitors' results and the shallow-water drilling and marine services industry in general, v) results excluding certain costs and expenses provide useful information for the understanding of the ongoing operations without the impact of significant special items, and vi) the payment of certain bonuses to members of our management is contingent upon, among other things, the satisfaction by the Company of financial targets, which may contain Non-GAAP measures as components. We acknowledge that there are limitations when using Non-GAAP measures. The measures below are not recognized terms under GAAP and do not purport to be an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. EBITDA and Adjusted EBITDA are not intended to be a measure of free cash flow for management's discretionary use, as it does not consider certain cash requirements such as tax payments and debt service requirements. Because all companies do not use identical calculations, the amounts below may not be comparable to other similarly titled measures of other companies.

Table of Contents

The following tables present a reconciliation of the GAAP financial measures to the corresponding adjusted financial measures (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Operating Income (Loss)	\$45,277	\$(18,274)	\$96,732	\$(76,927)
Adjustments:				
Asset impairment	—	60,693	—	108,216
Gain on sale of Platform Rig 3	—	(18,350)	—	(18,350)
Gain on Hercules 185 insurance settlement	—	(27,268)	—	(27,268)
Total adjustments	—	15,075	—	62,598
Adjusted Operating Income (Loss)	\$45,277	\$(3,199)	\$96,732	\$(14,329)
Income (Loss) from Continuing Operations attributable to Hercules Offshore, Inc.	\$17,180	\$(37,166)	\$74,070	\$(123,405)
Adjustments:				
Asset impairment	—	60,693	—	108,216
Gain on sale of Platform Rig 3	—	(18,350)	—	(18,350)
Gain on Hercules 185 insurance settlement	—	(27,268)	—	(27,268)
Loss on extinguishment of debt	—	—	—	9,156
Gain on equity investment	—	—	(14,876)	—
Tax benefit (a)	—	—	(37,729)	—
Tax impact of adjustments	—	7,042	—	(12,796)
Total adjustments	—	22,117	(52,605)	58,958
Adjusted Income (Loss) from Continuing Operations	\$17,180	\$(15,049)	\$21,465	\$(64,447)
Diluted Earnings (Loss) per Share from Continuing Operations	\$0.11	\$(0.23)	\$0.46	\$(0.81)
Adjustments:				
Asset impairment	—	0.38	—	0.71
Gain on sale of Platform Rig 3	—	(0.12)	—	(0.12)
Gain on Hercules 185 insurance settlement	—	(0.17)	—	(0.18)
Loss on extinguishment of debt	—	—	—	0.06
Gain on equity investment	—	—	(0.09)	—
Tax benefit	—	—	(0.24)	—
Tax impact of adjustments	—	0.05	—	(0.08)
Total adjustments	—	0.14	(0.33)	0.39
Adjusted Diluted Earnings (Loss) per Share from Continuing Operations	\$0.11	\$(0.09)	\$0.13	\$(0.42)
Income (Loss) from Continuing Operations attributable to Hercules Offshore, Inc.	\$17,180	\$(37,166)	\$74,070	\$(123,405)
Interest expense	19,360	18,249	54,495	54,915
Income tax provision (benefit)	8,400	1,319	(18,609)	(16,829)
Depreciation and amortization	38,040	34,529	110,906	108,143
EBITDA	82,980	16,931	220,862	22,824
Adjustments:				
Asset impairment	—	60,693	—	108,216
Gain on sale of Platform Rig 3	—	(18,350)	—	(18,350)
Gain on Hercules 185 insurance settlement	—	(27,268)	—	(27,268)
Loss on extinguishment of debt	—	—	—	9,156
Gain on equity investment	—	—	(14,876)	—

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Total adjustments	—	15,075	(14,876) 71,754
Adjusted EBITDA	\$82,980	\$32,006	\$205,986	\$94,578

(a) Tax benefit recognized of \$37.7 million related to the change in characterization of the Seahawk acquisition for tax purposes from a purchase of assets to a reorganization.

Table of Contents

CRITICAL ACCOUNTING POLICIES

We believe that our more critical accounting policies include those related to business combinations, property and equipment, derivatives, revenue recognition, income taxes, allowance for doubtful accounts, stock-based compensation and accrued self-insurance reserves. Inherent in such policies are certain key assumptions and estimates. For additional information regarding our critical accounting policies, please read "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2012, as amended by our current report on Form 8-K filed on August 23, 2013. Item 1 of Part I of this Quarterly Report on Form 10-Q and below.

Business Combinations

Discovery Offshore

On June 24, 2013, we acquired an additional 52% interest in Discovery by purchasing additional common stock to bring the total interest held to 84%. We began consolidating Discovery's results of operations as of the June 24, 2013 acquisition date ("Acquisition Date"). As of September 30, 2013, we held a 100% interest in Discovery as a result of additional purchases of shares of Discovery common stock subsequent to the Acquisition Date at 15 NOK per share (USD \$26.3 million in total).

The acquisition date fair value of our previously held equity interest in Discovery Offshore was \$52.0 million. We recognized a \$14.9 million gain as a result of remeasuring the 32% equity interest in Discovery at its fair value, as of the Acquisition Date, in accordance with Accounting Standards Codification ("ASC") Topic 805, Business Combinations. This gain is included in Gain on Equity Investment on the Consolidated Statements of Operations for the nine months ended September 30, 2013.

We accounted for this transaction as a business combination and accordingly the total consideration was allocated to Discovery's net tangible assets based on their estimated fair values. We are in the process of finalizing valuations of these net tangible assets. Therefore, these valuations are preliminary and are subject to change upon the receipt and management's review of the final valuations. Upon final valuation of the net tangible assets, the excess, if any, of the purchase price over these assets will be recorded as goodwill.

Seahawk

Effective April 27, 2011, we completed the Seahawk Transaction. Our financial statements were historically prepared assuming this transaction should be treated as a purchase of assets for tax purposes. Seahawk is in a Chapter 11 proceeding in the U.S. Bankruptcy Court. In February 2013, at the direction of the Court, Seahawk made certain distributions to its equity holders. These distributions, taken together with other aspects of the acquisition, changed the tax treatment and caused the Seahawk Transaction to be characterized as a reorganization pursuant to IRC §368(a)(1)(G). Therefore, we recorded a carryover basis in the Seahawk assets and other tax attributes. Because of the ownership change certain of these carryovers may be subject to specific, and in some cases an annual, limitation on their utilization. We recognized a valuation allowance as appropriate. These carryover attributes recognized include net operating losses of \$186.7 million, tax credits of \$17.1 million, and tax basis in assets of \$70.0 million. We recorded deferred tax assets, net of valuation allowance, of approximately \$37.7 million in the first quarter 2013. There can be no assurance that these deferred tax assets will be realized.

Principles of Consolidation

Our Consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries including the accounts of our wholly owned subsidiary Discovery from the date a majority controlling interest was acquired. All intercompany account balances and transactions have been eliminated.

OUTLOOK

Offshore

Demand for our oilfield services is driven by our exploration and production customers' capital spending, which can experience significant fluctuations depending on current commodity prices and their expectations of future price levels, among other factors.

Drilling activity levels in the shallow-water U.S. Gulf of Mexico are dependent on crude oil and natural gas prices, prospectivity of hydrocarbons, as well as our customers' ability to obtain necessary drilling permits to operate in the

region. Although natural gas has historically accounted for a greater percentage of hydrocarbon production in the U.S. Gulf of Mexico, our domestic offshore customers are increasingly focused on drilling activities that contain higher concentrations of crude oil and condensates. We expect this trend to continue, given the disparity between the price of crude oil and natural gas. As of October 10, 2013, the spot price for Louisiana Light Sweet (“LLS”) crude was \$106.01 per barrel. LLS crude oil prices have

Table of Contents

fluctuated significantly over the past year, peaking at a high of \$118.93 per barrel to a low of \$99.03 per barrel. Throughout this period of volatility, we did not experience any material reduction in demand for our services, and we believe current oil prices remain supportive for a continuation of activity levels.

The supply of marketed jackup rigs in the U.S. Gulf of Mexico has declined significantly since the financial crisis starting in 2008 and again with the imposition of new regulations during 2010. Drilling contractors have elected to cold stack, or no longer actively market, a number of rigs in the region, and in other instances have mobilized rigs out of the U.S. Gulf of Mexico. As a result, the number of existing, actively marketed jackup rigs in the U.S. Gulf of Mexico, has declined from approximately 63 rigs in late 2008 to 38 rigs as of October 10, 2013, of which we estimate that 35 rigs are contracted.

Discussions with our domestic customers suggest an extensive inventory of oil and liquids directed drilling opportunities exists in the U.S. Gulf of Mexico Shelf. Relatively high crude oil prices and our customers' emphasis on drilling oil and liquids rich prospects leads us to believe that healthy levels of rig demand and pricing in the region will persist. Tempering these positive conditions in the U.S. Gulf of Mexico is the market expectation for a prolonged period of low natural gas prices. We also expect to experience some inflationary pressures on operating costs, particularly in labor, as strong drilling activity worldwide has led to a tightening of skilled labor across the oilfield service industry. In addition, any new regulatory or legislative changes that would affect shallow-water drilling activity in the U.S. Gulf of Mexico could have a material impact on Domestic Offshore's financial results.

Demand for rigs in our International Offshore segment is primarily dependent on crude oil prices. Relatively high crude oil prices and capital budget announcements by National and International Oil Companies, leads us to believe that international capital spending and demand for drilling rigs overseas will increase in 2014. Our expectation for greater international rig demand is tempered by the anticipated growth in supply from newly constructed rigs. As of October 10, 2013, there were 425 existing, actively marketed jackup rigs outside of the U.S. Gulf of Mexico, excluding cold stacked rigs, of which only 15 rigs were uncontracted. In addition, globally, there are an estimated 122 new jackup rigs either under construction, on order, or planned for delivery from 2013 to 2017, of which 100 are without contracts. With the exception of the rigs we acquired from Discovery, all of the jackup rigs under construction have higher specifications than the rigs in our existing fleet.

Demand for rigs of similar class to the rigs acquired from Discovery is also dependent on the need by oil and gas companies to utilize high specification and harsh environment ("HS/HE") jackup rigs with capabilities that exceed many of the standard rigs currently in existence, and availability of these HS/HE rigs. In recent years, we believe that demand for HS/HE jackup rigs has grown, driven by harsher environmental conditions, greater well depths and increased complexities of the offshore wells drilled by oil and gas companies. We expect this trend to continue through the foreseeable future, as oil and gas companies further expand their exploration efforts into frontier areas that are often characterized by these greater challenges.

Liftboats

Demand for liftboats is typically a function of our customers' demand for offshore infrastructure construction, inspection and maintenance, well maintenance, well plugging and abandonment, and other related activities. Although activity levels for liftboats are not as closely correlated to commodity prices as our drilling segments, commodity prices are still a key driver of liftboat demand. Demand for liftboat services in West Africa has been strong and we expect such conditions to continue at least through 2013. However, expected mobilization of additional vessels to the region could potentially impact the utilization and pricing for our liftboat fleet. Utilization can and has been negatively impacted by local labor disputes and regional conflicts, particularly in West Africa. In the Middle East, we expect healthy multi-year demand for liftboats to support increases in construction and well servicing activity levels.

Over the long term, we believe that international liftboat demand will benefit from: (i) the aging offshore infrastructure and maturing offshore basins, (ii) desire by our international customers to economically produce from these mature basins and service their infrastructure and (iii) the cost advantages of liftboats to perform these services relative to alternatives. Tempering this demand outlook is (i) our expectation of increased competition from newly constructed liftboats and mobilizations of existing liftboats primarily from the U.S. Gulf of Mexico to international markets, (ii) the risk of recurring political, social and union unrest, principally in West Africa and (iii) increased pressure to have local ownership of assets, principally in Nigeria.

Table of Contents

LIQUIDITY AND CAPITAL RESOURCES

Sources and Uses of Cash

Sources and uses of cash for the nine month period ended September 30, 2013 are as follows (in millions):

Net Cash Provided by Operating Activities	\$ 179.4	
Net Cash Provided by (Used in) Investing Activities:		
Acquisition of Assets, Net of Cash Acquired	(201.0)
Additions of Property and Equipment	(307.1)
Deferred Drydocking Expenditures	(7.5)
Insurance Proceeds Received	1.4	
Proceeds from Sale of Assets, Net	107.4	
Other	2.2	
Total	(404.6)
Net Cash Provided by (Used in) Financing Activities:		
Long-term Debt Borrowing	400.0	
Redemption of 3.375% Convertible Senior Notes	(61.3)
Payment of Debt Issuance Cost	(8.2)
Other	1.3	
Total	331.8	
Net Increase in Cash and Cash Equivalents	\$ 106.6	

Sources of Liquidity and Financing Arrangements

Our liquidity is comprised of cash on hand, cash from operations and availability under our revolving credit facility.

We also maintain a shelf registration statement covering the future issuance from time to time of various types of securities, including debt and equity securities. If we issue any debt securities off the shelf or otherwise incur debt, in certain instances we would be required to allocate the proceeds of such debt to repay or refinance existing debt. We currently believe we will have adequate liquidity to fund our operations. However, to the extent we do not generate sufficient cash from operations we may need to raise additional funds through debt, equity offerings or the sale of assets. Furthermore, we may need to raise additional funds through debt or equity offerings or asset sales to refinance existing debt or for general corporate purposes.

Cash Requirements and Contractual Obligations

Debt

Our current debt structure is used to fund our business operations.

On April 3, 2012, we entered into a credit agreement (the "Credit Agreement"), which governs our senior secured revolving credit facility (the "Credit Facility"). On July 08, 2013, we amended the Credit Agreement to increase the senior secured revolving credit facility to \$150.0 million from \$75.0 million and the sublimit for the issuance of letters of credit to \$50.0 million from \$25.0 million. As of September 30, 2013, no amounts were outstanding and \$1.0 million in letters of credit had been issued under the Credit Facility, therefore, the remaining availability under this facility was \$149.0 million.

Prior to July 8, 2013, borrowings under the Credit Facility bore interest, at our option, at either (i) the Alternate Base Rate ("ABR") (the highest of the administrative agent's corporate base rate of interest, the federal funds rate plus 0.5%, or the one-month Eurodollar rate (as defined in the Credit Agreement) plus 1%), plus an applicable margin that ranged between 3.0% and 4.5%, depending on our leverage ratio, or (ii) the Eurodollar rate plus an applicable margin that ranged between 4.0% and 5.5%, depending on our leverage ratio. We paid a per annum fee on all letters of credit issued under the Credit Facility, which fee equaled the applicable margin for loans accruing interest based on the Eurodollar rate, and we paid a commitment fee of 0.75% per annum on the unused availability under the Credit Facility.

In addition, during any period of time that outstanding letters of credit under the Credit Facility exceed \$10 million or there are any revolving borrowings outstanding under the Credit Facility, we will have to maintain compliance with a maximum secured leverage ratio (as defined in the Credit Agreement, being generally computed as the ratio of secured indebtedness to consolidated cash flow). The maximum secured leverage ratio is 3.50 to 1.00.

Our obligations under the Credit Agreement are guaranteed by substantially all of our current domestic subsidiaries

Table of Contents

(collectively, the "Guarantors"), and the obligations of the Company and the Guarantors are secured by liens on substantially all of the vessels owned by the Company and the Guarantors, together with certain accounts receivable, equity of subsidiaries, equipment and other assets.

The amendment to the Credit Agreement, among other things:

- increased the senior secured revolving credit facility to \$150.0 million (subject to certain limitations which restrict borrowing to \$75.0 million while our 10.5% Senior Notes due 2017 are outstanding);

- extended the maturity date of the Credit Facility to July 8, 2018;

- increased the sublimit for the issuance of letters of credit to \$50.0 million;

- allowed for an increase in aggregate commitments of up to \$50.0 million;

- reduced the applicable margin for ABR Loans to a range between 1.5% and 3.0% depending on our total leverage ratio;

- reduced the applicable margin for Eurodollar Loans to a range between 2.5% and 4.0% depending on our total leverage ratio; and

- reduced the per annum commitment fee on unused availability under the Credit Facility to 0.50%.

We incurred costs of \$1.1 million related to the amendment of our Credit Agreement.

On July 8, 2013, we completed the issuance and sale of \$400.0 million aggregate principal amount of senior notes at a coupon rate of 8.75% ("8.75% Senior Notes") with maturity in July 2021. These notes were sold at par and we received net proceeds from the offering of the notes of approximately \$393.0 million after deducting the bank fees and estimated offering expenses. The net proceeds from this offering, together with cash on hand (including the proceeds of approximately \$103.9 million we received from the sales of our inland barge rigs, domestic liftboats and related assets), were used to fund our acquisition of Discovery shares, the final shipyard payments totaling \$333.9 million for Hercules Triumph and Hercules Resilience, related capital expenditures, as well as general corporate purposes. Interest on the notes will accrue from and including July 8, 2013 at a rate of 8.75% per year and is payable semi-annually in arrears on January 15 and July 15 of each year, beginning January 15, 2014.

The 8.75% Senior Notes are guaranteed by each of the Guarantors that guarantee our obligations under our Credit Agreement.

Prior to July 15, 2016, we may redeem the notes with the net cash proceeds of certain equity offerings, at a redemption price equal to 108.75% of the aggregate principal amount plus accrued and unpaid interest; provided, that (i) after giving effect to any such redemptions, at least 65% of the notes originally issued would remain outstanding immediately after such redemption and (ii) we make such redemption not more than 180 days after consummation of such equity offering. In addition, prior to July 15, 2017, we may redeem all or part of the notes at a price equal to 100% of the aggregate principal amount of the notes to be redeemed, plus the applicable premium, as defined in the indenture, and accrued and unpaid interest.

On or after July 15, 2017, we may redeem all or part of the notes at the redemption prices set forth below, together with accrued and unpaid interest, if any, to the redemption date, if redeemed during the 12-month period beginning July 15 of the years indicated:

Year	Optional Redemption Price	
2017	104.375	%
2018	102.188	%
2019 and thereafter	100.000	%

If we experience certain kinds of changes of control, holders of the notes will be entitled to require us to purchase all or any portion of the notes for a cash price equal to 101.0% of the principal amount of the applicable notes, plus accrued and unpaid interest, if any, to the date of purchase. Furthermore, in certain circumstances following an asset sale (as defined in the indenture), we may be required to use the excess proceeds to offer to repurchase the notes at an offer price in cash equal to 100% of their principal amount, plus accrued and unpaid interest.

On October 1, 2013, we completed the issuance and sale of \$300.0 million aggregate principal amount of senior notes at a coupon rate of 7.5% ("7.5% Senior Notes") with maturity in October 2021. These notes were sold at par and we received net proceeds from the offering of the notes of approximately \$294.5 million after deducting the bank fees and

estimated offering

37

Table of Contents

expenses. Interest on the notes will accrue from and including October 1, 2013 at a rate of 7.5% per year and is payable semi-annually in arrears on April 1 and October 1 of each year, beginning April 1, 2014.

The 7.5% Senior Notes are guaranteed by each of the Guarantors that guarantee our obligations under its Credit Agreement.

Prior to October 1, 2016, we may redeem the notes with the net cash proceeds of certain equity offerings, at a redemption price equal to 107.5% of the aggregate principal amount plus accrued and unpaid interest; provided, that (i) after giving effect to any such redemptions, at least 65% of the notes originally issued would remain outstanding immediately after such redemption and (ii) we make such redemption not more than 180 days after consummation of such equity offering. In addition, prior to October 1, 2016, we may redeem all or part of the notes at a price equal to 100% of the aggregate principal amount of the notes to be redeemed, plus the applicable premium, as defined in the indenture, and accrued and unpaid interest.

On or after October 1, 2016, we may redeem all or part of the notes at the redemption prices set forth below, together with accrued and unpaid interest, if any, to the redemption date, if redeemed during the 12-month period beginning October 1 of the years indicated:

Year	Optional Redemption Price	
2016	105.625	%
2017	103.750	%
2018	101.875	%
2019 and thereafter	100.000	%

If we experience certain kinds of changes of control, holders of the notes will be entitled to require us to purchase all or any portion of the notes for a cash price equal to 101.0% of the principal amount of the applicable notes, plus accrued and unpaid interest, if any, to the date of purchase. Furthermore, in certain circumstances following an asset sale (as defined in the indenture), we may be required to use the excess proceeds to offer to repurchase the notes at an offer price in cash equal to 100% of their principal amount, plus accrued and unpaid interest.

On September 17, 2013, we commenced a cash tender offer (the "Tender offer") for any and all of the \$300.0 million outstanding aggregate principal amount of our 10.5% Senior Notes due 2017. Senior notes totaling approximately \$253.6 million were tendered as of September 30, 2013 and were settled on October 1, 2013 for \$268.5 million using a portion of the proceeds from the issuance of the 7.5% Senior Notes due 2021. We expect to use the remaining net proceeds from the 7.5% Senior Notes due 2021 offering, together with cash on hand, to redeem the remaining \$46.4 million aggregate principal amount of the 10.5% Senior Notes in November 2013 for approximately \$48.8 million. In 2008, we issued \$250.0 million convertible senior notes at a coupon rate of 3.375% ("3.375% Convertible Senior Notes") with a maturity in June 2038.

The 3.375% Convertible Senior Notes will be convertible under certain circumstances into shares of our common stock ("Common Stock") at an initial conversion rate of 19.9695 shares of Common Stock per \$1,000 in original principal amount of notes, which is equal to an initial conversion price of approximately \$50.08 per share. Upon conversion of a note, a holder will receive, at our election, shares of Common Stock, cash or a combination of cash and shares of Common Stock. At September 30, 2013, the number of conversion shares potentially issuable in relation to our 3.375% Convertible Senior Notes was 0.1 million. We may redeem the 3.375% Convertible Senior Notes at our option and holders of the notes will have the right to require us to repurchase the notes on June 1, 2018 and certain dates thereafter or on the occurrence of a fundamental change.

We determined that upon maturity or redemption, we have the intent and ability to settle the principal amount of our 3.375% Convertible Senior Notes in cash, and any additional conversion consideration spread (the excess of conversion value over face value) in shares of our Common Stock.

In May 2012, we repurchased \$27.6 million aggregate principal amount of the 3.375% Convertible Senior Notes, resulting in a loss of \$1.3 million that is included in Loss on Extinguishment of Debt in the Consolidated Statements of Operations for the nine months ended September 30, 2012. The settlement consideration was allocated to the extinguishment of the liability component in an amount equal to the fair value of that component immediately prior to extinguishment with the difference between this allocation and the net carrying amount of the liability component and

unamortized debt issuance costs recognized as a gain or loss on debt extinguishment. If there would have been any remaining settlement consideration, it would have been allocated to the reacquisition of the equity component and recognized as a reduction of stockholders' equity.

Table of Contents

On May 1, 2013, we made an offer to purchase all of the outstanding notes in accordance with our repurchase obligation under the indenture and on June 1, 2013 repurchased \$61.3 million aggregate principal amount of the 3.375% Convertible Senior Notes pursuant to the terms of the tender offer.

The Credit Agreement as well as the indentures governing the 8.75% Senior Notes, 7.5% Senior Notes, 7.125% Senior Secured Notes, 10.25% Senior Notes, 10.5% Senior Notes and 3.375% Convertible Senior Notes contain customary events of default. In addition, the Credit Agreement as well as the indentures governing the 8.75% Senior Notes, 7.5% Senior Notes, 7.125% Senior Secured Notes, 10.25% Senior Notes, 10.5% Senior Notes and 3.375% Convertible Senior Notes also contain a provision under which an event of default by the Company or by any restricted subsidiary on any other indebtedness exceeding \$25.0 million would be considered an event of default under the Credit Agreement and indentures if such default: a) is caused by failure to pay the principal at final maturity, or b) permits the acceleration of such indebtedness prior to maturity.

The Credit Agreement as well as the indentures governing the 8.75% Senior Notes, 7.5% Senior Notes, 7.125% Senior Secured Notes, 10.25% Senior Notes and 10.5% Senior Notes contain covenants that, among other things, limit our ability and the ability of our restricted subsidiaries to:

- incur additional indebtedness or issue certain preferred stock;
- pay dividends or make other distributions;
- make other restricted payments or investments;
- sell assets;
- create liens;
- enter into agreements that restrict dividends and other payments by restricted subsidiaries;
- engage in transactions with affiliates; and
- consolidate, merge or transfer all or substantially all of our assets.

The indenture governing the 10.5% Senior Notes provides that all the liens securing the notes may be released if our total amount of secured indebtedness, other than the 10.5% Senior Notes, does not exceed the lesser of \$375.0 million and 15.0% of our consolidated tangible assets. We refer to such a release as a “collateral suspension.” When a collateral suspension is in effect, the 10.5% Senior Notes due 2017 become unsecured. Following the closing of the 2012 debt issuances and the use of proceeds thereof to repay in full the prior secured credit facility, the liens securing the 10.5% Senior Notes were released on April 3, 2012 and a collateral suspension is currently in effect. The indenture governing the 10.5% Senior Notes also provides that if, after any such collateral suspension, the aggregate principal amount of our total secured indebtedness, other than the 10.5% Senior Notes due 2017, were to exceed the greater of \$375.0 million and 15.0% of our consolidated tangible assets, as defined in such indenture, then the collateral obligations of the Company and guarantors thereunder will be reinstated and must be complied with within 30 days of such event. Substantially all of our domestic subsidiaries guarantee the obligations under the Credit Agreement, the 8.75% Senior Notes, 7.5% Senior Notes, 7.125% Senior Secured Notes, 10.25% Senior Notes and 10.5% Senior Notes.

Our obligations under the Credit Agreement and 7.125% Senior Secured Notes are secured on an equal and ratable first priority basis by liens on a majority of our vessels and substantially all of our other personal property.

We maintain insurance coverage that includes coverage for physical damage, third party liability, workers’ compensation and employer’s liability, general liability, vessel pollution and other coverages.

Effective May 1, 2013, we completed the annual renewal of all of our key insurance policies. Our primary marine package provides for hull and machinery coverage for substantially all of our rigs and liftboats up to a scheduled value of each asset. The total maximum amount of coverage for these assets is \$1.7 billion. The marine package includes protection and indemnity and maritime employer’s liability coverage for marine crew personal injury and death and certain operational liabilities, with primary coverage (or self-insured retention for maritime employer’s liability coverage) of \$5.0 million per occurrence with excess liability coverage up to \$200.0 million. The marine package policy also includes coverage for personal injury and death of third parties with primary and excess coverage of \$25.0 million per occurrence with additional excess liability coverage up to \$200.0 million, subject to a \$250,000 per-occurrence deductible. The marine package also provides coverage for cargo and charterer’s legal liability. The marine package includes limitations for coverage for losses caused in U.S. Gulf of Mexico named windstorms, including an annual aggregate limit of liability of \$75.0 million for property damage and removal of wreck liability

coverage. We also procured an additional \$75.0 million excess policy for removal of wreck and certain third-party liabilities incurred in U.S. Gulf of Mexico named windstorms. Deductibles for events that are not caused by a U.S. Gulf of Mexico named windstorm are 12.5% of the insured drilling rig values per occurrence, subject to a minimum of \$1.0 million, and \$1.0 million per occurrence for liftboats. The deductible for drilling rigs in a U.S. Gulf of Mexico named windstorm event is \$25.0 million. Vessel pollution is covered under a Water Quality Insurance Syndicate policy (“WQIS

Table of Contents

Policy”) providing limits as required by applicable law, including the Oil Pollution Act of 1990. The WQIS Policy covers pollution emanating from our vessels and drilling rigs, with primary limits of \$5.0 million (inclusive of a \$3.0 million per-occurrence deductible) and excess liability coverage up to \$200.0 million.

Control-of-well events generally include an unintended flow from the well that cannot be contained by equipment on site (e.g., a blow-out preventer), by increasing the weight of the drilling fluid, or that does not naturally close itself off through what is typically described as "bridging over". We carry a contractor's extra expense policy with \$25.0 million primary liability coverage for well control costs, pollution and expenses incurred to redrill wild or lost wells, with excess liability coverage up to \$200.0 million for pollution liability that is covered in the primary policy. The policies are subject to exclusions, limitations, deductibles, self-insured retention and other conditions. In addition to the marine package, we have separate policies providing coverage for onshore foreign and domestic general liability, employer's liability, auto liability and non-owned aircraft liability, with customary deductibles and coverage.

Our drilling contracts provide for varying levels of indemnification from our customers and in most cases, may require us to indemnify our customers for certain liabilities. Under our drilling contracts, liability with respect to personnel and property is customarily assigned on a "knock-for-knock" basis, which means that we and our customers assume liability for our respective personnel and property, regardless of how the loss or damage to the personnel and property may be caused. Our customers typically assume responsibility for and agree to indemnify us from any loss or liability resulting from pollution or contamination, including clean-up and removal and third-party damages arising from operations under the contract and originating below the surface of the water, including as a result of blow-outs or cratering of the well ("Blowout Liability"). The customer's assumption for Blowout Liability may, in certain circumstances, be limited or could be determined to be unenforceable in the event of our gross negligence, willful misconduct or other egregious conduct. In addition, we may not be indemnified for statutory penalties and punitive damages relating to such pollution or contamination events. We generally indemnify the customer for the consequences of spills of industrial waste or other liquids originating solely above the surface of the water and emanating from our rigs or vessels.

We have a separate primary marine package for Hercules Triumph that provides hull and machinery coverage up to \$250.0 million, subject to a \$2.5 million per-occurrence deductible, which increases to \$5.0 million for losses incurred during delivery voyages. The marine package also provides coverage for cargo, contractor's extra expense and loss of hire coverage. We also have operational protection and indemnity coverage up to \$500.0 million, subject to a \$50,000 per-occurrence deductible for claims originating outside the U.S. and a \$250,000 per-occurrence deductible for claims originating in the U.S. Additionally, we have coverage for extended contractual liability that includes subsea activities, property and personnel, and clean-up costs up to \$25.0 million and pollution-by-blowout coverage up to \$10.0 million, all subject to certain contractual assumptions and limitations. We do not have coverage inclusive of U.S. Gulf of Mexico named windstorms. Upon delivery of the Hercules Resilience, we obtained insurance policies for the Hercules Resilience substantially similar to those procured for the Hercules Triumph.

We are self-insured for the deductible portion of our insurance coverage. Management believes adequate accruals have been made on known and estimated exposures up to the deductible portion of our insurance coverage.

Management believes that claims and liabilities in excess of the amounts accrued are adequately insured. However, our insurance is subject to exclusions and limitations, and there is no assurance that such coverage will adequately protect us against liability from all potential consequences. In addition, there is no assurance of renewal or the ability to obtain coverage acceptable to us.

In 2013, in connection with the renewal of certain of our insurance policies, we entered into an agreement to finance a portion of our annual insurance premiums. Approximately \$30.7 million was financed through this arrangement with an interest rate of 3.24% and a maturity date of March 2014, of which \$18.5 million was outstanding as insurance notes payable as of September 30, 2013. There was \$9.1 million outstanding in insurance notes payable at December 31, 2012 which we fully paid by the maturity date of March 2013. Additionally \$0.7 million was outstanding on the \$1.3 million note, related to the 2013 insurance renewal for Hercules Triumph, with an interest rate of 3.24% and a maturity date of March 2014.

Hercules 265 Incident

On July 23, 2013, our jackup drilling rig Hercules 265, a 250' mat-supported cantilevered unit operating in the U.S. Gulf of Mexico Outer Continental Shelf lease block South Timbalier 220, experienced a well control incident. Natural gas flowing from the well ignited and spread to the rig. On July 25, 2013, the natural gas well apparently bridged over, and the flow of natural gas ceased and the well was thereafter secured by our customer. All 44 personnel aboard the jackup rig were safely evacuated with no reported injuries. Based on our limited survey, the rig sustained substantial damage in the incident. Our insurance underwriters have not been able to determine whether the rig will be a constructive total loss. The cause of the incident is unknown but is under investigation. The rig has an insured value of \$50.0 million. We also have removal of wreck coverage up to a total amount of \$110.0 million. The deductible under our package policy, which includes physical damage and removal of wreck coverage, is \$5.0 million, but the deductible does not apply in the event the rig is a total loss. In the event

Table of Contents

any pollution emanated from our rig or equipment as a result of the incident, our vessel pollution policy provides coverage, subject to deductibles and limitations. The rig has a net book value of approximately \$19.0 million at September 30, 2013.

Capital Expenditures

We expect capital expenditures and drydocking during the fourth quarter 2013 to range from \$220 million to \$240 million, which includes an approximate \$167 million final shipyard payment for the Hercules Resilience. Fourth quarter 2013 capital expenditures will also include a portion of the cost to reactivate the Hercules 203. The reactivation is expected to take through mid-2014 to complete, at an estimated cost of approximately \$20 million. The reactivation cost could increase if we elect to make selective upgrades and enhancements to the rig. Planned capital expenditures also include items related to general maintenance, regulatory, refurbishment, upgrades and contract specific modifications to our rigs and liftboats. Changes in timing of certain planned capital expenditure projects may result in a shift of spending levels beyond 2013. Should we elect to reactivate additional cold stacked rigs or upgrade and refurbish select rigs or liftboats, our capital expenditures will increase. Reactivations, upgrades and refurbishments are subject to our discretion and will depend on our view of market conditions and our cash flows. From time to time, we may review possible acquisitions of rigs, liftboats or businesses, joint ventures, mergers or other business combinations, and we may have outstanding from time to time bids to acquire certain assets from other companies. We may not, however, be successful in our acquisition efforts. If we acquire additional assets, we would expect that our ongoing capital expenditures as a whole would increase in order to maintain our equipment in a competitive condition.

Our ability to fund capital expenditures would be adversely affected if conditions deteriorate in our business.

Contractual Obligations

Our contractual obligations and commitments principally include obligations associated with our outstanding indebtedness, certain income tax liabilities, bank guarantees, surety bonds, letters of credit, future minimum operating lease obligations, purchase commitments and management compensation obligations. Except for the following, during the first nine months of 2013, there were no material changes outside the ordinary course of business in the specified contractual obligations.

- Settled \$9.1 million of insurance notes payable outstanding at December 31, 2012;
- Financed \$30.7 million related to the renewal of our insurance policies;
- Consolidated \$1.2 million for Discovery's insurance policy renewal financing as a result of the business combination;
- Retired \$61.3 million aggregate principal amount of the 3.375% Convertible Senior Notes;
- Issued \$400.0 million aggregate principal amount of 8.75% Senior Secured Notes due 2021 and amended our credit agreement (See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources-Cash Requirements and Contractual Obligations");
- Paid \$166.9 million for the final shipyard installment on Hercules Triumph.

On October 1, 2013, we issued \$300.0 million aggregate principal amount of 7.5% Senior Notes due October 2021 and used a portion of the proceeds to redeem \$253.6 million of the \$300.0 million aggregate principal amount of 10.5% Senior Notes due 2017 for \$268.5 million. We expect to use the remaining net proceeds from the 7.5% Senior Notes due 2021 offering, together with cash on hand, to redeem the remaining \$46.4 million aggregated principal amount of the 10.5% Senior Notes due 2017 in November 2013 for approximately \$48.8 million (See Item 2.

"Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources-Cash Requirements and Contractual Obligations").

On October 17, 2013, the final shipyard installment of \$166.9 million was paid on Hercules Resilience.

For additional information about our contractual obligations as of December 31, 2012, see "Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources-Contractual Obligations" in Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2012, as amended by our current report on Form 8-K filed on August 23, 2013.

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended ("the Securities Act"), and Section 21E of the Exchange Act that are applicable to

us and our business. All statements, other than statements of historical fact, included in this quarterly report that address outlook, activities, events or developments that we intend, contemplate, estimate, expect, project, believe or anticipate will or may occur in the future are forward-looking statements. These include such matters as:

- our levels of indebtedness, covenant compliance and access to capital under current market conditions;

Table of Contents

our ability to enter into new contracts for our rigs and liftboats, including our two ultra-high specification rigs, and future utilization rates and dayrates for the units;

- our ability to renew or extend our contracts, or enter into new contracts, when such contracts expire;
- demand for our rigs and our liftboats;
- activity levels of our customers and their expectations of future energy prices and ability to obtain drilling permits in an efficient manner or at all;
- sufficiency and availability of funds for required rig construction payments, capital expenditures, working capital and debt service;
- our ability to close the sale and purchase of assets on time;
- expected completion times for our repair, refurbishment and upgrade projects;
- our ability to complete our shipyard projects incident free;
- our ability to complete our shipyard projects on time to avoid cost overruns and contract penalties;
- our ability to effectively reactivate rigs that we have stacked;
- the timing and cost of shipyard projects and refurbishments and the return of idle rigs to work;
- our plans to increase international operations;
- expected useful lives of our rigs and liftboats;
- future capital expenditures and refurbishment, reactivation, transportation, repair and upgrade costs;
- liabilities and restrictions under coastwise and other laws of the United States and regulations protecting the environment;
- expected outcomes of litigation, investigations, claims, disputes and tax audits and their expected effects on our financial condition and results of operations;
- the existence of insurance coverage and the extent of recovery from our insurance underwriters for claims made under our insurance policies; and

expectations regarding offshore drilling activity and dayrates, market conditions, demand for our rigs and liftboats, operating revenue, operating and maintenance expense, insurance coverage, insurance expense and deductibles, interest expense, debt levels and other matters with regard to outlook and future earnings.

We have based these statements on our assumptions and analyses in light of our experience and perception of historical trends, current conditions, expected future developments and other factors we believe are appropriate in the circumstances. Forward-looking statements by their nature involve substantial risks and uncertainties that could significantly affect expected results, and actual future results could differ materially from those described in such statements. Although it is not possible to identify all factors, we continue to face many risks and uncertainties. Among the factors that could cause actual future results to differ materially are the risks and uncertainties described under “Risk Factors” in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012 and Item 1A of Part II of this quarterly report and the following:

- oil and natural gas prices and industry expectations about future prices;
- levels of oil and gas exploration and production spending;
- demand for and supply of offshore drilling rigs and liftboats;
- our ability to enter into and the terms of future contracts;
- the adequacy and costs of sources of credit and liquidity;
- the worldwide military and political environment, uncertainty or instability resulting from an escalation or additional outbreak of armed hostilities or other crises in the Middle East, North Africa, West Africa, Asia and other oil and natural gas producing regions or acts of terrorism or piracy;
- the ability of our customers in the U.S. Gulf of Mexico to obtain drilling permits in an efficient manner or at all;
- the impact of governmental laws and regulations, including laws and regulations in the U.S. Gulf of Mexico following the Macondo well incident;
- our ability to obtain in a timely manner visas and work permits for our employees working in international jurisdictions;
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the impact of local content and cabotage laws and regulations in international jurisdictions in which we operate, particularly Nigeria;

the impact of tax laws, regulations, interpretations and audits in jurisdictions where we conduct business;

uncertainties relating to the level of activity in offshore oil and natural gas exploration, development and production;

competition and market conditions in the contract drilling and liftboat industries;

Table of Contents

- the availability of skilled personnel and the rising cost of labor;
- labor relations and work stoppages, particularly in the Nigerian labor environments;
- operating hazards such as hurricanes, severe weather and seas, fires, cratering, blowouts and other well control incidents, war, terrorism and cancellation or unavailability of insurance coverage or insufficient insurance coverage;
- the enforceability and interpretations of indemnity and liability provisions contained in our drilling contracts, particularly in the U.S. Gulf of Mexico;
- the effect of litigation, investigations, audits and contingencies; and
- our inability to achieve our plans or carry out our strategy.

Many of these factors are beyond our ability to control or predict. Any of these factors, or a combination of these factors, could materially affect our future financial condition or results of operations and the ultimate accuracy of the forward-looking statements. These forward-looking statements are not guarantees of our future performance, and our actual results and future developments may differ materially from those projected in the forward-looking statements. Management cautions against putting undue reliance on forward-looking statements or projecting any future results based on such statements or present or prior earnings levels. In addition, each forward-looking statement speaks only as of the date of the particular statement, and we undertake no obligation to publicly update or revise any forward-looking statements except as required by applicable law.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are currently exposed to market risk from changes in interest rates. From time to time, we may enter into derivative financial instrument transactions to manage or reduce our market risk, but we do not enter into derivative transactions for speculative purposes. A discussion of our market risk exposure in financial instruments follows.

Interest Rate Exposure

We are subject to interest rate risk on our fixed-interest rate borrowings. Fixed rate debt, where the interest rate is fixed over the life of the instrument, exposes us to changes in market interest rates reflected in the fair value of the debt and to the risk that we may need to refinance maturing debt with new debt at a higher rate.

Fair Value of Warrants and Derivative Asset

Previously we had warrants issued from Discovery Offshore that were recorded as a Derivative Asset. This asset, valued at \$3.5 million as of June 24, 2013, was included as a purchase adjustment in connection with the purchase of a controlling interest in Discovery. Previously, we estimated the fair value of these instruments using a Monte Carlo simulation which takes into account a variety of factors including the strike price, the target price, the stock value, the expected volatility, the risk-free interest rate, the expected life of warrants, and the number of warrants. We were required to revalue this asset each quarter. We believe that the assumption that had the greatest impact on the determination of fair value was the closing price of Discovery Offshore's stock.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and our chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Our chief executive officer and chief financial officer evaluated whether our disclosure controls and procedures as of the end of the period covered by this report were designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934 is (1) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and (2) accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective to achieve the foregoing objectives as of the end of the period covered by this report.

There were no changes in our internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth under the caption "Legal Proceedings" in Note 12 of the Notes to the Unaudited Consolidated Financial Statements in Item 1 of Part 1 of this report is incorporated by reference in response to this item.

Table of Contents

ITEM 1A. RISK FACTORS

For additional information about our risk factors, see Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012 and Item 1A of our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2013 and June 30, 2013.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table sets forth for the periods indicated certain information with respect to our purchases of our common stock:

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan (2)	Maximum Number of Shares That May Yet Be Purchased Under the Plan (2)
July 1-31, 2013	24,331	\$7.05	N/A	N/A
August 1-31, 2013	—	—	N/A	N/A
September 1-30, 2013	—	—	N/A	N/A
Total	24,331	7.05	N/A	N/A

(1) Represents the surrender of shares of our common stock to satisfy tax withholding obligations in connection with the vesting of restricted stock issued to employees under our stockholder-approved long-term incentive plan.

(2) We did not have at any time during the quarter, and currently do not have, a share repurchase program in place.

Table of Contents

ITEM 6. EXHIBITS

- 4.1 — Third Supplemental Indenture dated as of October 1, 2013 to Indenture dated as of October 20, 2009, by and among Hercules Offshore, Inc., the Guarantors named therein and U.S. Bank National Association as Trustee (incorporated by reference to Exhibit 4.1 to the Current Report on Form 8-K filed October 7, 2013 (the "October 2013 8-K")).
- 4.2 — Indenture dated as of October 1, 2013, by and among Hercules Offshore, Inc., the Guarantors named therein and U.S. Bank National Association as Trustee (incorporated by reference to Exhibit 4.2 to the October 2013 8-K).
- 4.3 — Form of 7.50% Senior Note Due 2021 (included as Exhibit A to Exhibit 4.2 of the October 2013 8-K). Purchase Agreement, dated September 17, 2013, by and among Hercules Offshore, Inc., the guarantors party thereto, Deutsche Bank Securities Inc., Credit Suisse Securities (USA) LLC, Goldman, Sachs & Co., UBS Securities LLC and Capital One Securities, Inc., as representatives of the initial purchasers named in Schedule I thereto (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K filed September 23, 2013).
- 10.1 —
- *31.1 — Certification of Chief Executive Officer of Hercules pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- *31.2 — Certification of Chief Financial Officer of Hercules pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- *32.1 — Certification of the Chief Executive Officer and the Chief Financial Officer of Hercules pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- *101.INS — XBRL Instance Document
- *101.SCH — XBRL Schema Document
- *101.CAL — XBRL Calculation Linkbase Document
- *101.DEF — XBRL Definition Linkbase Document
- *101.LAB — XBRL Label Linkbase Document
- *101.PRE — XBRL Presentation Linkbase Document

* Filed herewith.

Table of Contents

SIGNATURES

Pursuant to the requirements 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.

HERCULES OFFSHORE, INC.

By: /S/ John T. Rynd
John T. Rynd
Chief Executive Officer and President
(Principal Executive Officer)

By: /S/ Stephen M. Butz
Stephen M. Butz
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

By: /S/ Troy L. Carson
Troy L. Carson
Senior Vice President and Chief Accounting Officer
(Principal Accounting Officer)

Date: October 24, 2013