

FREESEAS INC.  
Form 20-F  
May 07, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F**

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

**OR**

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

**For the fiscal year ended December 31, 2011**

**OR**

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

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

**Date of event requiring this shell company report**

**For the transition period from                      to                      .**

**COMMISSION FILE NUMBER 000-51672**

**FREESEAS INC.**

**(Exact Name of Registrant as Specified in its Charter)**

**Republic of the Marshall Islands**

**(Jurisdiction of incorporation or organization)**

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10, Eleftheriou Venizelou Street (Panepistimiou Ave.) 106 71, Athens, Greece

(Address of principal executive offices)

Ion G. Varouxakis

10, Eleftheriou Venizelou Street (Panepistimiou Ave.)

106 71, Athens, Greece

Telephone: +30-210-4528770

Fax: +30-210-4291010

(Name, Telephone, E-mail and/or Facsimile Number and Address of Company contact person)

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

| Title of each class  | Name of each exchange on which registered |
|--|---|
| Shares of common stock, par value \$0.001 per share                            | NASDAQ Global Market                      |
| Securities registered or to be registered pursuant to Section 12(g) of the Act |   |

None

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

None

We had 6,475,625 shares of common stock outstanding as of December 31, 2011.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 126-2 of the Exchange Act. (Check one):

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Large accelerated filer  Accelerated filer  Non-accelerated filer

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

U.S. GAAP

IFRS as issued by IASB

Other

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

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

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***CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS***

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

our future operating or financial results;

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

our ability to take deliveries of two dry bulk vessels under construction;

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

our ability to pay dividends in the future;

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

future, pending or recent acquisitions, business strategy, areas of possible expansion, and expected capital spending or operating expenses and general and administrative expenses;

the useful lives and value of our vessels;

our ability to receive in full or partially our accounts receivable and insurance claims;

greater than anticipated levels of drybulk vessel new building orders or lower than anticipated rates of drybulk vessel scrapping;

changes in the cost of other modes of bulk commodity transportation;

availability of crew, number of off-hire days, dry-docking requirements and insurance costs;

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changes in condition of our vessels or applicable maintenance or regulatory standards (which may affect, among other things, our anticipated dry-docking costs);

competition in the seaborne transportation industry;

global and regional economic and political conditions;

fluctuations in currencies and interest rates;

our ability to leverage to our advantage Free Bulkers S.A. s, our Manager, relationships and reputation in the drybulk shipping industry;

the overall health and condition of the U.S. and global financial markets;

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changes in seaborne and other transportation patterns;

changes in governmental rules and regulations or actions taken by regulatory authorities;

acts of terrorism and other hostilities; and

other factors discussed in the section titled "Risk Factors" in this annual report.

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

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

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

Unless otherwise indicated:

All references to "\$" and "dollars" in this document are to U.S. dollars

Financial information presented in this document that is derived from financial statements appearing elsewhere in this document is prepared in accordance with the U.S. generally accepted accounting principles, and

All references to dollar amounts in this document are expressed in thousands of U.S. dollars.

All share-related and per share information throughout the document have been adjusted to give effect to the one share for five share reverse stock split that was effective on October 1, 2010.

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

**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**  
Not applicable.



**Table of Contents****ITEM 3. KEY INFORMATION****A. Selected Consolidated Financial Data**

The selected consolidated financial information set forth below has been derived from our audited financial statements for the years ended December 31, 2011, 2010, 2009, 2008 and 2007. The information is only a summary and should be read in conjunction with our audited consolidated financial statements for the years ended December 31, 2011, 2010 and 2009 and notes thereto contained elsewhere herein. The financial results should not be construed as indicative of financial results for subsequent periods. See Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects.

|   | 6,485,072               | 6,485,072 | 6,485,072 | 6,485,072 | 6,485,072 |
|---|-------------------------|-----------|-----------|-----------|-----------|
|   | Year Ended December 31, |           |           |           |           |
|   | 2011                    | 2010      | 2009      | 2008      | 2007      |
| <b>Statement of Operations Data:</b>      |                         |           |           |           |           |
| Operating revenues                        | \$ 29,538               | \$ 57,650 | \$ 57,533 | \$ 66,689 | \$ 20,147 |
| Income/ (loss) from operations            | (84,109)                | (17,000)  | 11,459    | 26,570    | 5,761     |
| Other expense                             | (4,087)                 | (4,821)   | (4,600)   | (7,378)   | (5,917)   |
| Net income/ (loss)                        | (88,196)                | (21,821)  | 6,859     | 19,192    | (156)     |
| <b>Earnings Per Share Data:</b>           |                         |           |           |           |           |
| Net income /(loss) per share:             |                         |           |           |           |           |
| Basic earnings/ (loss) per share          | \$ (13.60)              | \$ (3.46) | \$ 1.35   | \$ 4.57   | \$ (0.09) |
| Diluted earnings/ (loss) per share        | \$ (13.60)              | \$ (3.46) | \$ 1.35   | \$ 4.56   | \$ (0.09) |
| Weighted average number of shares:        |                         |           |           |           |           |
| Basic weighted average number of shares   | 6,485,072               | 6,313,606 | 5,092,772 | 4,201,299 | 1,757,613 |
| Diluted weighted average number of shares | 6,485,072               | 6,313,606 | 5,092,772 | 4,210,393 | 1,757,613 |
| Dividends per share                       | \$                      | \$        | \$        | \$ 2.25   | \$ 0.875  |

|   | 000000000               | 000000000 | 000000000 | 000000000 | 000000000 |
|---|-------------------------|-----------|-----------|-----------|-----------|
|   | Year Ended December 31, |           |           |           |           |
|   | 2011                    | 2010      | 2009      | 2008      | 2007      |
| <b>Selected Balance Sheet Data:</b>       |                         |           |           |           |           |
| Total cash                                | 1,456                   | 10,074    | 9,591     | 5,973     | 63,744    |
| Vessels, net                              | 81,419                  | 213,691   | 270,701   | 275,405   | 108,021   |
| Total assets                              | 134,980                 | 250,984   | 297,321   | 307,861   | 191,972   |
| Long-term debt, including current portion | 88,946                  | 120,459   | 137,959   | 160,350   | 56,300    |
| Total shareholders' equity                | 35,119                  | 123,190   | 144,452   | 120,855   | 112,626   |

**B. Capitalization and Indebtedness**

Not applicable.

**C. Reasons for the Offer and Use of Proceeds**

Not applicable.

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**D. Risk Factors**

**Risk Factors Relating to the Drybulk Shipping Industry**

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

The drybulk shipping industry is cyclical with volatility in charter hire rates and profitability. The degree of charter hire rate volatility among different types of drybulk vessels has varied widely. Since the middle of the third quarter of 2008, charter hire rates for drybulk vessels have decreased substantially, they may remain volatile for the foreseeable future and could continue to decline further. Additionally, charter rates have been particularly volatile during 2011 and have substantially decreased. As a result, our charter rates could further decline significantly, resulting in a loss and a reduction in earnings.

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

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

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

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

The drybulk shipping industry is cyclical with attendant volatility in charter hire rates and profitability. The degree of charter hire rate volatility among different types of dry bulk vessels has varied widely; however, the continued downturn in the drybulk charter market has severely affected the entire dry bulk shipping industry and charter hire rates for drybulk vessels have declined significantly from historically high levels. The Baltic Dry Index (the BDI), which is published daily by the Baltic Exchange Limited, a London-based membership organization that provides daily shipping market information to the global investing community, is a daily average of charter rates in selected shipping routes measured on a time charter and voyage basis covering Handysize, Supramax, Panamax and Capesize drybulk carriers. The BDI has long been viewed as the main benchmark to monitor the movements of the dry bulk vessel charter market and the performance of the entire drybulk shipping market. The BDI declined 94% in 2008 from a peak of 11,793 in May 2008 to a low of 663 in December 2008 and remained volatile during 2009, ranging from a low of 772 in January 2009 to a high of 4,661 in November 2009. The BDI continued its volatility in 2010, reaching a high of 4,209 in May 2010 and a low of 1,700 in July 2010, and 2011, ranging from a low of approximately 1,043 in February 2011 and a high of approximately 2,173 in October 2011. As of April 18, 2012, the BDI had fallen to 1,006. The decline and volatility in charter rates has been due to various factors, including the lack of trade financing for purchases of commodities carried by sea, which had resulted in a significant decline in cargo shipments. The decline and volatility in charter rates in the drybulk market also affects the value of our drybulk vessels, which follows the trends of drybulk charter rates, and earnings on our charters, and similarly, affects our cash flows, our ability to repay our indebtedness and compliance with the covenants contained in our loan agreements.

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***Economic recession and disruptions in world financial markets and the resulting governmental action in the United States and in other parts of the world could have a further material adverse impact on our results of operations, financial condition and cash flows.***

We face risks resulting from changes in economic environments, changes in interest rates and instability in the banking, energy, commodities and securities markets around the world, among other factors. Major market disruptions, the adverse changes in market conditions and the regulatory climate in the United States and worldwide may adversely affect our business, impair our ability to borrow amounts under our existing credit facility or any credit facilities we enter into. In addition, the economic environment in Greece, which is where our operations are based, may have adverse impacts on us. We cannot predict how long the current market conditions will last. However, these economic and governmental factors, together with the concurrent decline in charter rates, could have a significant effect on our results of operations and could affect the price of our common stock.

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

We anticipate a significant number of the port calls made by our vessels will continue to involve the loading or discharging of drybulk commodities in ports in the Asia Pacific region. As a result, any negative changes in economic conditions in any Asia Pacific country, particularly in China, may exacerbate the effect of recent slowdowns in the economies of the European Union and may have a material adverse effect on our business, financial condition and results of operations, as well as our future prospects. Before the global economic financial crisis that began in 2008, China had one of the world's fastest growing economies in terms of gross domestic product (GDP) which had a significant impact on shipping demand. The growth rate of China's GDP decreased to approximately 9.5% for the year ended December 31, 2011, as compared to approximately 10.3% for the year ended December 31, 2010, and continues to remain below pre-2008 levels. It is possible that China and other countries in the Asia Pacific region will continue to experience slowed or even negative economic growth in the near future. Moreover, the current economic slowdown in the economies of the European Union and other Asian countries may further adversely affect economic growth in China and elsewhere. Our business, financial condition and results of operations, as well as our future prospects, will likely be materially and adversely affected by a further economic downturn in any of these countries.

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

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

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

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

crew strikes and/or boycotts;

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marine disaster;

piracy;

environmental accidents;

cargo and property losses or damage; and

business interruptions caused by mechanical failure, human error, war, terrorism, political action in various countries, labor strikes or adverse weather conditions.

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

*M/V Free Goddess* was hijacked by Somali pirates on February 7, 2012 while transiting the Indian Ocean eastbound. The vessel is held off the coast of Somalia and the Company is currently in communication with the pirates for the release of the vessel and her crew. The vessel was on a time charter trip at the time she was hijacked. Under the charter party agreement, the BIMCO Piracy clause was applied which provided, among other things, for the charterers to have the vessel covered with kidnap and ransom insurance and loss of hire insurance. The vessel was also covered by the war risk underwriters who were duly informed about the transit and had confirmed cover.

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

The market supply of drybulk vessels has been increasing, and the number of drybulk vessels on order is near historic highs. As of December 31, 2011, newbuilding orders had been placed for an aggregate of approximately 32% of the total DWT of the then-existing global drybulk fleet, with deliveries expected mainly during the succeeding 36 months, although available data with regard to cancellations of existing newbuilding orders or delays of new build deliveries are not always accurate. As of December 31, 2010, newbuilding orders had been placed for an aggregate of approximately 47% of the total DWT of the then-existing global drybulk fleet, with deliveries expected mainly during the succeeding 36 months, although available data with regard to cancellations of existing new build orders or delays of new build deliveries are not always accurate. An over-supply of drybulk carrier capacity may result in a reduction of charter hire rates. Because the factors affecting the supply and demand for vessels are outside of our control and are unpredictable, the nature, timing, direction and degree of changes in industry conditions are also unpredictable.

Factors that influence demand for vessel capacity include:

supply and demand for energy resources, commodities, semi-finished and finished consumer and industrial products;

changes in the exploration or production of energy resources, commodities, semi-finished and finished consumer and industrial products;

the location of regional and global exploration, production and manufacturing facilities;

the location of consuming regions for energy resources, commodities, semi-finished and finished consumer and industrial products;

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the globalization of production and manufacturing; global and regional economic and political conditions, including armed conflicts, terrorist activities, embargoes and strikes;

developments in international trade;

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changes in seaborne and other transportation patterns, including the distance cargo is transported by sea;

environmental and other regulatory developments;

currency exchange rates; and weather.

The factors that influence the supply of vessel capacity include:

the number of newbuilding deliveries;

port and canal congestion;

the scrapping rate of older vessels;

vessel casualties; and

the number of vessels that are out of service.

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

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

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

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

Regulations by the U.S. Coast Guard and rules pursuant to the International Convention for the Safety of Life at Sea have imposed increased compliance costs on vessel owners and charterers. These costs include certification costs imposed by relevant agencies and bonding costs under U.S. Customs and Border Protection, as well as potential delays in transit due to increased security procedures regulating the entry into harbors or the discharge of cargo. For a further description of the various requirements, please see Item 4. Information on the Company -Environmental and Other Regulation-Vessel Security Regulations.

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

## **Risk Factors Relating to FreeSeas**

***At December 31, 2011 the Company's current liabilities exceeded its current assets, which could impair its ability to successfully operate its business and could have material adverse effects on its revenues, cash flows and profitability and its ability to comply with its debt covenants and pay its debt service and other obligations.***



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At December 31, 2011, the Company's current liabilities exceeded its current assets by \$47,186. As a result of the historically low charter rates for drybulk vessels which have been affecting the Company for over one year, and the resulting material adverse impact on the Company's results from operations, the Company has undertaken negotiations with each of its lenders to restructure the Company's debt repayments. On February 15 2012, the Company received from Credit Suisse restructuring head terms for the full payment holiday of the principal and partial interest payment until March 31, 2014 conditional on the approval from our other lenders, Deutsche Bank Nederland and FBB.

In February, March and April 2012, the Company received notifications from the Deutsche Bank Nederland and FBB that the Company is in default under its loan agreements as a result of the breach of certain covenants and the failure to pay principal and interest due under the loan agreements. Although the Company is seeking and will continue to seek waivers to these covenants from its lenders, and continues negotiations with the lenders to restructure its debt, there can be no assurances that we will be able to obtain such waivers or restructure our debt. If the Company is not able to obtain the necessary waivers and/or restructure its debt, this could lead to the acceleration of the outstanding debt under its debt agreements. The Company's failure to satisfy its covenants under its debt agreements, and any consequent acceleration and cross acceleration of its outstanding indebtedness would have a material adverse effect on the Company's business operations, financial condition and liquidity.

All of the above raises doubt regarding the Company's ability to continue as a going concern.

The Company is currently exploring several alternatives aiming to manage its working capital requirements and other commitments if current market charter hire rates continue, including a share capital increase, disposition of certain vessels in its current fleet, and taking steps to achieve additional reductions in operating and other costs.

Generally accepted accounting principles require that long term debt be classified as a current liability when a covenant violation gives the lender the right to call the debt at the balance sheet date, absent a waiver. Accordingly, as of December 31, 2011, the Company is required to reclassify its long term debt as current liabilities in its consolidated balance sheet since the Company has not received waivers in respect of the covenants that are breached at such time. As the Company believes it will succeed in restructuring its debt and receive the necessary waivers, the consolidated financial statements as of December 31, 2011, were prepared assuming that the Company would continue as a going concern. Accordingly, the financial statements did not include any adjustments relating to the recoverability and classification of recorded asset amounts, the amounts and classification of liabilities, or any other adjustments that might result in the event the Company is unable to continue as a going concern, except for the current classification of debt.

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

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

If a determination is made that a vessel's future useful life is limited or its future earnings capacity is reduced, it could result in an impairment of its carrying amount on our financial statements that would result in a charge against our earnings and the reduction of our shareholders' equity. If for any reason we sell our vessels at a time when prices have fallen, the sale price may be less than the vessels' carrying amount on our financial statements, and we would incur a loss and a reduction in earnings. During the year ended December 31, 2011, we incurred an impairment loss of \$69,998 due to expected sales of certain vessels.

We have incurred secured debt under loan agreements for all of our vessels. The market value of our vessels is based, in part, on charter rates and the stability of charter rates over a period of time. As a result of global economic conditions, volatility in charter rates, generally declining charter rates, and other factors, we have recently experienced a decrease in the market value of our vessels. Due to the decline of the market value of our fleet, we were not in compliance with certain covenants of our existing loan agreements that relate to maintenance of asset



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values and, as a result, we may not be able to refinance our debt or obtain additional financing. There can be no assurances that charter rates will stabilize or increase, that the market value of our vessels will stabilize or increase or that we will regain compliance with the financial covenants in our loan agreements or that our lenders will agree to waivers or forbearances.

On November 8, 2011, we sold the M/V Free Lady for a sale price of \$21.9 million. If we fail to sell our other vessels currently held for sale (the M/V Free Hero, the M/V Free Jupiter, the M/V Free Impala, and the M/V Free Neptune), or fail to sell them at prices acceptable to us, we may not be able to acquire the vessels necessary to implement our fleet renewal program which, in turn, could have a material adverse effect on our competitiveness and business operations.

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

Our loan agreements require that we comply with certain financial and other covenants. As a result of the drop in our drybulk asset values we were not in compliance with covenants relating to vessel values as of December 31, 2011. In addition, we were in breach of interest cover ratios, leverage and minimum liquidity covenants with certain banks not previously waived. A violation of these covenants constitutes an event of default under our credit facilities, which would, unless waived by our lenders, provide our lenders with the right to require us to post additional collateral, increase our interest payments and/or pay down our indebtedness to a level where we are in compliance with our loan covenants. Furthermore, our lenders may accelerate our indebtedness and foreclose their liens on our vessels, in which case our vessels may be auctioned or otherwise transferred which would impair our ability to continue to conduct our business. As a result of these breaches, our total indebtedness of \$88.9 million is presented within current liabilities in the December 31, 2011 consolidated balance sheet.

Pursuant to letter agreements dated September 6, 2011 and September 19, 2011 with Credit Suisse, which resolved a default by us under the Credit Suisse facility agreement, the Company agreed to execute a sale contract in respect of either of the M/V Free Jupiter or the M/V Free Lady no later than October 10, 2011. On November 8, 2011, we sold the M/V Free Lady for a sale price of \$21.9 million. Pursuant to the Fifth Supplemental Agreement dated November 7, 2011 with Credit Suisse, the Company agreed to enter into a period time charter of at least 12 months for all our mortgaged vessels no later than December 31, 2011, which charter would cover the vessel's debt service plus \$1.0 million. If the foregoing time charter was not entered into by the required date, the Company agreed that will sell either the M/V Free Jupiter or both the M/V Free Goddess and the M/V Free Hero by January 31, 2012. The Company has not concluded any time charter agreement and any agreement for the sale of the above mentioned vessels. On February 15, 2012, the Company received from Credit Suisse restructuring head terms for the full payment holiday of the principal and partial interest holiday payment until March 31, 2014, which is conditioned on receiving approval from our other lenders.

In February, March and April 2012, the Company received notifications from Deutsche Bank Nederland and FBB that the Company is in default under its loan agreements as a result of the breach of certain covenants and the failure to pay principal and interest due under the loan agreements. Although the Company is seeking and will continue to seek waivers to these covenants from its lenders, and continues negotiations with the lenders to restructure its debt, there can be no assurances that we will be able to obtain such waivers or restructure our debt. If the Company is not able to obtain the necessary waivers and/or restructure its debt, this could lead to the acceleration of the outstanding debt under its debt agreements. The Company's failure to satisfy its covenants under its debt agreements, and any consequent acceleration and cross acceleration of its outstanding indebtedness would have a material adverse effect on the Company's business operations, financial condition and liquidity.

All of the above raises doubt regarding the Company's ability to continue as a going concern.

***Our loan agreements contain covenants that may limit our liquidity and corporate activities, including our ability to pay dividends.***

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

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

As described above, the Company was in breach of its financial covenants as of December 31, 2011 and received in February, March and April 2012 notifications from Deutsche Bank Nederland and FBB that the Company is in default under its loan agreements as a result of the breach of certain covenants and the failure to pay principal and interest due under the loan agreements. Although the Company is seeking and will continue to seek waivers to these covenants from its lenders, it is uncertain that will be able to obtain such waivers. Management will seek to restructure the Company's indebtedness. If the Company is not able to obtain the necessary waivers and/or restructure its debt, this could lead to the acceleration of the outstanding debt. The Company's failure to satisfy its covenants under its debt agreements, and any consequent acceleration and cross acceleration of its outstanding indebtedness, would have a material adverse effect on the Company's business operations, financial condition and liquidity.

All of the above raises doubt regarding the Company's ability to continue as a going concern.

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

incur additional indebtedness;

create liens on our assets;

sell capital stock of our subsidiaries;

make investments;

engage in mergers or acquisitions;

pay dividends;

make capital expenditures;

change the management of our vessels or terminate or materially amend our management agreements; and

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sell our vessels.

The amended and restated credit agreement dated September 15, 2009 with Deutsche Bank Nederland does not allow us to pay dividends without

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their prior written approval, such approval not to be unreasonably withheld. If we need covenant waivers, our lenders may impose additional restrictions and may require the payment of additional fees, require prepayment of a portion of our indebtedness to them, accelerate the amortization schedule for our indebtedness, and increase the interest rates they charge us on our outstanding indebtedness. We may be required to use a significant portion of the net proceeds from any future capital raising to repay a portion of our outstanding indebtedness. We agreed to pay Deutsche Bank Nederland up to 10% of the net proceeds of any capital raises up to a maximum of \$3.0 million in the aggregate. We have already paid approximately \$1.7 million from our proceeds from the July 2009 follow-on offering. These potential restrictions and requirements may limit our ability to pay dividends to you, finance our future operations, make acquisitions or pursue business opportunities.

***Servicing debt may limit funds available for other purposes and inability to service debt may lead to acceleration of debt and foreclosure on our fleet.***

To finance our fleet, we incurred secured debt under various loan agreements. As of December 31, 2011, we had outstanding an aggregate of \$88,946 in debt. We will be required to dedicate a significant portion of our cash flow from operations to pay the principal and interest on our debt. These payments will limit funds otherwise available for working capital, capital expenditures and other purposes. We will need to incur additional indebtedness as we further renew and expand our fleet, which may increase our ratio of debt to equity. We may not be able to obtain such financing when desired or on terms acceptable to us. The need to service our debt may limit funds available for other purposes, including distributing cash to our shareholders, and our inability to service debt could lead to acceleration of our debt and foreclosure of our fleet. We may not be able to generate cash flow in amounts that are sufficient for these purposes.

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

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

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

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

Since we intend to continue to charter most of our vessels in the spot market, we will be exposed to the cyclicity and volatility of the spot charter market, and we may not have long term, fixed time charter rates to mitigate the adverse effects of downturns in the spot market. Handysize and Handymax vessels, which we currently operate, have been less volatile compared to larger vessels such as panamax and capesize vessels but this may discontinue in the future. We cannot assure you that we will be able to successfully charter our vessels in the future at rates sufficient to allow us to meet our obligations. The supply of and demand for shipping capacity strongly influences freight rates. Because the factors affecting the supply and demand for vessels are outside of our control and are unpredictable, the nature, timing, direction and degree of changes in industry conditions are also unpredictable.

Factors that influence demand for drybulk vessel capacity include:

demand for and production of drybulk products;

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global and regional economic and political conditions including developments in international trade, fluctuations in industrial and agricultural production and armed conflicts;

the distance drybulk cargo is to be moved by sea;

environmental and other regulatory developments; and

changes in seaborne and other transportation patterns.

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

the number of newbuilding deliveries;

port and canal congestion;

the scrapping rate of older vessels;

vessel casualties; and

the number of vessels that are out of service, i.e., laid-up, drydocked, awaiting repairs or otherwise not available for hire.

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

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

We currently employ all of our vessels in the spot market, all with charters scheduled to expire within one to three months, by which time we will have to negotiate new employment for these vessels. If the rates in the charter market fall significantly throughout 2012, it will affect the charter revenue we will receive from these vessels, which would have an adverse effect on our revenues, cash flows and profitability, as well as our ability to comply with our debt covenants.

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

We will generally attempt to recharter our vessels at favorable rates with reputable charterers. All of our vessels currently operate in the spot market. If the drybulk shipping market is in a period of depression when our vessels' charters expire, it is likely that we may be forced to re-charter them at reduced rates, if such charters are available at all. We cannot assure you that we will be able to obtain new charters at

comparable or higher rates or

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with comparable charterers, or that we will be able to obtain new charters at all. The charterers under our charters have no obligation to renew or extend the charters. We will generally attempt to recharter our vessels at favorable rates with reputable charterers as our charters expire. Failure to obtain replacement charters at rates comparable to our existing charters will reduce or eliminate our revenue, will adversely affect our ability to service our debt, and will delay our ability to pay dividends to shareholders. Further, we may have to reposition our vessels without cargo or compensation to deliver them to future charterers or to move vessels to areas where we believe that future employment may be more likely or advantageous. Repositioning our vessels would increase our vessel operating costs. If any of the foregoing events were to occur, our revenues, net income and earnings may be materially adversely affected.

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

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

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

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

We have historically derived a significant part of our revenue from a small number of charterers. During 2011, we derived approximately 46% of our gross revenue from three charterers, and during 2010, we derived approximately 42% of our gross revenues from three charterers. If we do remain dependent, in large part, on a small number of charterers, if one or more of our charterers is unable to perform under one or more charters with us, if we are not able to find appropriate replacement charterers, or if a charterer exercises certain rights to terminate its charter, we could suffer a loss of revenues that could materially adversely affect our business, financial condition and results of operations.

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

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

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

The M/V *Free Jupiter* was on time charter with Korea Line Corp., or KLC, a South Korean company, from June 8, 2007 until she was re-delivered to us on February 22, 2011. KLC made several unilateral deductions from

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hire payments during the three-year course of the time charter, and no hire was received from KLC from February 8, 2011 until the actual redelivery of the vessel on February 22, 2011. The Company commenced arbitration proceedings against KLC, and has taken action to obtain security, including the arrest of KLC assets. As a result, the Company obtained third-party security in the amount of \$1.68 million (which includes provision for interest and legal costs) in the form of a letter of undertaking (the LOU ) from KLC's P&I club covering KLC's unilateral deductions from the hire. The Company also obtained cash security held in escrow in the amount of \$159 from the execution of a lien on sub-hires. KLC has counterclaimed by way of set-off, alleging that KLC is entitled to retain the amount of hire that was deducted because of the Company's alleged breach of charterparty. The Company denies these allegations and continues to assert its claim to recover the full amount deducted by KLC. On January 25, 2011, KLC announced that it had filed a petition for the rehabilitation proceeding for court receivership in the Seoul Central District Court, and the court approved and confirmed a rehabilitation plan. Upon the issuance of the final award of the arbitration tribunal, and for any amount in excess of the third-party security and cash security, the Company may participate in the approved rehabilitation plan. As of December 31, 2011, the outstanding balance of the KLC time charter was \$1,372 after provisions of \$136, which is below the security obtained as described above. On January 17, 2012, the Company obtained an interim award under which it was awarded the part of the claim that KLC had admitted was undisputed, \$832, plus interest, legal costs, and the cost of the tribunal. Following the interim award, the Company received approximately \$321. The majority of the balance of \$511 that has been awarded is unsecured. The Company is considering its options if KLC does not pay the balance, including the possibility of pursuing this in the Korean rehabilitation proceedings, where the hearing of the Company's claim has been stayed pending the outcome of the London arbitration. The Company believes that, if the Korean claim succeeds, the Company should make a recovery in accordance with the rehabilitation plan, which has been approved by the Korean court. There will be a further award (if this matter does not settle) for the disputed balance which is adequately secured.

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

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

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

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

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



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

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

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

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

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

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

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

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

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

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

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

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

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

We may not be adequately insured against all risks, and our insurers may not pay particular claims. With respect to war risks insurance, which we usually obtain for certain of our vessels making port calls in designated war zone areas, such insurance may not be obtained prior to one of our vessels entering into an actual war zone, which could result in that vessel not being insured. Even if our insurance coverage is adequate to cover our losses, we may not be able to timely obtain a replacement vessel in the event of a loss. Under the terms of our credit facilities, we will be subject to restrictions on the use of any proceeds we may receive from claims under our insurance policies. Furthermore, in the future, we may not be able to maintain or obtain adequate insurance coverage at reasonable rates for our fleet. We may also be subject to calls, or premiums, in amounts based not only on our own claim records but also the claim records of all other members of the protection and indemnity associations through which we receive indemnity insurance coverage for tort liability. Our insurance policies also contain deductibles, limitations and

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exclusions which, although we believe are standard in the shipping industry, may nevertheless increase our costs in the event of a claim or decrease any recovery in the event of a loss. If the damages from a catastrophic oil spill or other marine disaster exceeded our insurance coverage, the payment of those damages could have a material adverse effect on our business and could possibly result in our insolvency.

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

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

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

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

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

When our estimate of future undiscounted net operating cash flows for any vessel is lower than the vessel's carrying value, the carrying value is written down, by recording a charge to operations, to the vessel's fair market value if the fair market value is lower than the vessel's carrying value. The carrying values of our vessels may not represent their fair market value because the market prices of secondhand vessels tend to fluctuate with changes in charter rates and the cost of newbuildings. Any impairment charges incurred as a result of declines in charter rates could have a material adverse effect on our business, results of operations, cash flows and financial condition.

***We have failed to make payments due under our current contracts to purchase newbuilding vessels. As a result, the contracting shipyard has terminated one contract and could terminate the other contract or sell the vessel and, in either case, claim losses as a result of our default.***

We have entered into contracts with a Chinese shipyard to purchase two newbuilding Handysize drybulk vessels, of approximately 33,600 dwt each, for an aggregate purchase price of approximately \$48.8 million (excluding extra costs of approximately \$1,080). As of December 31, 2011, we have paid the Chinese shipyard \$9.76 million in the aggregate. By letter dated February 25, 2012, the Company received notice from the shipyard that the Company had failed to pay the payment of \$3,660 due on February 11, 2012 under one of the contracts and was therefore in default under its obligations under this contract. The shipyard terminated this contract by notice dated April 28, 2012 to the Company.

If we do not renegotiate the payment terms under the remaining newbuilding contract, the shipyard could terminate it. In addition, the shipyard may claim losses incurred as a result of our default. In such event, we may not be able to reclaim the payments made by us. Further, the payment of any claims arising from such default and failure to successfully implement our fleet renewal plan could adversely affect our earnings, our financial conditions and our business opportunities. In addition, the Company's agreement with ABN AMRO Bank (ABN AMRO) to

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finance these newbuilding vessels was terminated by ABN AMRO. Pursuant to a settlement agreement entered into on April 13, 2012, ABN AMRO agreed to return to the Company all commitment fees paid to date, totaling \$418 less legal fees, and all further obligations of the parties have been terminated. As a result, we no longer have financing committed for the remaining installments due under the remaining newbuilding contract, making it unlikely that we will be able to take delivery of this newbuilding.

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

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

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

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

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

locating and acquiring suitable vessels;

placing newbuilding orders and taking delivery of vessels;

identifying and consummating acquisitions or joint ventures;

integrating any acquired vessel successfully with our existing operations;

enhancing our customer base;

managing our expansion; and

obtaining the required financing.

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

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

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

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

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

*If we acquire additional drybulk carriers and those vessels are not delivered on time or are delivered with significant defects, our earnings and financial condition could suffer.*

We expect to acquire additional vessels in the future. A delay in the delivery of any of these vessels to us or the failure of the contract counterparty to deliver a vessel at all could cause us to breach our obligations under a related time charter and could adversely affect our earnings, our financial condition and the amount of dividends, if any, that we pay in the future. The delivery of these vessels could be delayed or certain events may arise which could result in us not taking delivery of a vessel, such as a total loss of a vessel, a constructive loss of a vessel, or substantial damage to a vessel prior to delivery. In addition, the delivery of any of these vessels with substantial defects could have similar consequences.

*We currently rely on our Manager to manage and charter our fleet.*

We currently have no employees and contract all of our financial, accounting, including our financial reporting and internal controls, and other back-office services, and the management of our fleet, including crewing, maintenance and repair, through our Manager. Our Manager has entered previously into a sub-management agreement with Safbulk, a company controlled by the Restis family, one of our shareholders, for the commercial management of our fleet, including negotiating and obtaining charters, relations with charter brokers and performance of post-charter activities. Such sub-management agreement was terminated in March 2012 and the Manager has commenced the provision of the commercial management of our fleet. We rely on our Manager to provide the technical management of our fleet and to attract charterers and charter brokers. The loss of its services or failure to perform its obligations could reduce our revenues and net income and adversely affect our operations and business if we are not able to contract with other companies to provide these services or take over these aspects of our business directly. FreeSeas has no control over our Manager. Our Manager is not liable to us for any losses or damages, if any, that may result from its management of our fleet unless the same shall have resulted from willful misconduct or gross negligence of our Manager or any person to whom performance of the management services has been delegated by our Manager. Pursuant to its agreement with us, our Manager's liability for such acts, except in certain limited circumstances, may not exceed ten times the annual management fee payable by the applicable subsidiary to our Manager. Although we may have rights against our Manager, if our Manager defaults on its obligations to us, we may have no recourse against our Manager. Further, we will need approval from our lenders if we intend to replace our Manager as our fleet manager.

*If our Manager is unable to perform under its vessel management agreements with us, our results of operations may be adversely affected.*

As we expand our fleet, we will rely on our Manager to recruit suitable additional seafarers and to meet other demands imposed on our Manager. We cannot assure you that our Manager will be able to meet these demands as we expand our fleet. If our Manager's crewing agents encounter business or financial difficulties, they may not be able to adequately staff our vessels. If our Manager is unable to provide the commercial and technical management service for our vessels, our business, results of operations, cash flows and financial position and our ability to pay dividends may be adversely affected.

*We and one of our executive officers have affiliations with our Manager that could create conflicts of interest detrimental to us.*

Our Chairman, Chief Executive Officer and President, Ion G. Varouxakis, is also the controlling shareholder and officer of our Manager. These dual responsibilities of our officer and the relationships between the two companies could create conflicts of interest between our Manager and us. Each of our operating subsidiaries has a nonexclusive management agreement with our Manager. Our Manager has subcontracted until March 2012, when the sub-agreement was terminated, the charter and post-charter management of our fleet to Safbulk, which is

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controlled by FS Holdings Limited, one of our principal shareholders. Although our Manager currently serves as manager for vessels owned by us, our Manager is not restricted from entering into management agreements with other competing shipping companies. Our Manager could also allocate charter and/or vessel purchase and sale opportunities to others. There can be no assurance that our Manager would resolve any conflicts of interest in a manner beneficial to us.

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

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

***Our Manager is a privately held company, and there is little or no publicly available information about it.***

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

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

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

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

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

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

***The derivative contracts we have entered into to hedge our exposure to fluctuations in interest rates could result in higher than market interest rates and charges against our income.***

We have entered into two interest rate swaps for purposes of managing our exposure to fluctuations in interest rates applicable to indebtedness under two of our credit facilities with Credit Suisse, which provide for a floating interest rate based on LIBOR. Our hedging strategies, however, may not be effective and we may incur substantial losses if interest rates move materially differently from the fixed rates agreed to in our derivative contracts. Since our existing interest rate swaps do not, and future derivative contracts may not, qualify for treatment as hedges for accounting purposes, we recognize fluctuations in the fair value of such contracts in our income statement. In addition, our financial condition could be materially adversely affected to the extent we do not hedge our exposure to interest rate fluctuations under our financing arrangements. Any hedging activities we engage in may not effectively manage our interest rate exposure or have the desired impact on our financial conditions or results of operations.

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From time to time in the future, we may take positions in derivative instruments including freight forward agreements, or FFAs. FFAs and other derivative instruments may be used to hedge a vessel owner's exposure to the charter market by providing for the sale of a contracted charter rate along a specified route and period of time. Upon settlement, if the contracted charter rate is less than the average of the rates, as reported by an identified index, for the specified route and time period, the seller of the FFAs is required to pay the buyer an amount equal to the difference between the contracted rate and the settlement rate, multiplied by the number of days in the specified period. Conversely, if the contracted rate is greater than the settlement rate, the buyer is required to pay the seller the settlement sum. If we take positions in FFAs or other derivative instruments and do not correctly anticipate charter rate movements over the specified route and time period, we could suffer losses in the settling or termination of the FFA. This could adversely affect our results of operation and cash flow. As of the date of this annual report, we had no FFAs outstanding.

***Economic conditions and regulatory pressures impacting banks in Greece may cause disruptions to one of our lenders, which may cause an increase in the cost of our borrowings from that lender.***

One of our lenders is FBB, located in Greece. As a result of the recent financial crisis in Greece, Greek banks have been under significant pressure from the applicable banking regulators to increase capital, increase earnings or merge with other banks. There can be no assurances that our banking relationship with FBB would continue if FBB were to merge with another bank or that FBB might not attempt to invoke provisions in our loan agreement that permits it to pass along increases in its cost of regulations. In either event, our financial condition and results of operations could be materially adversely affected.

***We are a holding company, and we will depend on the ability of our subsidiaries to distribute funds to us in order to satisfy our financial obligations or to make dividend payments.***

We are a holding company and our subsidiaries, which are all wholly owned by us, conduct all of our operations and own all of our operating assets. We have no significant assets other than the equity interests in our wholly owned subsidiaries. As a result, our ability to make dividend payments depends on our subsidiaries and their ability to distribute funds to us. We and our subsidiaries will be permitted to pay dividends to us only for so long as we are in compliance with all applicable financial covenants, terms and conditions of our debt. In addition, we and our subsidiaries are subject to limitations on the payment of dividends under Marshall Islands laws. In 2009, we suspended the payment of cash dividends on our common stock because of prevailing economic conditions and to comply with restrictions in certain of our loan agreements. Because economic conditions remain uncertain, and because we are focusing on the renewal of our fleet, we have determined not to resume the payment of cash dividends at this time.

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

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

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

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



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

The majority of our vessels were acquired second-hand, and we estimate their useful lives to be 28 years from their date of delivery from the yard, depending on various market factors and management's ability to comply with government and industry regulatory requirements. As of December 31, 2011, the average age of the vessels in our current fleet was 14 years. Part of our business strategy includes the continued acquisition of second hand vessels when we find attractive opportunities.

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

expenditures for alterations to existing equipment;

the addition of new equipment; or

restrictions on the type of cargo a vessel may transport.

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

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

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

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

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

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

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

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

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

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

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

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

***Rising fuel prices may adversely affect our profits.***

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

***Our Board of Directors has determined to suspend the payment of cash dividends as a result of the prevailing market conditions in the international shipping industry and our financial condition. Until such market conditions and our financial condition improve, it is not likely that we will reinstate the payment of dividends.***

In light of a lower freight environment and a highly challenging financing environment, which has adversely affected our results of operations and our compliance with our debt obligations, our Board of Directors, beginning in February 2009, suspended the cash dividend on our common stock. Our dividend policy will be assessed by our Board of Directors from time to time; however, it is not likely that we will reinstate the payment of dividends until market conditions improve. In addition, our loan agreements do not allow us to pay dividends

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without the prior written approval of our lenders. See Item 5. Operating and Financial Review and Prospects. Therefore, there can be no assurance that, if we were to determine to resume paying cash dividends, our lenders would provide any required consent.

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

We generate all of our revenues in U.S. dollars, but we expect that portions of our future expenses will be incurred in currencies other than the U.S. dollar. This difference could lead to fluctuations in our net income due to changes in the value of the dollar relative to the other currencies, in particular the Euro. Expenses incurred in foreign currencies against which the dollar falls in value can increase, decreasing net income. Although for the year ended December 31, 2010 and for the year ended December 31, 2011, the fluctuation in the value of the dollar against foreign currencies did not have a material impact on us.

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

Under the laws of the countries of our and our subsidiaries incorporation and/or vessels' registration, we are not subject to tax on international shipping income; however, we are subject to registration and tonnage taxes, which have been included in Vessel operating expenses in our consolidated statement of operations. Pursuant to the Internal Revenue Code of the United States, or the Code, U.S. source income from the international operations of ships is generally exempt from U.S. tax if the company operating the ships meets both of the following requirements, (1) more than 50% of the value of our stock is owned, directly or indirectly, by qualified shareholders, which includes persons (i) who are residents of our country of organization or of another foreign country that grants an equivalent exemption to corporations organized in the United States, and (ii) who comply with certain documentation requirements, which we refer to as the Qualified Shareholder Ownership Test, or (2) our stock is primarily and regularly traded on one or more established securities markets in our country of organization, in another country that grants an equivalent exemption to United States corporations, or in the United States, which we refer to as the Publicly-Traded Test; and we are not considered closely held, which we refer to as the Closely-Held Test;

To complete the exemption process, our shipowning subsidiaries must file a U.S. tax return, state the basis of their exemption and obtain and retain documentation attesting to the basis of their exemptions. Our subsidiaries will complete the filing process for 2011 on or prior to the applicable tax filing deadline.

All of our ship-operating subsidiaries currently satisfy the Publicly-Traded Test based on the trading volume and the widely-held ownership of our common stock, but no assurance can be given that this will remain so in the future, since continued compliance with this rule is subject to factors outside our control. Based on our U.S. source Shipping Income for 2009, 2010 and 2011, we would be subject to U.S. federal income tax of approximately \$159, \$34, and \$93 respectively, in the absence of an exemption under Section 883.

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

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

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

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

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

***The Public Company Accounting Oversight Board is currently unable to inspect the audit work and practices of auditors operating in Greece, including our auditor.***

Auditors of U.S. public companies are required by law to undergo periodic Public Company Accounting Oversight Board (PCAOB) inspections that assess their compliance with U.S. law and professional standards in connection with performance of audits of financial statements filed with the SEC. Certain European Union, or EU, countries do not permit the PCAOB to conduct inspections of accounting firms established and operating in EU countries, even if they are part of major international firms. Accordingly, unlike for most U.S. public companies, the PCAOB is prevented from evaluating our auditor's performance of audits and its quality control procedures, and, unlike the shareholders of most U.S. public companies, our shareholders are deprived of the possible benefits of such inspections.

## **Risks Related to the Common Stock**

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

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

quarterly variations in our results of operations;

our lenders' willingness to extend our loan covenant waivers, if necessary;

changes in market valuations of similar companies and stock market price and volume fluctuations generally;

changes in earnings estimates or publication of research reports by analysts;

speculation in the press or investment community about our business or the shipping industry generally;

strategic actions by us or our competitors such as acquisitions or restructurings;



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the thin trading market for our common stock, which makes it somewhat illiquid;

the current ineligibility of our common stock to be the subject of margin loans because of its low current market price;

regulatory developments;

additions or departures of key personnel;

general market conditions; and

domestic and international economic, market and currency factors unrelated to our performance.

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

***As long as our stock price remains below \$5.00 per share, our shareholders will face restrictions in using our shares as collateral for margin accounts. Further, if our stock price remains below \$1.00 or our market capitalization falls below \$5 million, we may be subject to delisting or be forced to take action to cure this problem.***

The last reported sale price of our common stock on the NASDAQ Global Market on May 4, 2012 was \$1.11 per share. If the market price of our shares of common stock remains below \$5.00 per share, under Federal Reserve regulations and account maintenance rules of many brokerages, our shareholders will face restrictions in using such shares as collateral for borrowing in margin accounts. These restrictions on the use of our common stock as collateral may lead to sales of such shares creating downward pressure on and increased volatility in, the market price of our shares of common stock. In addition, many institutional investors will not invest in stocks whose prices are below \$5.00 per share. Under the rules of the NASDAQ Stock Market, listed companies have historically been required to maintain a share price of at least \$1.00 per share and if the share price declines below \$1.00 for a period of 30 consecutive business days, then the listed company would have a cure period of at least 180 days to regain compliance with the \$1.00 per share minimum. If our share price remains below \$1.00 for a period of 30 consecutive days, we may be required to take action, such as a reverse stock split, in order to comply with NASDAQ rules that may be in effect at the time. We are also required to maintain a minimum market capitalization of \$5 million. We may raise additional equity capital at the market and/or in privately negotiated transactions. The effect of this may be to depress our share price and dilute our shareholders' investment and there can be no assurance that these actions will have a positive impact on our share price or market capitalization. In the event we are not able to cure and regain compliance with the \$1.00 share or \$5 million market capitalization minimum, we may be delisted from NASDAQ. If a delisting of our common stock happens it could result in our shares being illiquid and our shareholders may find it difficult to sell our common stock. A delisting may also further depress the value of our common stock.

On December 9, 2011, we received a deficiency letter from NASDAQ stating that, because our common stock has not maintained a minimum bid price of \$1.00 per a share for the last 30 consecutive business days, the Company was no longer in compliance with NASDAQ Listing Rule Section 5450(a)(1). In order to regain compliance, the Company had until June 4, 2012 for the closing bid price of its common stock to meet or exceed \$1.00 for a minimum of 10 consecutive business days. On January 6, 2012, the Company received a deficiency letter from NASDAQ stating that, because the Company has not maintained a minimum Market Value of Publicly Held Shares (the "MVPHS") of \$5,000,000 for the last 30 consecutive business days, the Company is no longer in compliance with NASDAQ Listing Rule Section 5450(b)(1)(C). In order to regain compliance, the Company had until July 2, 2012 for the Company's MVPHS to meet or exceed \$5,000,000 for a minimum of 10 consecutive business days. By letter dated February 29, 2012, the Company received notice from NASDAQ that it has regained compliance with Listing Rules 5450(a)(1) and 5450(b)(1)(C), since for the last 10 consecutive business days, from February 14, 2012 to February 28, 2012, the closing bid price of the Company's common stock has been at \$1.00 per share or greater and the Company's minimum market value of publicly held shares has been \$5 million or greater, respectively.

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

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

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

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

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

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

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

Several provisions of our amended and restated articles of incorporation and by-laws, and certain provisions of the Marshall Islands corporate law, could make it difficult for our shareholders to change the

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composition of our Board of Directors in any one year, preventing them from changing the composition of management. In addition, these provisions may discourage, delay or prevent a merger or acquisition that shareholders may consider favorable. These provisions include:

authorizing our Board of Directors to issue blank check preferred stock without shareholder approval;

providing for a classified Board of Directors with staggered, three year terms;

prohibiting cumulative voting in the election of directors;

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

limiting the persons who may call special meetings of shareholders;

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

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

Pursuant to the terms of our management agreement, our Manager is entitled to a termination fee if such agreement is terminated upon a change of control, which term includes, but is not limited to, the election of a director not recommended by the then-current Board of Directors, any person or entity or group of affiliated persons or entities that becomes a beneficial owner of 15% or more of our voting securities, a merger of FreeSeas where less than a majority of the shares of the resulting entity are held by the FreeSeas shareholders or the sale of all or substantially all of FreeSeas assets. The termination fee as of December 31, 2011 would be approximately \$101 million. In addition, we have implemented a shareholder rights plan pursuant to which the holders of our common stock receive one right to purchase one one-thousandth of a share of our Series A Participating Preferred Stock at an exercise price of \$90.00 per share, subject to adjustment. The rights become exercisable upon the occurrence of certain change in control events. These provisions and our shareholder rights plan could substantially impede the ability of public shareholders to benefit from a change in control and, as a result, may adversely affect the market price of our common shares and your ability to realize any potential change of control premium.

## **ITEM 4. INFORMATION ON THE COMPANY**

### **Our Organization and Corporate Structure**

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

We became a public reporting company on December 15, 2005, when we completed a merger with Trinity Partners Acquisition Company Inc., or Trinity, a blank check company formed to serve as a vehicle to complete a business combination with an operating business, in which we were the surviving corporation. At the time of the merger we owned three drybulk carriers. We currently own nine vessels, each of which is owned through a separate wholly owned subsidiary.

In January 2007, Ion G. Varouxakis purchased all of the common stock owned by our two other co-founding shareholders. He simultaneously sold a portion of the common stock owned by him to FS Holdings Limited, an entity controlled by the Restis family, and to certain other investors. Immediately following these transactions, our Board of Directors appointed Ion G. Varouxakis Chairman of the Board and President, our two other co-founding shareholders and one other director resigned from the Board of Directors, and two new directors were appointed to



fill the vacancies.

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On September 30, 2010, our shareholders approved a five-to-one reverse split of our outstanding common stock effective October 1, 2010.

As of December 31 2011, we had outstanding 6,475,625 shares of our common stock.

Our common stock currently trades on the NASDAQ Global Market under the trading symbol FREE .

Our principal executive offices are located at 10, Eleftheriou Venizelou Street (Panepistimiou Ave.), 10671, Athens, Greece and our telephone number is 011-30-210-452-8770.

## **Capital Expenditures and Divestitures**

During the last three fiscal years, our capital expenditures and divestitures related to our efforts to renew and expand our fleet were as follows:

On November 8, 2011, the Company sold the *M/V Free Lady*, a 2003-built, 50,246 dwt Handymax dry bulk vessel, for a sale price of \$21.9 million. From the net proceeds of the sale, the Company paid on November 8, 2011 the amount of \$19.8 million constituting prepayment towards the Credit Suisse loan facility.

On May 13, 2011, the Company sold the *M/V Free Envoy*, a 1984 built 26,318 dwt Handysize dry bulk vessel for a sale price of \$4.2 million and recognized a gain of \$1,561 as a result of the sale. From the net proceeds of the sale, the Company paid on May 13, 2011 an amount of \$3.7 million constituting prepayment towards the Deutsche Bank Nederland loan facility B. According to the loan terms, all future installments have been reduced to nil until the balloon payment due in November 2012.

We have entered into contracts with a Chinese shipyard to purchase two newbuilding Handysize drybulk vessels, of approximately 33,600 dwt each, for an aggregate purchase price of approximately \$48.8 million (excluding extra costs of approximately \$1,080). The vessels are scheduled for delivery in the second and third quarters of 2012. As of December 31, 2011, we have paid the Chinese shipyard \$9.76 million in the aggregate. By letter dated February 25, 2012, the Company received notice from the shipyard pursuant to its newbuilding contracts that the Company had failed to pay the payment of \$3,660 due on February 11, 2012 under one of the contracts and was therefore in default under its obligations under this contract. The shipyard terminated this contract by notice dated April 28, 2012 to the Company. If we do not renegotiate the payment terms under the remaining newbuilding contract, the shipyard could terminate it. In addition, the shipyard may claim losses incurred as a result of our default. In such event, we may not be able to reclaim the payments made by us. Further, the payment of any claims arising from such default and failure to successfully implement our fleet renewal plan could adversely affect our earnings, our financial conditions and our business opportunities. In addition, the Company's agreement with ABN AMRO to finance these newbuilding vessels was terminated by ABN AMRO. Pursuant to a settlement agreement entered into on April 13, 2012, ABN AMRO agreed to return to the Company all commitment fees paid to date, totaling \$418 less legal fees, and all further obligations of the parties have been terminated. As a result, we no longer have financing committed for the remaining installments due under the remaining newbuilding contract, making it unlikely that we will be able to take delivery of this newbuilding.

On July 30, 2010, we entered into an agreement to sell the *M/V Free Destiny* for a price of \$3,213. The vessel was delivered to the buyers on August 27, 2010 and we recognized a gain of \$807.

On August 5, 2009, we purchased the *M/V Free Neptune* from an unaffiliated third party for approximately \$11 million and related purchase costs of \$302.

**Table of Contents****Our Fleet**

We are an international drybulk shipping company incorporated under the laws of the Republic of the Marshall Islands with principal executive offices in Athens, Greece. Our existing fleet consists of six Handysize vessels and two Handymax (one of which was sold on November 8, 2011) vessels that carry a variety of drybulk commodities, including iron ore, grain and coal, which are referred to as major bulks, as well as bauxite, phosphate, fertilizers, steel products, cement, sugar and rice, or minor bulks. As of December 31, 2011, the aggregate dwt of our operational fleet was approximately 197,200 dwt and the average age of our fleet was approximately 14 years.

Our investment and operational focus is in the Handysize sector, which is generally defined as less than 40,000 dwt of carrying capacity. Handysize vessels are, we believe, more versatile in the types of cargoes that they can carry and trade routes they can follow, and offer less volatile returns than larger vessel classes. We believe this segment also offers better demand and supply demographics than other drybulk asset classes.

We have contracted the management of our fleet to our Manager, Free Bulkers S.A., an entity controlled by Ion G. Varouxakis, our Chairman, President and Chief Executive Officer, and one of our principal shareholders. Our Manager provides technical management of our fleet, financial reporting and accounting services and office space. Our Manager has subcontracted until March 2012 the charter and post-charter management of our fleet to Safbulk Pty Ltd., a company controlled by the Restis family, which also is one of our shareholders. Such sub-management agreement was terminated in March 2012 and the Manager has resumed the commercial management of our fleet. While the Manager is responsible for finding and arranging charters for our vessels, the final decision to charter our vessels remains with us.

The following table presents our fleet information as of May 3, 2012:

| Vessel Name              | Type      | Built | Dwt    | Employment   |
|--------------------------|-----------|-------|--------|--|
| <b>M/V Free Jupiter</b>  | Handymax  | 2002  | 47,777 | About 20 day time charter trip at \$15,500 per day through May 2012.   |
| <b>M/V Free Knight</b>   | Handysize | 1998  | 24,111 | About 20 day time charter trip at \$9,000 per day through May 2012   |
| <b>M/V Free Maverick</b> | Handysize | 1998  | 23,994 | About 30-35 day time charter trip at \$8,000 per day through May 2012  |
| <b>M/V Free Impala</b>   | Handysize | 1997  | 24,111 | About 30-35 day time charter trip at \$5,500 per day through May 2012  |
| <b>M/V Free Neptune</b>  | Handysize | 1996  | 30,838 | About 45-50 day time charter trip at \$6,500 per day for the first 45 days and \$8000 per day thereafter through June 2012 |
| <b>M/V Free Hero</b>     | Handysize | 1995  | 24,318 | About 40-45 day time charter trip at \$5,600 per day through June 2012   |
| <b>M/V Free Goddess</b>  | Handysize | 1995  | 22,051 | Currently seized by pirates  |

*M/V Free Goddess* was hijacked by Somali pirates on February 7, 2012 while transiting the Indian Ocean eastbound. The vessel is held off the coast of Somalia and the Company is currently in communication with the pirates for the release of the vessel and her crew. The vessel was on a time charter trip at the time she was hijacked. Under the charterparty agreement, the BIMCO Piracy clause was applied which provided, amongst other things, for the charterers to have the vessel covered with kidnap and ransom insurance and loss of hire insurance. The vessel was also covered by the war risk underwriters who were duly informed about the transit and had confirmed cover.



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### **Competitive Strengths**

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

***Positive macro environment.*** The broader shipping sector is currently at a cyclical low and poised for a significant upswing in a positive macroeconomic environment. Several key market indicators support increased seaborne dry trade, including growing Chinese and Japanese iron ore and coal imports as well as strengthening Indian demand for thermal coal imports. Industrial production in emerging and developing economies constitutes a major driving force and is expected to generate enhanced demand for dry bulk commodities in the near term. The rising world population and economic recovery in the importing regions are also expected to contribute to the overall growth of the seaborne dry bulk trade.

***Solid Handysize fundamentals.*** We are strategically well positioned to take advantage of the growing Handysize fleet shortage. Approximately 42% of the worldwide Handysize fleet is over 21 years old, and nearing the end of its useful life, making it considerably older than any other fleet type. In addition, Handysize fleet growth is expected to be less than half the growth of any other vessel type. Operationally, Handysize vessels are more versatile than other drybulk vessels. Their shallow draft allows for access to smaller ports unserviceable by larger Panamax and Capesize vessels, and they are equipped with on-board cranes, enabling entry into ports with inadequate loading and discharging facilities.

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

### **Business Strategy**

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

***Optimize our fleet.*** Our fleet of drybulk carriers consists of Handysize and Handymax vessels. Given the relatively low number of Handysize drybulk vessels on order, and a relatively great number of Handysize drybulk vessels at an age of 20 years or older, we believe there will be continued demand for such vessels. Handysize vessels are typically shallow-drafted and equipped with onboard cranes. This makes them more versatile and able to access a wider range of loading and discharging ports than larger ships that are unable to service many ports due to their size or the lack of local port infrastructure. Many countries in the Asia Pacific region, including China, as well as countries in Africa and South America, have shallow ports. We believe that our vessels, and any Handysize that we may acquire, should enable us to transport a wider variety of cargoes and to pursue a greater number of chartering opportunities than if we owned larger drybulk vessels. Handysize vessels have also historically achieved greater charter rate stability than larger drybulk vessels. Since prices for vessels have fallen considerably since the middle of 2008, we may periodically encounter opportunities to acquire high quality, high specification secondhand vessels or newbuildings for attractive prices. We perform a technical review and financial analysis of each potential acquisition and only purchase vessels as market conditions and opportunities dictate and warrant. Furthermore, as part of our fleet renewal program, we will continue to sell vessels in order to renew our fleet when we believe it is in our and our stakeholders' best interests.

***Build upon strategic relationships.*** We intend to continue to build upon our extensive experience and relationships with ship brokers, financial institutions, industrial partners and commodity traders. We use these relationships to identify chartering and acquisition opportunities and gain access to sources of additional financing, industry contacts and market intelligence. Our current specialization in a single asset class allows us to not only monitor markets with a single measure, but also makes us a partner of choice for businesses that have a need or requirement for a Handysize specialist.



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### **Vessel Employment**

We have employed and continue to employ our vessels in the spot charter market, under trip time charters and period time charters.

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

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

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

### **Customers**

During 2011, we derived approximately 46% of our gross revenues from three charterers, and during 2010, we derived approximately 42% of our gross revenues from three charterers. We believe that our customer base is composed of established charterers.

### **Management of Operations and Fleet**

Pursuant to our amended and restated services agreement with our Manager, our operations are executed and supervised by our Manager, based on the strategy devised by the board of directors and subject to the approval of our board of directors as described below. We paid a monthly fee of \$118.5, (on the basis that the dollar/Euro exchange rate is 1.35 or lower; if on the last business day of each month the dollar/Euro exchange rate exceeds 1.35 then the service fee payable will be adjusted for the following month in question, so that the amount payable in dollars will be the equivalent in Euro based on 1.35 dollar/Euro exchange rate) as compensation for services (described below) related to accounting, financial reporting, implementation of Sarbanes-Oxley internal control over financial reporting procedures and general administrative and management services. Effective June 1, 2011, the monthly fee increased to \$136.3. Our Manager is also entitled to a termination fee if the agreement is terminated upon a change of control as defined in the services agreement. The termination fee as of December 31, 2011 would have been \$100,525.

Our Manager provides us with the following services:

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

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

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

We also contract the technical and commercial management of our vessels to our Manager. Our Manager has a separate management contract with each of our ship-owning subsidiaries and provides a wide range of services on a fixed fee per vessel basis, as described below. These services include vessel operations, maintenance, regulatory compliance, crewing, supervising dry-docking and repairs, arranging insurance for vessels, vessel supplying, advising on the purchase and sale of vessels, and performing certain accounting and other administrative services, including financial reporting and internal controls requirements. Pursuant to our amended management agreement with our Manager, we pay our Manager a monthly technical management fee of \$16.5 (on the basis that the dollar/Euro exchange rate is 1.30 or lower; if on the first business day of each month the dollar/Euro exchange rate exceeds 1.30 then the management fee payable will be increased for the month in question, so that the amount payable in dollars will be the equivalent in Euro based on 1.30 dollar/Euro exchange rate) plus a fee of \$0.4 per day for superintendant attendance and other direct expenses. Effective June 1, 2011, the monthly technical management fee increased to \$18.975.

We also pay our Manager a fee equal to 1.25% of the gross freight or hire from the employment of FreeSeas vessels and a 1% commission on the gross purchase price of any new vessel acquired or the gross sale price of any vessel sold by FreeSeas with the assistance of our Manager. Our Manager had previously entered into an agreement with Safbulk, for the provision of charter and post-charter services for our fleet. Such sub-management agreement was terminated in March 2012 and the Manager has resumed the commercial management of our fleet. Additionally, we pay our Manager a monthly fee of \$118.5 as compensation for services related to accounting, financial reporting, implementation of Sarbanes-Oxley internal control over financial reporting procedures and general administrative and management services plus expenses. Effective June 1, 2011, the monthly compensation has been increased to \$136.275.

Our Manager currently manages all of our vessels and we anticipate that our Manager will manage any additional vessels we may acquire in the future.

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

### **Crewing and Employees**

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

### **Long-Term Debt**

We and our subsidiaries are parties to various loan facilities secured by our vessels. Please see Item 5. Operating and Financial Review and Prospects Long-Term Debt for a description of these facilities, our current non-compliance with our obligations and covenants under the facility agreements, and the status of our efforts to restructure the terms of these agreements.

All the Company's credit facilities bear interest at LIBOR plus a margin, ranging from 2.25% to 4.25%, and are secured by mortgages on the financed vessels and assignments of vessels' earnings and insurance coverage proceeds. They also include affirmative and negative financial covenants of the borrowers, including maintenance of operating accounts, minimum cash deposits, average cash balances to be maintained with the lending banks and



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minimum ratios for the fair values of the collateral vessels compared to the outstanding loan balances. Each borrower is restricted under its respective loan agreement from incurring additional indebtedness, changing the vessels' flag without the lender's consent or distributing earnings. The weighted average interest rate for the year ended December 31, 2011 and 2010 was 2.9% and 3%, respectively. Interest expense incurred under the above loan agreements amounted to \$3,173 (net of capitalized interest \$282), \$3,932 and \$3,708 for the years ended December 31, 2011, 2010 and 2009, respectively, and is included in "Interest and Finance Costs" in the consolidated statements of operations.

### **Charter Hire Rates**

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

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

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

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

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

### **Property**

In June 2011, we relocated our principal offices to Athens, Greece and we reimbursed the Manager in an amount equal to \$144 (equivalent of Euro 100) for the expenses incurred in relation to this relocation and early termination cost for previous lease agreement. In addition, we entered into an agreement with our Manager pursuant to which we agreed to pay our Manager 65% of the rents due from our Manager to the lessor of our rented office space, commencing in June 2011, and 65% of the apportioned common expenses and maintenance expenses.

### **Competition**

We operate in markets that are highly competitive and based primarily on supply and demand. Ownership of drybulk carriers is highly fragmented and is divided among approximately 1,200 drybulk carrier owners. We compete for charters on the basis of price, vessel location, size, age and condition of the vessel, as well as on our reputation. There are many drybulk shipping companies which are publicly traded on the U.S. stock markets, such as DryShips Inc., Diana Shipping Inc., Eagle Bulk Shipping Inc., Euroseas Ltd., Excel Maritime Carriers Ltd. and Baltic Trading Limited, which are significantly larger than we are and have substantially more capital, more and larger vessels, personnel, revenue and profits and which are in competition with us. There is no assurance that we can successfully compete with such companies for charters or other business.

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

## **Seasonality**

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

## **Environmental and Other Regulations**

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

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

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

## ***International Maritime Organization***

The International Maritime Organization, or IMO, the United Nations agency for maritime safety and the prevention of pollution by ships, has adopted the International Convention for the Prevention of Marine Pollution, 1973, as modified by the related Protocol of 1978, or the MARPOL Convention, which has been updated through

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various amendments. The MARPOL Convention establishes environmental standards relating to oil leakage or spilling, garbage management, sewage, air emissions, handling and disposal of noxious liquids and handling of harmful substances in packaged forms. The IMO adopted regulations that set forth pollution prevention requirements applicable to drybulk carriers. These regulations have been adopted by over 150 nations, including many of the jurisdictions in which our vessels operate.

In September 1997, the IMO adopted Annex VI to the MARPOL Convention to address air pollution from ships. Annex VI sets limits on sulfur oxide and nitrogen oxide emissions from ship exhausts and prohibits deliberate emissions of ozone depleting substances, such as chlorofluorocarbons. Annex VI also includes a global cap on the sulfur content of fuel oil and allows for special areas to be established with more stringent controls on sulfur emissions. In October 2008, IMO adopted amendments to Annex VI regarding particulate matter, nitrogen oxide, and sulfur oxide emission standards that apply as of July 1, 2010. Among other things, the Annex VI amendments will progressively reduce sulfur oxide emissions from ships, with the global sulfur cap reduced initially to 3.50% (from the current 4.50%), effective from January 2012; then progressively to 0.50%, effective from January 2020. The limits applicable in Sulfur Emission Control Areas (SECAs) will be reduced to 1.00%, beginning on July 2010 (from the current 1.50%); being further reduced to 0.10%, effective from January 2015. The United States ratified the Annex VI amendments in October 2008, thereby rendering its emission standards equivalent to IMO requirements. As a result, Annex VI entered into force for the United States in January 2009. In March 2010, the IMO designated the area extending 200 miles from the territorial sea baseline adjacent to the Atlantic/Gulf and Pacific coasts of the United States and Canada, the main Hawaiian Islands, and the French Territories of St. Pierre and Miquelon as an Emission Control Area. The new SECA will enter into force in August 2011 and become legally enforceable in August 2012. New requirements associated with the SECA may increase the cost of operation of our vessels in U.S. and Canadian waters. Other SECAs may be designated, and the jurisdictions in which our vessels operate may adopt more stringent emission standards independent of IMO. We believe we are in substantial compliance with current Annex VI requirements, but we may incur costs to comply with the new standards in future years.

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

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

***The U.S. Oil Pollution Act of 1990***

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

Under OPA, vessel owners, operators, charterers and management companies are responsible parties and are jointly, severally and strictly liable (unless the spill results solely from the act or omission of a third party, an act of God or an act of war) for all containment and removal costs and other damages arising from discharges or threatened discharges of oil from their vessels, including bunkers (fuel). Effective July 31, 2009, the U.S. Coast Guard adjusted the limits of OPA liability for drybulk vessels to the greater of \$1000 per gross ton or \$854,400 and established a procedure for adjusting the limits for inflation every three years. CERCLA contains a liability scheme that is similar to that under the OPA, and liability under CERCLA is limited to the greater of \$300 per gross ton or

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\$5 million for vessels carrying a hazardous substance as cargo and the greater of \$300 per gross ton or \$0.5 million for any other vessel. These limits of liability do not apply if an incident was directly caused by violation of applicable U.S. federal safety, construction or operating regulations or by a responsible party's gross negligence or willful misconduct, or if the responsible party fails or refuses to report the incident or to cooperate and assist in connection with oil removal activities. In response to the 2010 oil spill in the Gulf of Mexico resulting from the explosion of the *Deepwater Horizon* drilling rig, bills have been introduced in the U.S. Congress to increase the limits of OPA liability for all vessels.

OPA requires owners and operators of vessels to establish and maintain with the United States Coast Guard evidence of financial responsibility sufficient to meet their potential liabilities under OPA. Under the regulations, vessel owners and operators may evidence their financial responsibility by showing proof of insurance, surety bond, self-insurance, or guaranty. Upon satisfactory demonstration of financial responsibility, a Certificate of Financial Responsibility, or COFR, is issued by the United States Coast Guard. This certificate must be carried aboard the vessel to comply with these financial responsibility regulations. We have complied with these financial responsibility regulations by obtaining and carrying COFRs for each of our vessels that operate in U.S. waters, currently the *M/V Free Goddess*, the *M/V Free Impala* and the *M/V Free Jupiter*. We may incur additional costs to obtain COFRs for additional vessels, if required, and to comply with increased limits of liability in the future.

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

### ***The United States Clean Water Act***

The United States Clean Water Act, or CWA, prohibits the discharge of oil or hazardous substances in navigable waters and imposes strict liability in the form of penalties for any unauthorized discharges. The CWA also imposes substantial liability for the costs of removal, remediation and damages and complements the remedies available under the OPA and CERCLA.

The United States Environmental Protection Agency, or EPA, regulates the discharge of ballast water and other wastewater incidental to the operation of a vessel under the CWA. EPA regulations require vessels greater than 79 feet in length (excluding commercial fishing vessels) to obtain coverage under the Vessel General Permit, or VGP, to discharge ballast water and other wastewaters into U.S. waters by submitting a Notice of Intent. We have submitted Notices of Intent for all of our vessels. The new VGP requires vessel owners and operators to comply with a range of best management practices, reporting, and other requirements, for various types of discharges and incorporates United States Coast Guard requirements for ballast water management and exchange. In order to remain covered by the VGP, vessels must comply with numerous inspection, monitoring, reporting and recordkeeping requirements. Vessel owners/operators must, among other things, conduct and document routine self-inspection to track compliance with the VGP, and must conduct a comprehensive vessel inspection every 12 months. As part of a settlement of a lawsuit challenging the VGP, EPA has recently agreed to propose a new VGP with numerical restrictions on organisms in ballast water discharges by November 2011. Compliance with the current VGP and any new VGP could require the installation of equipment on our vessels to treat ballast water before it is discharged or the implementation of other port facility disposal arrangements or procedures at potentially substantial cost, and/or otherwise restrict our vessels from entering U.S. waters.

### ***Other Environmental Initiatives***

In waters of the European Union, our vessels are subject to regulation European Union-level directives implemented by the various nations through laws and regulations of these requirements. These laws and regulations prescribe measures to prevent pollution, protect the environment, and support maritime safety. For instance, the European Union has adopted directives that require member states to refuse access to their ports to certain sub-standard

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vessels, according to vessel type, flag, and number of previous detentions. Member states must inspect at least 25% of vessels using their ports annually and provide increased surveillance of vessels posing a high risk to maritime safety or the marine environment. If deficiencies are found that are clearly hazardous to safety, health or the environment, the state is required to detain the vessel until the deficiencies are addressed. Member states are also required to implement a system of penalties for breaches of these standards.

The EU's directive on the sulfur content of fuels restricts the maximum sulfur content of marine fuels used in vessels operating in EU member states' exclusive economic zones. Under this directive, our vessels may need to make expenditures to comply with the sulfur fuel content limits in the marine fuel they use in order to avoid delays or other obstructions to their operations. The EU has also issued a directive adopting the IMO's standards for the maximum sulfur content of marine fuels used in special sulfur oxide Emission Control Areas, or ECAs, in the Baltic Sea, the North Sea, and for any other seas or ports the IMO may designate as sulfur oxide ECAs 12 months after the date of entry into force of the designation. These and other related requirements may increase our costs of operating and may affect financial performance.

In 2005, the European Union adopted a directive on ship-source pollution. In October 2009, the European Union amended the directive to impose criminal sanctions for illicit ship-source discharges of polluting substances, including minor discharges, if committed with intent, recklessly, or with serious negligence and the discharges individually or in the aggregate result in deterioration of the quality of water. The directive could result in criminal liability for pollution from vessels in waters of European countries that adopt implementing legislation. Criminal liability for pollution may result in substantial penalties or fines and increased civil liability claims.

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

Although the United States is not a party thereto, many countries have ratified and currently follow the liability plan adopted by the IMO and set out in the International Convention on Civil Liability for Oil Pollution Damage of 1969, or the 1969 Convention. Under this convention, and depending on whether the country in which the damage results is a party to the 1992 Protocol to the International Convention on Civil Liability for Oil Pollution Damage, a vessel's registered owner is strictly liable for pollution damage caused in the territorial waters of a contracting state by discharge of persistent oil, subject to certain complete defenses. The limits on liability outlined in the 1992 Protocol use the International Monetary Fund currency unit of Special Drawing Rights, or SDR. Under an amendment to the 1992 Protocol that became effective in November 2003, for vessels of 5,000 to 140,000 gross tons, liability is limited to approximately 4.51 million SDR plus 631 SDR for each additional gross ton over 5,000. For vessels of over 140,000 gross tons, liability is limited to 89.77 million SDR. The exchange rate between SDRs and U.S. dollars was 0.632939 SDR per U.S. dollar on March 28, 2011. Under the 1969 Convention, the right to limit liability is forfeited where the spill is caused by the owner's actual fault; under the 1992 Protocol, a shipowner cannot limit liability where the spill is caused by the owner's intentional or reckless conduct. Vessels trading in jurisdictions that are parties to these conventions must provide evidence of insurance covering the liability of the owner. In jurisdictions where the 1969 Convention has not been adopted, including the United States, various legislative schemes or common law govern, and liability is imposed either on the basis of fault or in a manner similar to that convention. We believe that our protection and indemnity insurance will cover the liability under the plan adopted by the IMO.

The U.S. National Invasive Species Act, or NISA, was enacted in 1996 in response to growing reports of harmful organisms being released into U.S. ports through ballast water taken on by ships in foreign ports. The United States Coast Guard adopted regulations under NISA that impose mandatory ballast water management practices for all vessels equipped with ballast water tanks entering U.S. waters. These requirements can be met by performing mid-ocean ballast exchange, which is the exchange of ballast water on the waters beyond the exclusive economic zone from an area more than 200 miles from any shore, by retaining ballast water on board the ship or by using environmentally sound alternative ballast water management methods approved by the United States Coast Guard. However, mid-ocean ballast exchange is mandatory for ships heading to the Great Lakes or Hudson Bay. Mid-ocean ballast exchange is the primary method for compliance with the United States Coast Guard regulations, since holding ballast water can prevent ships from performing cargo operations upon arrival in the United States,

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and alternative methods are still under development. Vessels that are unable to conduct mid-ocean ballast exchange due to voyage or safety concerns may discharge minimum amounts of ballast water (in areas other than the Great Lakes and the Hudson River), provided that they comply with recordkeeping requirements and document the reasons they could not follow the required ballast water management requirements. The Coast Guard has issued proposed standards for ballast water discharge, which could set maximum acceptable discharge limits for various invasive species, or lead to requirement for active treatment of ballast water. Compliance with any new regulations could require the installation of equipment on our vessels to treat ballast water before it is discharged or arranging for disposal at port facilities at potentially substantial costs.

At the international level, the IMO adopted an International Convention for the Control and Management of Ships' Ballast Water and Sediments, or the BWM Convention, in February 2004. The BWM Convention's implementing regulations call for a phased introduction of mandatory ballast water exchange requirements, to be replaced in time with mandatory concentration limits. The BWM Convention will not be in force until 12 months after it has been adopted by 30 countries, the combined merchant fleets of which represent not less than 35% of the gross tonnage of the world's merchant shipping. As of April 18, 2012, the BWM Convention has been adopted by 27 states, representing approximately 25.32% of the world's tonnage. Despite the lack of ratification, the Marine Environment Protection Committee of IMO passed a resolution in March 2010 calling upon those countries that have ratified the treaty to encourage the installation of ballast water management systems.

### ***Greenhouse Gas Regulation***

In February 2005, the Kyoto Protocol to the United Nations Framework on Climate Change, or Kyoto Protocol, entered into force. Under the Kyoto Protocol, adopting countries are required to implement national programs to reduce emissions of certain gases, generally referred to as greenhouse gases, which are suspected of contributing to global warming. Currently, emissions of greenhouse gases from international shipping are not subject to the Kyoto Protocol. At the December 2010 meeting of the United Nations Climate Change Conference in Cancun, the IMO proposed measures to control greenhouse gas emissions from international shipping. The EU indicated that if the IMO did not decide how to address greenhouse gas emissions from international shipping before December 2010, the EU would include international shipping in its emissions trading scheme. The IMO is currently evaluating various mandatory measures to reduce greenhouse gas emissions from international shipping, including market-based mechanisms and energy efficiency standards. In the United States, the EPA has issued a finding that greenhouse gases threaten public health and safety and has adopted regulations governing the emission of greenhouse gases from motor vehicles and large stationary sources. The EPA may decide in the future to regulate greenhouse gas emissions from ships and is considering a petition from the California Attorney General to regulate greenhouse gas emissions from ocean-going vessels.

Any passage of climate change legislation or other regulatory initiatives by the IMO, the European Union, the United States or other countries where we operate that restrict emissions of greenhouse gases could require us to make significant financial expenditures that we cannot predict with any certainty at this time.

### ***Vessel Security Regulation***

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

Among the various requirements are:

on-board installation of automatic information systems, to enhance vessel-to-vessel and vessel-to-shore communications;

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on-board installation of ship security alert systems;

the development of vessel security plans; and

compliance with flag state security certification requirements.

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

***Inspection by Classification Societies***

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

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

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

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

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

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

| Vessel                   | Next Intermediate<br>Dry-docking | Next Special Survey<br>Dry-docking |
|--------------------------|----------------------------------|------------------------------------|
| M/V <i>Free Goddess</i>  | Third quarter 2013               | Third quarter 2015                 |
| M/V <i>Free Hero</i>     | Third quarter 2013               | Third quarter 2015                 |
| M/V <i>Free Impala</i>   | Second quarter 2015              | Second quarter 2012                |
| M/V <i>Free Jupiter</i>  | Second quarter 2015              | Second quarter 2012                |
| M/V <i>Free Knight</i>   | Second quarter 2016              | Second quarter 2013                |
| M/V <i>Free Maverick</i> | First quarter 2016               | First quarter 2013                 |
| M/V <i>Free Neptune</i>  | Fourth quarter 2014              | Third quarter 2016                 |

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

### **Risk of Loss and Liability Insurance**

#### ***General***

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

#### ***Hull and Machinery Insurance***

We have obtained marine hull and machinery and war risk insurance, which include the risk of actual or constructive total loss, for all of our vessels. The vessels are each covered up to at least their fair market values or such higher amounts as may be required to meet the requirements of any outstanding indebtedness on a particular vessel, with deductibles in amounts of approximately \$100 to \$200.

#### ***Protection and Indemnity Insurance***

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

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

#### ***Loss of Hire Insurance***

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

#### ***Kidnap and Ransom***

We have kidnap and ransom insurance on a case by case basis, generally when one of our vessels is transitioning in an area where acts of piracy are known to take place. Kidnap and ransom insurance generally



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provides coverage of ransom paid, including interest if ransom money are through financing products and including delivery expense of ransom, fees of negotiators and crisis management personnel and the cost of reinstatement of replacement crew. The loss of hire extension covers the insured for any hire lost during seizure for a certain number of days that have been agreed on at the inception of the coverage, typically either 90, 120 or 180 days.

### ***Procedures in the Event of an Insured Event***

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

### **Legal Proceedings**

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

### **Exchange Controls**

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

## **ITEM 4A. UNRESOLVED STAFF COMMENTS**

None.

## **ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

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

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

### **Overview**

Our fleet currently consists of six Handysize vessels and one Handymax vessel that carry a variety of drybulk commodities, including iron ore, grain and coal, which are referred to as "major bulks," as well as bauxite, phosphate, fertilizers, steel products, cement, sugar and rice, or "minor bulks." As of April 30, 2012, the aggregate dwt of our operational fleet is approximately 197,200 dwt and the average age of our fleet is approximately 14.6 years.

Our investment focus is in the Handysize sector. Handysize vessels are, we believe, more versatile in the types of cargoes that they can carry and trade routes they can follow, and offer less volatile returns than larger vessel classes. We believe this segment also offers better demand and supply demographics than other drybulk asset classes. We may, however, acquire larger drybulk vessels if desirable opportunities arise.



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We have contracted the management of our fleet to our Manager. Our Manager provides technical management of our fleet, commercial management of our fleet, financial reporting and accounting services and office space. While the Manager is responsible for finding and arranging charters for our vessels, the final decision to charter our vessels remains with us.

## **Recent Developments**

On January 27, 2012, the Company entered into a First Supplemental Agreement with FBB, which amends its existing credit facility to defer the repayment installment of \$837.5 and the interest payment of \$197 both due on December 16, 2011 until the next repayment date March 16, 2012. In addition, the bank granted a waiver to the security value covenant and the financial covenants, whose testing has been waived until March 16, 2012.

On February 2, 2012, the Company agreed by letter with Credit Suisse to defer its payments totaling \$700 originally due on January 31, 2012 until the next repayment date April 30, 2012. In addition, the interest payment of \$348 originally due on February 8, 2012, has been agreed to be paid in two installments as follows: \$147 to be paid on February 8, 2012 and \$201 to be paid on April 30, 2012.

*M/V Free Goddess* was hijacked by Somali pirates on February 7, 2012 while transiting the Indian Ocean eastbound. The vessel is held off the coast of Somalia and the Company is currently in communication with the pirates for the release of the vessel and her crew. The vessel was on a time charter trip at the time she was hijacked. Under the charterparty agreement, the BIMCO Piracy clause was applied which provided, among other things, for the charterers to have the vessel covered with kidnap and ransom insurance and loss of hire insurance. The vessel was also covered by the war risk underwriters who were duly informed about the transit and had confirmed cover.

By letter dated February 25, 2012, the Company received notice from the shipyard pursuant to its newbuilding contracts that the Company had failed to pay the payment of \$3,660 due on February 11, 2012 and was therefore in default under its obligations under this contract. The shipyard terminated this contract by notice dated April 28, 2012 to the Company.

By letter dated February 29, 2012, the Company received notice from NASDAQ that it has regained compliance with Listing Rules 5450(a)(1) and 5450(b)(1)(C), since for the last 10 consecutive business days, from February 14, 2012 to February 28, 2012, the closing bid price of the Company's common stock has been at \$1.00 per share or greater and the Company's minimum market value of publicly held shares has been \$5,000 or greater, respectively.

On February 15, 2012, the Company received notice from Deutsche Bank Nederland, according to which the Company's failure to (i) repay the installment due in December 2011, (ii) pay regular interest on the loan, (iii) pay default interest on the loan, (iv) pay the success fee due in November 2011, (v) set new financial covenants and (vi) comply with the loan to value covenant, are considered an event of default. Deutsche Bank Nederland requested that the Company fulfill its obligations by March 15, 2012. The Company has not paid the aforementioned amounts or the \$750 repayment installment along with accrued interest due in March 2012. On April 26, 2012, the Company was advised by Deutsche Bank Nederland that it would approve the request to permanently amend the amortization schedule including refinancing of the balloon due in November 2012, subject to documentation and receiving approval from FBB for the restructuring of the facilities.

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On January 27, 2012, the Company entered into a First Supplemental Agreement with FBB, which amends its existing credit facility to defer the repayment installment of \$837.5 and the interest payment of \$197 both due on December 16, 2011 until the next repayment date March 16, 2012. In addition, FBB granted a waiver to the security value covenant and the financial covenants (for more information, please see Note 10 to the financial statements included elsewhere in this report), whose testing was waived until March 16, 2012. On March 23, 2012, the Company received a notice from FBB according to which failure to (i) pay the \$1,675 repayment installment due in March 2012 (ii) pay accrued interest and (iii) failure to pay default interest constitute an event of default. On April 12, 2012, the Company received notice from FBB according to which along with the previously mentioned events, failure to make periodic monthly installments into the retention account since September 2011 and violation of loan to value covenant constitute events of default and notifies the Company that if remedy of all of the above is not made up to April 20, 2012, FBB will take whatever action is open to them. The Company is in discussions to permanently amend the amortization schedule.

According to the Credit Suisse Fifth Supplemental dated November 7, 2011, the Company had agreed to enter into a period time charter of at least twelve months for all of its mortgaged vessels not later than December 31, 2011, which charter would cover the vessels debt service plus \$1.0 million. If the foregoing time charters would not have been entered into by the date required, the Company had agreed that would sell, not later than January 31, 2012, either the M/V *Free Jupiter* or both the M/V *Free Goddess* and the M/V *Free Hero*. The Company has not concluded any time charter agreement, nor has it entered into an agreement for the sale of the above-mentioned vessels. On February 2, 2012, the Company agreed by letter with Credit Suisse to defer its payments totaling \$700 originally due on January 31, 2012 until the next repayment date April 30, 2012, which was further deferred to May 31, 2012 as per letter dated April 25, 2012. The interest payment of \$348 originally due on February 8, 2012, has been agreed to be paid in two installments as follows: \$147 paid on February 8, 2012 and \$201 to be paid on April 30, 2012, which was further deferred to May 31, 2012 as per letter dated April 25, 2012. In addition the interest payment of \$348 originally due on May 10, 2012, has been agreed to be paid in two installments as follows: \$147 to be paid on May 10, 2012 and \$201 on May 31, 2012. On February 15 2012, the Company received a proposal from Credit Suisse containing restructuring head terms for the full payment holiday of the principal and partial interest holiday payment until March 31, 2014, subject to approval from the Company's other lenders. We have been advised by Deutsche Bank Nederland that it will approve this proposal, and we are currently in discussions with FBB.

Pursuant to a settlement agreement entered into on April 13, 2012, ABN AMRO has agreed to return to the Company all commitment fees paid to date less expenses and all further obligations of the parties have been terminated.

At its April 2012 meeting, the Company's Board of Directors approved the issuance of 1,660,694 shares of the Company's common stock to the Manager in payment of the \$926 in unpaid fees due to the Manager for the first quarter of 2012 under the management and services agreements with the Company. The number of shares to be issued to the Manager was based on the closing prices of the Company's common stock on the first day of each month during the quarter, which are the dates the management and services fees were due and payable. Upon issuance of these restricted shares, Mr. Varouxakis, who is our Chairman, Chief Executive Officer and President and the owner of the Manager, will beneficially own 26% of the outstanding common stock of the Company. The Board also approved the issuance of an aggregate of 199,642 shares of the Company's common stock to the non-executive members of our Board of Directors in payment of \$31 per person in unpaid Board fees for the last three quarters of 2011. The aggregate number of shares to be issued to the directors was based on the closing prices of the Company's common stock on the last day of each of the last three quarters of 2011, which are the dates that the Board fees were due and payable. All of the foregoing shares will be restricted shares under applicable U.S. securities laws.

**Table of Contents****Employment and Charter Rates**

All of our vessels are currently being chartered in the spot market. The following table details the vessels in our fleet as of May 3, 2012:

| Vessel Name                  | Type      | Built | Dwt    | Employment  |
|------------------------------|-----------|-------|--------|---|
| <b>M/V Free<br/>Jupiter</b>  | Handymax  | 2002  | 47,777 | About 20 day time charter trip at \$15,500 per day through May 2012.  |
| <b>M/V Free<br/>Knight</b>   | Handysize | 1998  | 24,111 | About 20 day time charter trip at \$9,000 per day through May 2012  |
| <b>M/V Free<br/>Maverick</b> | Handysize | 1998  | 23,994 | About 30-35 day time charter trip at \$8,000 per day through May 2012   |
| <b>M/V Free<br/>Impala</b>   | Handysize | 1997  | 24,111 | About 30-35 day time charter trip at \$5,500 per day through May 2012   |
| <b>M/V Free<br/>Neptune</b>  | Handysize | 1996  | 30,838 | About 45-50 day time charter trip at \$6,500 per day for the first 45 days and \$8,000 per day thereafter through June 2012 |
| <b>M/V Free Hero</b>         | Handysize | 1995  | 24,318 | About 40-45 day time charter trip at \$5,600 per day through June 2012  |
| <b>M/V Free<br/>Goddess</b>  | Handysize | 1995  | 22,051 | Currently seized by pirates   |

*M/V Free Goddess* was hijacked by Somali Pirates on February 7, 2012 while transiting the Indian Ocean Eastbound. The vessel is held off the coast of Somalia and the Company is currently in communication with the Pirates for the release of the vessel and her crew. The vessel was on a time charter trip at the time she was hijacked. Under the charterparty agreement, the BIMCO Piracy clause was applied which provided, amongst other things, for the charterers to have the vessel covered with kidnap and ransom insurance and loss of hire insurance. The vessel was also covered by the war risk underwriters who were duly informed about the transit and had confirmed cover.

**Acquisition of Vessels**

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

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

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

When a vessel has been under a voyage charter, the seller delivers the vessel free of charter to the buyer. When a vessel is under time charter and the buyer wishes to assume that charter, the buyer cannot acquire the vessel without the charterer's consent and an agreement between the buyer

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and the charterer for the buyer to assume the charter. The purchase of a vessel does not in itself transfer the charter because the charter is a separate service agreement between the former vessel owner and the charterer.

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

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

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

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

Arrange for a new crew for the vessel;

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

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

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

Implement a new planned maintenance program for the vessel; and

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

**Business Components and Activities**

Our business comprises the following primary components:

Employment and operation of our drybulk carriers; and

Management of the financial, general and administrative elements involved in the ownership and operation of our drybulk vessels. The employment and operation of our vessels involve the following activities:

Vessel maintenance and repair;

Planning and undergoing dry-docking, special surveys and other major repairs;

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Organizing and undergoing regular classification society surveys;

Crew selection and training;

Vessel spares and stores supply;

Vessel bunkering;

Contingency response planning;

Onboard safety procedures auditing;



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Accounting;

Vessel insurance arrangements;

Vessel chartering;

Vessel hire management; and

Vessel performance monitoring.

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

In Critical Accounting Policies Impairment of Long Lived Assets, we discuss our policy for impairing the carrying values of our vessels. Historically, the market values of vessels have experienced volatility, which from time to time may be substantial. As a result, the charter-free market value, or basic market value, of certain of our vessels may have declined below those vessels' carrying value, even though we would not impair those vessels' carrying value under our accounting impairment policy, due to our belief that future undiscounted cash flows expected to be earned by such vessels over their operating lives would exceed such vessels' carrying amounts. Based on: (i) the carrying value of each of our vessels as of December 31, 2011 and (ii) what we believe the charter free market value of each of our vessels was as of December 31, 2011, the aggregate carrying value of three of the vessels in our fleet as of December 31, 2011 exceeded their aggregate charter-free market value by approximately \$52.2 million, as noted in the table below. This aggregate difference represents the approximate analysis of the amount by which we believe we would have to reduce our net income if we sold all of such vessels at December 31, 2011, on industry standard terms, in cash transactions, and to a willing buyer where we were not under any compulsion to sell, and where the buyer was not under any compulsion to buy. For purposes of this calculation, we have assumed that these vessels would be sold at a price that reflects our estimate of their charter-free market values as of December 31, 2011. However, as of December 31, 2011 and as of the date of this report, we are holding the M/V *Free Hero*, the M/V *Free Jupiter*, the M/V *Free Impala* and the M/V *Free Neptune* for sale.

Our estimates of charter-free market value assume that our vessels are all in good and seaworthy condition without need for repair and if inspected would be certified in class without notations of any kind. Our estimates are based on information available from various industry sources, including:

reports by industry analysts and data providers that focus on our industry and related dynamics affecting vessel values;

news and industry reports of similar vessel sales;

news and industry reports of sales of vessels that are not similar to our vessels where we have made certain adjustments in an attempt to derive information that can be used as part of our estimates;

approximate market values for our vessels or similar vessels that we have received from shipbrokers, whether solicited or unsolicited, or that shipbrokers have generally disseminated;

offers that we may have received from potential purchasers of our vessels; and

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vessel sale prices and values of which we are aware through both formal and informal communications with shipowners, shipbrokers, industry analysts and various other shipping industry participants and observers.

As we obtain information from various industry and other sources, our estimates of basic market value are inherently uncertain. In addition, vessel values are highly volatile; as such, our estimates may not be indicative of the current or future charter-free market value of our vessels or prices that we could achieve if we were to sell them.

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We also refer you to the risk factor in Item 3. Key Information D. Risk Factors The market values of our vessels have declined and may further decrease, and we may incur losses when we sell vessels or we may be required to write down their carrying value, which may adversely affect our earnings and our ability to implement our fleet renewal program .

| Drybulk Vessels | DWT     | Year Built | Carrying Value as of 31/12/2011 (in million USD) |
|-----------------|---------|------------|--|
| Free Hero*      | 24,318  | 1995       | \$ 8.6   |
| Free Jupiter*   | 47,777  | 2002       | \$ 16.7  |
| Free Goddess    | 22,051  | 1995       | \$ 19.0**  |
| Free Impala*    | 24,111  | 1997       | \$ 9.5   |
| Free Knight     | 24,111  | 1998       | \$ 31.8**  |
| Free Maverick   | 23,994  | 1998       | \$ 30.9**  |
| Free Neptune*   | 30,838  | 1996       | \$ 10.5  |
| Total           | 197,200 |            | \$ 127.0   |

\* Vessels classified as held for sale.

\*\* Indicates drybulk carriers for which we believe, as of December 31, 2011, the basic charter-free market value is lower than the vessel's carrying value. We believe that the aggregate carrying value of these vessels exceeds their aggregate basic charter-free market value by approximately \$52.2 million.

**Critical Accounting Policies**

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

*Impairment of Long-lived Assets:* The Company follows the guidance under ASC 360, Property, Plant and Equipment, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. The standard requires that, long-lived assets and certain identifiable intangibles held and used or disposed of by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. When the estimate of undiscounted cash flows, excluding interest charges, expected to be generated by the use of the asset is less than its carrying amount, the Company should evaluate the asset for an impairment loss. Measurement of the impairment loss is based on the fair value of the asset which is determined based on management estimates and assumptions and by making use of available market data. The Company evaluates the carrying amounts and periods over which long-lived assets are depreciated to determine if events have occurred which would require modification to their carrying values or useful lives. In evaluating useful lives and carrying values of long-lived assets, management reviews certain indicators of potential impairment, such as future undiscounted net operating cash flows, vessel sales and purchases, business plans and overall market conditions. In performing the recoverability tests the Company determines future undiscounted net operating cash flows for each vessel and compares it to the vessel's carrying value. The future undiscounted net operating cash flows are determined by considering the Company's alternative courses of action, estimated vessel's utilization, its

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scrap value, the charter revenues from existing time charters for the fixed fleet days and an estimated daily time charter equivalent for the unfixed days over the remaining estimated useful life of the vessel, net of vessel operating expenses adjusted for inflation, and cost of scheduled major maintenance. When the Company's estimate of future undiscounted net operating cash flows for any vessel is lower than the vessel's carrying value, the carrying value is written down, by recording a charge to operations, to the vessel's fair market value if the fair market value is lower than the vessel's carrying value.

As of December 31, 2011, the Company performed an impairment assessment of its long-lived assets by comparing the undiscounted net operating cash flows for each vessel to its respective carrying value. The significant factors and assumptions the Company used in each future undiscounted net operating cash flow analysis included, among others, operating revenues, off-hire days, dry-docking costs, operating expenses and management fee estimates. Revenue assumptions were based on contracted time charter rates up to the end of life of the current contract of each vessel as well as Forward Freight Agreements (FFAs) and market historical average time charter rates for the remaining life of the vessel after the completion of the current contracts. In addition, the Company used an annual operating expenses escalation factor and an estimate of off hire days. All estimates used and assumptions made were in accordance with the Company's internal budgets and historical experience of the shipping industry. The Company's assessment concluded that for vessels that it is intended to be held and used no impairment existed as of December 31, 2011, as the future undiscounted net operating cash flows per vessel exceeded the carrying value of each vessel. For the vessels for which alternative courses of action (including their sale) are under consideration, an impairment charge of \$69,998 was recognized in 2011 and is separately reflected in the 2011 consolidated statement of operations.

*Vessels Depreciation:* The cost of the Company's vessels is depreciated on a straight-line basis over the vessels' remaining economic useful lives from the acquisition date, after considering the estimated residual value. Effective April 1, 2009, and following management's reassessment of the useful lives of the Company's assets, the fleet useful life was increased from 27 to 28 years. Management's estimate was based on the current vessels' operating condition, as well as the conditions prevailing in the market for the same type of vessels.

*Accounting for Special Survey and Dry-docking Costs:* Accounting for Special Survey and Dry-docking Costs: The Company follows the deferral method of accounting for special survey and dry-docking costs, whereby actual costs incurred are deferred and are amortized over periods of five and two and a half years, respectively. If special survey or dry-docking is performed prior to the scheduled date, the remaining un-amortized balances are immediately written-off. In our consolidated financial statements, costs deferred are presented on a consistent basis and are limited to actual costs incurred at the yard, paints, class renewal expenses, and parts used in the dry docking or special survey. Indirect costs and/or costs related to ordinary maintenance, carried out while at dry dock, are expensed when incurred as they do not provide any future economic benefit.

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

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### **Important Measures for Analyzing Results of Operations**

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

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

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

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

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

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

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

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

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

**Adjusted EBITDA** represents net earnings before taxes, depreciation and amortization, amortization of deferred revenue, back log asset, (gain)/loss on derivative instruments, stock-based



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

## **Revenues**

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

The nature and duration of our charters;

The amount of time that we spent repositioning its vessels;

The amount of time that our vessels spent in dry-dock undergoing repairs;

Maintenance and upgrade work;

The age, condition and specifications of our vessels;

The levels of supply and demand in the drybulk carrier transportation market; and

Other factors affecting charter rates for drybulk carriers under voyage charters.

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

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





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Vessels operating in the spot charter market generate revenues that are less predictable, but can yield increased profit margins during periods of improvements in drybulk rates. Spot charters also expose vessel owners to the risk of declining drybulk rates and rising fuel costs. Our vessels were chartered in the spot market during the year ended December 31, 2011.

A standard maritime industry performance measure is the TCE. TCE rates are defined as our time charter revenues less voyage expenses during a period divided by the number of our available days during the period, which is consistent with industry standards. Voyage expenses include port charges, bunker (fuel oil and diesel oil) expenses, canal charges and commissions. Our average TCE rate for financial year 2009, 2010 and 2011 was \$16,105, \$15,742 and \$9,408 respectively.

### **Vessel Operating Expenses**

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

### **Principal Factors Affecting Our Business**

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

Number of vessels owned and operated;

Charter market rates and periods of charter hire;

Vessel operating expenses and direct voyage costs, which are incurred in both U.S. dollars and other currencies, primarily Euros;

Management fees and service fees;

Depreciation and amortization expenses, which are a function of vessel cost, any significant post-acquisition improvements, estimated useful lives, estimated residual scrap values, and fluctuations in the carrying value of our vessels, as well as, drydocking and special survey costs;

Financing costs related to indebtedness associated with the vessels; and

Fluctuations in foreign exchange rates.

### **Performance Indicators**

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

The following performance measures were derived from our audited consolidated financial statements for the year ended December 31, 2011, 2010 and 2009 included elsewhere in this report. The historical data included below is not necessarily indicative of our future performance.

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|   | For the year ended December 31, |                  |                  |
|---|---------------------------------|------------------|------------------|
|   | 2011                            | 2010             | 2009             |
| <b>Adjusted EBITDA (1)</b>              | <b>\$ 5,833</b>                 | <b>\$ 26,834</b> | <b>\$ 30,337</b> |
| <b>Fleet Data:</b>                      |                                 |                  |                  |
| Average number of vessels (2)           | 8.21                            | 9.65             | 9.35             |
| Ownership days (3)                      | 2,998                           | 3,523            | 3,414            |
| Available days (4)                      | 2,960                           | 3,430            | 3,373            |
| Operating days (5)                      | 2,865                           | 3,329            | 3,294            |
| Fleet utilization (6)                   | 96.8%                           | 97.1%            | 97.7%            |
| <b>Average Daily Results:</b>           |                                 |                  |                  |
| Average TCE rate (7)                    | \$ 9,408                        | \$ 15,742        | \$ 16,105        |
| Vessel operating expenses (8)           | 4,858                           | 5,282            | 5,218            |
| Management fees (9)                     | 634                             | 561              | 549              |
| General and administrative expenses(10) | 1,538                           | 1,117            | 1,073            |
| Total vessel operating expenses (11)    | \$ 5,492                        | 5,843            | 5,767            |

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

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|   | For the year ended December 31, |             |          |
|---|---------------------------------|-------------|----------|
|   | 2011                            | 2010        | 2009     |
| Net income/(loss)                                     | \$ (88,196)                     | \$ (21,821) | \$ 6,859 |
| Depreciation and amortization                         | 9,579                           | 17,253      | 17,748   |
| Amortization of deferred revenue                      | (136)                           | (1,034)     | (81)     |
| Back log asset  |                                 |             | 907      |
| Stock-based compensation expense                      | 122                             | 559         | 494      |
| Vessel impairment loss                                | 69,998                          | 26,631      |          |
| Impairment of advances for vessels under construction | 11,717                          |             |          |
| Gain/(loss) on derivative instruments                 | 178                             | 465         | 111      |
| Interest and finance cost, net of interest income     | 3,999                           | 4,338       | 4,299    |
| (Gain) on sale of vessel                              | (1,561)                         |             |          |