



**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Consolidated Financial Statements

December 31, 2008 and 2007

(With Independent Auditors' Report Thereon)

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

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**KPMG LLP**  
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## **Independent Auditors' Report**

The Members

Island Global Yachting Ltd.:

We have audited the accompanying consolidated balance sheets of Island Global Yachting Ltd. and subsidiaries (the Company) as of December 31, 2008 and 2007, and the related consolidated statements of operations, members' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Island Global Yachting Ltd. and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

**KPMG LLP**

Greenville, South Carolina  
October 30, 2009

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Consolidated Balance Sheets

December 31, 2008 and 2007

<b>Assets</b>	<b>2008</b>	<b>2007</b>
Current assets:		
Cash and cash equivalents	\$ 17,371,336	10,219,041
Restricted cash	2,548,789	3,256,560
Accounts receivable, net of allowance	6,200,381	6,512,863
Note receivable	3,000,000	—
Income tax receivable	685,086	561,660
Deferred income taxes	186,923	258,751
Unbilled revenue	990,538	1,577,384
Prepaid expenses and other current assets	2,590,848	4,354,555
Total current assets	33,573,901	26,740,814
Assets held for sale	7,400,000	10,300,000
Note receivable, excluding current portion	3,010,875	—
Investments in affiliated companies	34,561,872	24,033,254
Deposits toward future acquisitions	—	2,022,957
Land and land estate rights, net	91,109,396	92,350,747
Property and equipment, net	161,276,297	141,818,601
Intangible assets, net	2,655,888	4,183,857
Goodwill	27,589,332	42,359,654
Deferred financing costs, net	2,409,620	3,191,240
Deferred expenses	2,055,382	4,872,761
Other assets	2,394,831	1,935,397
Total assets	\$ 368,037,394	353,809,282
<b>Liabilities and Members' Equity</b>		
Current liabilities:		
Bank overdraft	\$ 324,917	1,372,384
Notes payable and short-term credit facilities	10,421,568	119,327,825
Accounts payable, accrued expenses, and other current liabilities	16,098,772	21,245,560
Income taxes payable	1,095,345	830,673
Due to affiliates (note 4)	—	1,976,206
Deferred revenue	6,339,077	561,003
Customer deposits	2,540,254	2,916,197
Total current liabilities	36,819,933	148,229,848
Notes payable, excluding current portion	167,270,732	118,066,612
Deferred lease obligation	5,006,497	4,035,696
Deferred income taxes	26,175,031	27,870,246
Deferred revenue	446,104	19,265,778
Other noncurrent liabilities	1,444,488	1,190,445
Noncontrolling interest in consolidated subsidiaries	6,694,143	5,971,536
Total liabilities	243,856,928	324,630,161
Members' equity	124,180,466	29,179,121
Commitments and contingencies		
Total liabilities and members' equity	\$ 368,037,394	353,809,282

See accompanying notes to consolidated financial statements.

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Consolidated Statements of Operations

Years ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Revenues:		
Engineering and other services	\$ 52,186,498	15,364,040
Marina management services	2,445,675	1,616,286
Marina facilities	50,574,973	35,537,999
Upland facilities	16,485,662	21,760,685
	<u>121,692,808</u>	<u>74,279,010</u>
Costs and expenses:		
Engineering and other services (note 4)	44,215,664	23,147,089
Marina management services	2,008,171	3,466,566
Marina and upland facilities (note 4)	64,198,008	62,904,563
Depreciation and amortization	10,822,535	11,973,561
Impairment losses on long-lived assets (notes 2, 7 and 12)	6,605,212	131,232,336
Impairment losses on goodwill (note 12)	14,770,322	—
General and administrative (note 4)	31,539,226	25,372,933
	<u>174,159,138</u>	<u>258,097,048</u>
Operating loss	(52,466,330)	(183,818,038)
Other income (expense):		
Interest income (note 4)	1,321,952	852,857
Loss allocated to noncontrolling interests	2,368,847	33,099,756
Interest expense	(14,664,903)	(18,191,304)
(Loss) income on investments in affiliated companies	(779,180)	71,592
Gain on troubled debt restructuring	61,328,133	—
Gain on forgiveness of related-party obligations (note 4)	1,436,546	—
Gain on sale of investment (note 13)	1,431,026	—
Amortization of deferred financing costs	(679,484)	(924,058)
Loss before income taxes	(703,393)	(168,909,195)
Income tax expense	60,950	604,126
Net loss	\$ <u>(764,343)</u>	<u>(169,513,321)</u>

See accompanying notes to consolidated financial statements.

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Consolidated Statements of Members' Equity

Years ended December 31, 2008 and 2007

	<u>Class A member</u>	<u>Class B members</u>	<u>Receivable from Parent</u>	<u>Total</u>
Balance at December 31, 2006	\$ 52,055,932	33,873,516	—	85,929,448
Capital contributions from members	49,500,000	65,000,000	—	114,500,000
Partners' capital structuring fee	—	(2,800,000)	—	(2,800,000)
Shares issued for acquisition	—	2,795,563	—	2,795,563
Share-based compensation	—	1,086,136	—	1,086,136
Advance to Parent (note 4)	—	—	(2,818,705)	(2,818,705)
Net loss	<u>(113,679,536)</u>	<u>(55,833,785)</u>	<u>—</u>	<u>(169,513,321)</u>
Balance at December 31, 2007	(12,123,604)	44,121,430	(2,818,705)	29,179,121
Capital contributions from members	—	97,650,000	—	97,650,000
Shares repurchased	—	(648,900)	—	(648,900)
Share-based compensation	—	718,843	—	718,843
Advance to Parent (note 4)	—	—	(1,954,255)	(1,954,255)
Net loss	<u>(413,270)</u>	<u>(351,073)</u>	<u>—</u>	<u>(764,343)</u>
Balance at December 31, 2008	\$ <u><u>(12,536,874)</u></u>	<u><u>141,490,300</u></u>	<u><u>(4,772,960)</u></u>	<u><u>124,180,466</u></u>

See accompanying notes to consolidated financial statements.

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows

Years ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Net loss	\$ (764,343)	(169,513,321)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation expense	8,687,859	9,697,967
Amortization of land estate rights	1,241,351	1,203,698
Amortization of intangible assets	893,325	1,071,896
Impairment losses on long-lived assets	6,605,212	131,232,336
Impairment losses on goodwill	14,770,322	—
Provision for losses on accounts receivable	13,484,163	—
Amortization of deferred financing costs	679,484	924,058
Gain on troubled debt restructuring	(61,328,133)	—
Loss (gain) on sale of property	485,873	(61,042)
Gain on forgiveness of related party obligation	(1,436,546)	—
Write-off of deposits toward future acquisitions	2,022,957	—
Interest incurred added to note payable balance	7,271,751	—
Interest income on receivable from Parent added to note	(768,528)	—
Accrual of deferred lease obligation	970,801	943,649
Increase in cash surrender value of life insurance	(181,324)	(120,860)
Deferred income taxes	(1,623,387)	(745,765)
Loss allocated to noncontrolling interests	(2,368,847)	(33,099,756)
Share-based compensation	718,843	1,086,136
Gain on sale of investment in affiliated company	(1,431,026)	—
Loss (income) on investment in affiliated companies	779,180	(71,592)
Changes in operating assets and liabilities:		
Accounts receivable	(13,171,681)	(2,513,152)
Unbilled revenue	586,846	(489,932)
Prepaid expenses and other current assets	1,763,707	(2,651,874)
Deferred expenses	2,817,379	(2,762,903)
Other assets	(278,110)	(525,329)
Accounts payable and accrued expenses	(2,374,722)	(5,427,983)
Due to affiliates	(539,660)	1,821,206
Customer deposits and other liabilities	(121,900)	702,444
Deferred revenue	(13,041,600)	14,297,733
Income taxes receivable/payable	141,246	(693,964)
Net cash used in operating activities	<u>(35,509,508)</u>	<u>(55,696,350)</u>
Cash flows from investing activities:		
Decrease (increase) in restricted cash	707,771	(871,902)
Purchases of property and equipment	(34,937,018)	(39,276,182)
Proceeds from sale of property and equipment	37,571	5,096,982
Acquisition of American Yacht Harbor assets, less cash acquired (note 11)	—	(25,234,460)
Acquisition of Sun Resorts shares, less cash acquired (note 11)	—	(10,356,058)
Acquisition of Montauk assets, less cash acquired (note 11)	—	(3,998,220)
Acquisition of Isle de Sol, less cash acquired (note 11)	—	(33,974,963)
Proceeds from sale of noncontrolling interest (note 11)	—	12,458,763
Issuance of note receivable	(6,010,875)	—
Investments in affiliated companies	(16,307,798)	(13,750,941)
Proceeds from sale of investment in affiliated company	6,431,026	—
Deposits toward future acquisitions	—	(269,673)
Net cash used in investing activities	<u>(50,079,323)</u>	<u>(110,176,654)</u>

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Consolidated Statements of Cash Flows  
Years ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from financing activities:		
(Decrease) increase in bank overdrafts	\$ (1,047,467)	1,257,789
Net borrowings (repayments) under short-term credit facilities	11,564,697	(22,680,000)
Proceeds from notes payable issued	16,114,086	83,012,540
Principal payments on notes payable	(32,797,017)	(13,761,362)
Capital contributions from members	97,650,000	114,500,000
Partners' capital structuring fee	—	(2,800,000)
Advance to Parent	(1,185,727)	(2,818,705)
Shares repurchased	(648,900)	—
Subsidiary membership interests issued to noncontrolling interests	3,091,454	7,668,546
Dividends paid by subsidiary to noncontrolling interests	—	(255,330)
Deferred financing costs paid	—	(2,879,517)
	<u>92,741,126</u>	<u>161,243,961</u>
Net cash provided by financing activities		
	<u>92,741,126</u>	<u>161,243,961</u>
Net increase (decrease) in cash and cash equivalents	7,152,295	(4,629,043)
Cash and cash equivalents at beginning of year	10,219,041	14,848,084
Cash and cash equivalents at end of year	\$ <u>17,371,336</u>	<u>10,219,041</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest and letter-of-credit fees, of which \$1,229,484 and \$459,777 was capitalized in 2008 and 2007, respectively	\$ 8,095,678	22,869,613
Cash paid for income taxes	1,507,224	1,404,620
Supplemental disclosure of noncash financing activities:		
Interest incurred added to note payable balance	\$ 7,271,751	—
Loan proceeds paid directly to noncontrolling interest holder (note 11)	—	7,508,969
Shares issued for Sun Resorts shares (note 11)	—	2,795,563
Note payable issued for Montauk acquisition (note 11)	—	31,025,000

See accompanying notes to consolidated financial statements.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

#### (1) Description of Business and Organization

Island Global Yachting Ltd. (IGY or the Company), a Cayman Islands exempted company, was formed as a subsidiary of Island Global Yachting L.P. (IGY1 or Parent) in October 2005. The Company was capitalized with additional equity from three partnerships, Island Global Yachting II L.P. (IGY2), a Delaware limited partnership, Island Global Yachting III L.P. (IGY3), a Delaware limited partnership, and Island Global Yachting IV L.P. (IGY4), a Cayman Islands exempted limited partnership. Each of IGY2, IGY3, and IGY4 is a holder of Class B Shares (as defined below) in IGY.

As of December 31, 2008 and 2007, IGY1 held 12,000,000 Class A (voting) shares (Class A Shares) of the Company. Class A Shares entitle the shareholder to vote on company matters. In addition, the Company had 12,380,814 and 7,557,803 Class B (nonvoting) shares (Class B Shares) outstanding as of December 31, 2008 and 2007, respectively.

IGY conducts its business primarily through its subsidiaries, Island Global Yachting Services Ltd. (IGYS) and Island Global Yachting Facilities Ltd. (IGYF). IGYS and its subsidiaries provide marina design and development services, marina and property management services, and environmental, water resources, and coastal engineering services. IGYF, through its various operating subsidiaries, acquires direct and indirect interests (including controlling and noncontrolling interests) in luxury marina and related upland facilities in key yachting and nautical tourism areas around the world and operates these facilities.

In 2008 and 2007, IGY's operations were conducted mainly in the Caribbean, the United States of America, Mexico, and Dubai, United Arab Emirates.

#### (2) Summary of Significant Accounting Policies

##### (a) Principles of Consolidation

The consolidated financial statements include the financial statements of IGY and its controlled subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. The Company accounts for the portion of a subsidiary that is not owned as noncontrolling interests. Noncontrolling interests in an acquired enterprise are reported in the consolidated financial statements at either the book value or fair value of the net assets acquired by the Company at the date of acquisition depending upon the nature of the acquisition plus the cumulative allocation of net income (loss) from that date forward to the noncontrolling interests based on its ownership percentage.

In addition, the Company evaluates its relationships with other entities to identify whether they are variable interest entities as defined by Financial Accounting Standards Board (FASB) Interpretation No. 46(R), (FIN 46(R)), *Consolidation of Variable Interest Entities*, and to assess whether it is the primary beneficiary of such entities. If the determination is made that the Company is the primary beneficiary, then that entity is included in the consolidated financial statements in accordance with FIN 46(R).

The Company reports its operating results by classifying all revenues and costs and expenses to its IGYF and IGYS segments. General and administrative expenses relate to the indirect operating costs of the Company. Impairment losses related to IGYS and IGYF are reported as a single component in the Company's consolidated financial statements.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

**(b) Cash and Cash Equivalents**

For purposes of the consolidated statements of cash flows, the Company considers liquid investments with original maturities of three months or less to be cash equivalents. Short-term investments included as cash equivalents are \$649,976 and \$2,327,235 at December 31, 2008 and 2007, respectively. At various times throughout the year, the Company maintains cash balances in excess of federally insured limits. The Company's management believes it mitigates this risk by banking with major financial institutions. As of December 31, 2008 and 2007, \$2,548,789 and \$3,256,560, respectively, of the Company's cash is restricted under the terms of its loan agreements (note 9).

**(c) Accounts Receivable**

Accounts receivable are recorded at the invoiced amount and do not bear interest. Amounts collected on accounts receivable are included in net cash flows from operating activities in the consolidated statements of cash flows. The allowance for doubtful accounts is management's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company determines the allowance based on specific account analysis. Past-due balances over 90 days and over specified amounts are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. Accounts receivable at December 31, 2008 and 2007 are net of an allowance of \$14,008,153 and \$738,531, respectively. The Company does not have any off-balance-sheet credit exposure related to its customers. Of the Company's accounts receivable, \$1,294,206 and \$2,914,778 served as collateral for the notes payable and credit facilities (note 9) at December 31, 2008 and 2007, respectively.

**(d) Prepaid Expenses and Other Current Assets**

Prepaid expenses and other current assets consist primarily of prepaid rent and insurance, and security deposits.

**(e) Investments in Affiliated Companies**

Investments in two entities are accounted for under the cost method. These investments are periodically evaluated for factors that may indicate an other than temporary decrease in fair value compared to the carrying value.

The Company accounts for its other investments in partnership or membership interests using the equity method. Investments accounted for under the equity method generally represent an investment of 50% or less or where the Company does not have control, but is able to exhibit substantial influence. Under the equity method, the initial investment is recorded as an asset, and a liability is recorded for the amount of capital commitment the Company is contractually obligated to invest. Subsequently, the asset is adjusted for income or loss allocations and the receipt of distributions of capital, and the liability is reduced for investments made pursuant to the commitment.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

**(f) Deposits toward Future Acquisitions**

The Company capitalizes certain deposits and other capitalizable costs directly incurred with respect to pending or anticipated transactions. The Company reviews these costs periodically as transactions occur for allocation to the cost of an acquired entity. Costs associated with potential transactions that are no longer being pursued are expensed.

**(g) Note Receivable**

Note receivable relates to a financing arrangement that was entered into in conjunction with an intended acquisition. The note bears interest at a market rate based on the borrower's credit quality and is recorded at face value. Interest is recognized over the life of the note. The Company has a security interest in certain collateral of the borrower in support of the note. The Company does not intend to sell this receivable. Interest collected on notes receivable is included in net cash provided by operating activities in the consolidated statements of cash flows. There is no loan loss allowance with respect to this note receivable at December 31, 2008.

**(h) Assets Held for Sale**

Assets held for sale at December 31, 2008 consist of nine condominium units and a travel lift. The Company is actively marketing these assets for sale through various brokerage firms.

During 2008, management performed an impairment analysis in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, for the assets held for sale. Management determined that the fair value less cost to sell was below the carrying value for both the nine condominium units and the travel lift. The fair value of these assets was estimated using recent sales transactions. As a result, the Company recorded an impairment charge of \$5,871,342, which is included in impairment losses on long-lived assets in the accompanying consolidated statement of operations, relating to its IGYF segment, to reduce the carrying value of the assets held for sale to fair value less cost to sell. In 2007, the Company recorded an impairment charge of \$4,352,694, relating to the IGYF segment, to reduce the carrying value of the condominium units to fair value less cost to sell.

**(i) Land and Land Estate Rights**

The Company owns land and holds long-term leases (land estate rights) for land and submerged land at various marina sites. These assets are recorded at original cost or at their fair value on the date of acquisition if acquired in a purchase business combination. Land estate rights are amortized using the straight-line method over the respective lease term.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(j) **Property and Equipment**

Property and equipment are stated at cost. Depreciation on property and equipment is calculated on the straight-line method over the estimated useful lives of the assets. The estimated useful lives of the Company's assets are as follows:

Buildings	30 – 55 years
Marina buildings and structures	15 – 30 years
Equipment	3 – 7 years
Vehicles	5 years
Furniture and fixtures	5 – 10 years

For projects under development, the Company capitalizes all direct costs related to the acquisition, development, and construction of the project, including interest, property taxes, and amortization of deferred financing costs as well as indirect costs such as allocations of wages and expenses of employees of certain affiliates under common control that clearly and directly relate to the project. Upon completion of the project, assets are placed into service and depreciated over their estimated useful lives.

Leasehold improvements are amortized straight-line over the shorter of the lease term or estimated useful life of the asset.

In accordance with SFAS No. 144, long-lived assets, such as property and equipment and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets determined to be held for sale and real estate held for sale are separately presented in the consolidated balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held-for-sale would be presented separately in the appropriate asset and liability section of the consolidated balance sheet.

(k) **Goodwill and Other Intangible Assets**

Goodwill represents the excess of the aggregate purchase price over the fair value of net assets acquired in a business combination. Goodwill and intangible assets determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually or earlier if triggering events occur, in accordance with the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets*. The goodwill impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including goodwill). If the fair value of the reporting unit is less than its carrying value, an indication of goodwill impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS No. 141, *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. The Company performs its annual impairment review of goodwill at December 31 and when a triggering event occurs between annual impairment tests.

Intangible assets with estimable useful lives are amortized using the straight-line method over their respective estimated useful lives and reviewed for impairment in accordance with SFAS No. 144.

**(l) *Deferred Financing Costs***

Costs incurred to obtain financing are being amortized using the straight-line method, which approximates the effective-interest method, over the term of the related debt. For project-specific financing, the amortization is recorded and capitalized as real estate development costs until the developed real estate is placed into service. Deferred financing costs at December 31, 2008 and 2007 of \$2,409,620 and \$3,191,240 are net of accumulated amortization of \$1,403,528 and \$621,909, respectively.

**(m) *Other Assets***

Other assets consist primarily of straight-line rent receivable related to retail leases, leasing commissions, cash surrender value of officer life insurance policies, and notes receivable from employees.

**(n) *Advertising and Marketing Costs***

Advertising costs are expensed as incurred. Advertising and marketing costs amounted to \$4,899,471 and \$5,009,236 for the years ended December 31, 2008 and 2007, respectively, and are included in both segment-specific cost and general and administrative expenses.

**(o) *Income Taxes***

The Company is not subject to U.S. federal or state income taxes as the tax effects of the Company's activities are reported directly by the members on their respective income tax returns.

However, certain of the Company's subsidiaries are taxable corporations operating in U.S. and foreign jurisdictions that impose income taxes. For these subsidiaries, income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

The Company is a withholding agent for U.S. federal tax purposes with respect to its foreign members. As a result, the Company would have to make periodic U.S. federal tax payments, to the extent the Company earns income during a period, on behalf of its foreign members to satisfy this withholding obligation and file related annual information tax returns with the Internal Revenue Service (IRS). Any U.S. withholding payments made on behalf of a foreign member would be treated as cash distributions to such member. To the extent the Company is subsequently found by the IRS to have underwithheld on its foreign members' distributive share of the Company's income, the Company and its Parent may become liable for such underwithholding as a result of the Company's status as a withholding agent for this purpose.

**(p) Retirement Plans**

On January 1, 2007, the Company sponsored the establishment of a defined contribution 401(k) profit sharing plan (the 401k Plan) for substantially all its employees in the United States of America. Employees are eligible to participate after completing three months of service. The Company may contribute each year an amount determined by management. Discretionary employer contributions are allocated based on the compensation of each employee and the total compensation of all participants. Additionally, the 401k Plan allows for voluntary employee contributions, which vest immediately. Each employee is allowed to contribute 100% of his/her salary up to a maximum of \$15,500. The Company will make a matching contribution of 30% of the employee contribution, not to exceed 10% of the employee's total compensation. The combined employer and employee contribution may not exceed the lesser of \$15,500 or 100% of the employee's salary. The employer contribution vests at 20% per year for each completed year of employment. The Company has made no discretionary contributions to the 401k Plan for the years ended December 31, 2008 and 2007. In 2009, the Company elected to suspend the matching contributions.

A subsidiary of the Company has a supplemental employee retirement plan covering its executive officers. The benefits are based on years of service and certain levels (but not all) of the officer's compensation at retirement.

**(q) Rent Expense and Deferred Lease Obligation**

The Company leases land, submerged land, and office space. Minimum rental expenses are recognized over the term of the lease. The Company recognizes minimum rent starting when possession of the property is taken. When a lease contains a predetermined fixed escalation of the minimum rent, the Company recognizes the related rent expense on a straight-line basis and records the difference between the recognized rent expense and the amounts payable under the lease as deferred lease obligation.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

(r) **Revenue Recognition**

The Company's revenues are primarily comprised of services provided by IGYS and rentals and services provided by IGYF. The following details the Company's revenue recognition policies by reporting segment (note 15).

**IGYS**

IGYS provides engineering, development, and marina management services. IGYS engineering revenue is recognized under the percentage-of-completion method as defined in American Institute of Certified Public Accountants Statement of Position (SOP) 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*, which recognizes income as work on a contract (or group of contracts if they meet the criteria for combination) progresses. The recognition of revenues and profits is generally related to cost incurred in providing the services required under the contract. Additional factors related to recognition are probable collection of the relevant receivable, persuasive evidence that an arrangement exists, and fixed and determinable sales price. Reimbursed expenses billed to customers are recorded as revenues from engineering and other services at actual cost plus an administrative fee and as costs of engineering and other services in the consolidated statements of operations. Losses on fixed price projects are recognized during the period in which the loss first becomes evident. Project losses are determined to be the amount by which the estimated total costs of the project exceed the total fixed price per the agreement. Customer billings in excess of revenues earned are recorded as deferred revenues or customer deposits. Engineering services are sold principally on a time-and-materials basis or in some cases at a fixed price. Time and material projects are distinguished from fixed price agreements in that the price of the services are quoted based on days incurred on the project or some other measure of time such as hours, weeks, or months. Fixed price agreements are defined as any agreements entered into for a predetermined total price regardless of the number of days actually needed to complete the project or any agreements entered into on a time-and-materials basis that have a cap.

IGYS development revenue is derived from service fees earned under multiple phase agreements. SOP 81-1 requires that the Company record these revenues under the completed-contract method. Under this method, contract costs and related billings are accumulated and reported as deferred revenues in the accompanying consolidated balance sheets until the project is completed or substantially completed. During the fourth quarter of 2008, the Company received notification from the customer of the termination of substantially all long-term development contracts in which it was engaged in the United Arab Emirates, which comprised substantially all of its business in the region. As a result of this termination, which triggered completion under the terms of the contracts, the Company recognized substantially all of the revenues and expenses related to these projects and recorded reserves for those receivables it deemed to be uncollectible.

IGYS marina management revenues are monthly fees earned for management services provided to third parties. Management revenues to owned subsidiaries, which are the majority of such revenues, are eliminated in consolidation.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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#### **IGYF**

IGYF revenues are primarily derived from ownership of marina and upland facilities and are recognized primarily at the time services are performed or products are sold.

When long-term slip rentals or advance deposits are received, revenues are deferred and recognized over the term of the lease or rental agreement. Revenues from leases are recognized over the term of each lease. The Company recognizes minimum rental starting when possession is taken. When a lease contains a predetermined fixed escalation of the minimum rental, the Company recognizes the related rental income on a straight-line basis and records the difference between the recognized rent income and the accounts receivable under the lease as straight-line rent receivable. As of December 31, 2008 and 2007, approximately \$441,381 and \$748,041, respectively, has been recognized as straight-line rents receivable, which amounts are included in other assets in the consolidated balance sheets.

The Company may provide a lessee with an allowance for construction of leasehold improvements. Leasehold improvements are capitalized as part of the building, recorded as tenant improvements, and depreciated over the shorter of the useful life of the improvements or the lease term.

Expense recoveries from tenants related to property operating costs are recognized as revenue based upon a predetermined formula in the period in which the applicable costs are charged to tenants. Deferred leasing costs and other direct costs associated with the acquisition of tenants are capitalized and amortized on a straight-line basis over the terms of the related leases.

The Company accounts for real estate sales under the full accrued method in accordance with SFAS No. 66, *Accounting for Sales of Real Estate*. The factors used to determine when revenue is recognized are that a sales is consummated, the buyer's initial and continuing investment are adequate to demonstrate a commitment to pay for the property and that the seller has transferred to the buyer the usual risks and rewards of ownership and does not have a substantial continuing involvement with the property.

(s) ***Major Maintenance Activities***

The Company incurs maintenance costs for all its major property and equipment. Repair and maintenance costs are expensed as incurred.

(t) ***Commitments and Contingencies***

Liabilities for loss contingencies, including environmental remediation costs not within the scope of SFAS No. 143, *Accounting for Asset Retirement Obligations*, arising from claims, assessments, litigation, fines, and penalties and other sources are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. Legal costs incurred in connection with loss contingencies are expensed as incurred.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

**(u) Share-Based Compensation**

Effective January 1, 2006, the Company adopted SFAS No. 123(R), *Share-Based Payment*. This statement requires that all stock-based compensation be recognized at fair value of the award. The Company recognizes compensation costs for awards with only service conditions that have a graded vesting schedule on a straight-line basis over the requisite service period for the entire award. The Company recognizes compensation costs for awards with performance conditions when the achievement of the performance condition is considered probable.

**(v) Push Down Accounting**

The Company has elected to use push down accounting to account for the acquisitions described in note 11.

**(w) Foreign Currency**

As required in SFAS No. 52, *Foreign Currency Translation*, management evaluates various factors in determining the functional currency of its subsidiaries, including the currency of its revenues, labor and material components, and the overall economic environment in which the subsidiary operates. Exchange gains and losses for transactions that are denominated in a currency other than a subsidiary's functional currency are recognized in the consolidated statements of operations. The U.S. dollar is the functional currency used in the consolidated financial statements.

**(x) Reclassifications**

Certain 2007 amounts have been reclassified in the consolidated financial statements to conform to the 2008 presentation. There was no change to net loss or members' equity as a result of such reclassifications.

**(y) Use of Estimates**

The preparation of the consolidated financial statements requires management of the Company to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the carrying amount of property and equipment, intangible assets, and goodwill, valuation allowances for receivables and unbilled revenue, the fair value of the Company's shares in certain instances, and deferred income tax assets. Actual results could differ from those estimates.

**(z) Recently Issued Accounting Standards**

FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, addresses the uncertainty about how tax positions will be treated under the tax law. This uncertainty leads to questions about whether tax positions taken or to be taken should be reflected in the financial statements before the uncertainty is ultimately resolved with the taxing authority. FIN 48 establishes the threshold for recognizing the benefits of tax return positions in the financial statements as "more likely than not" to be sustained by the taxing authority, and prescribes a measurement methodology for those positions meeting the recognition threshold. FIN 48 became effective for fiscal years

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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beginning after December 15, 2006. However, FASB Staff Position (FSP) FIN 48-3, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, defers the effective date of FIN 48 for nonpublic enterprises until fiscal years beginning after December 15, 2008. The Company has elected to defer the application of FIN 48 for the year ended December 31, 2008 and currently evaluates any uncertain tax positions in accordance with SFAS No. 5, *Accounting for Contingencies*.

In December 2007, the FASB issued SFAS No. 141R, *Business Combinations*, and SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51*. SFAS Nos. 141R and 160 require most identifiable assets, liabilities, noncontrolling interests, and goodwill acquired in a business combination to be recorded at "full fair value" and require noncontrolling interests (previously referred to as minority interest) to be reported as a component of equity, which changes the accounting for transactions with noncontrolling interest holders. Both statements are effective for periods beginning on or after December 15, 2008, and earlier adoption is prohibited. SFAS No. 141R will be applied to business combinations occurring after the effective date. SFAS No. 160 will be applied prospectively to all noncontrolling interests, including any that arose before the effective date. The Company is currently evaluating the impact the adoption of SFAS No. 160 could have on its consolidated financial statements.

In April 2008, the FASB issued FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets*. FSP FAS 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142. FSP FAS 142-3 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact, if any, of adopting FSP FAS 142-3 on its financial position and results of operations.

In November 2008, the FASB's Emerging Issues Task Force (EITF) reached a consensus on EITF Issue No. 08-6 (EITF 08-6), *Equity Method Investment Accounting Considerations*. EITF 08-6 continues to follow the accounting for the initial carrying value of equity method investments in Accounting Principles Board (APB) Opinion No. 18 (APB 18), *The Equity Method of Accounting for Investments in Common Stock*, which is based on a cost accumulation model and generally excludes contingent consideration. EITF 08-6 also specifies that other-than-temporary impairment testing by the investor should be performed at the investment level and that a separate impairment assessment of the underlying assets is not required. An impairment charge by the investee should result in an adjustment of the investor's basis of the impaired asset for the investor's pro-rata share of such impairment. In addition, EITF 08-6 reached a consensus on how to account for an issuance of shares by an investee that reduces the investor's ownership share of the investee. An investor should account for such transactions as if it had sold a proportionate share of its investment with any gains or losses recorded through earnings. EITF 08-6 also addresses the accounting for a change in an investment from the equity method to the cost method after adoption of SFAS No. 160. EITF 08-6 affirms the existing guidance in APB 18, which requires cessation of the equity method of accounting and application of SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, or the cost method under APB 18, as appropriate. EITF 08-6 is effective for transactions occurring on or after December 15, 2008. It is anticipated that the adoption of EITF 08-6 will materially impact the Company's financial position or results of operations.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

#### (3) Liquidity

The Company experienced net losses of \$764,343 and \$169,513,321, and used cash of \$35,509,508 and \$55,696,350, in operating activities for the years ended December 31, 2008 and 2007, respectively. The Company has incurred additional losses and net uses of cash from operations in 2009.

The Company's management believes cash on hand at December 31, 2008, combined with cash available from operations, and funds currently available to the Company through capital commitments of \$31,000,000 already drawn and held by IGY4 are sufficient to support its operations through 2009 and a reasonable period thereafter.

#### (4) Related-Party Transactions

- (a) Fees paid or payable to Island Capital Group LLC (ICG) are all pursuant to the relevant partnership agreements of certain Company shareholders and the subscription and shareholder agreements between each such shareholder partnership and the Company. Fees paid or payable to Island Fund I (IFI) are pursuant to the relevant development agreement. The following is a summary of fees incurred for the years ended December 31, 2008 and 2007:

	<b>2008</b>	<b>2007</b>
Included in costs and expenses:		
Development fees payable to IFI	\$ —	750,000
Asset management fees to ICG	3,032,525	2,454,620
Rent expense on related party leases	407,022	180,202
Included in other income:		
Gain on forgiveness of amounts payable to IFI	\$ 880,209	—
Gain on forgiveness of amounts payable to ICG	556,337	—
Interest income on receivable from Parent	768,528	—
Other transaction costs:		
Acquisition fees paid to ICG	\$ —	1,210,465
Letter of credit fees paid to IGY1	—	610,093
Partner capital structuring fees paid to ICG	—	2,800,000

Personnel and overhead costs of \$1,727,126 and \$2,963,906 included in the consolidated statements of operations are charges from ICG relating to ICG employees who performed services for the Company and rent allocated from ICG to IGY for the years ended December 31, 2008 and 2007, respectively.

- (b) Due to affiliates of \$1,976,206 at December 31, 2007 consists of \$905,000 due to IFI for development fees and development cost advances and \$1,071,206 due to ICG for overhead costs and development cost advances. During 2008, in conjunction with the debt restructuring at Yacht Haven USVI LLC (Yacht Haven) (note 9) certain amounts due by the Company to ICG and IFI were settled, resulting in a gain on forgiveness of related-party obligations of \$1,436,546.

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

- (c) In November 2007, IGY1 executed a \$5,500,000 note to IGY to enable IGY1 to meet its obligation under the letter of credit posted in favor of the lender on the construction loan facility for Yacht Haven, of which \$2,818,705 was advanced during 2007 and \$1,185,727 was advanced during 2008. The receivable from the Parent is secured by a first-priority security interest in, lien on, and right of setoff against all IGY shares owned by the Parent, together with all dividends and distributions thereon and all proceeds thereof. Interest is payable quarterly on the principal amount (including interest permitted by IGY to be added to principal) at 18%. The Company recognized interest income of \$768,528 on this note in 2008. The amount receivable from the Parent was \$4,772,960 at December 31, 2008 and is reflected as an offset to members' equity in the accompanying consolidated financial statements.

**(5) Land and Land Estate Rights**

Land and land estate rights consisted of the following at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Land	\$ 57,259,191	57,259,191
Land estate rights	<u>35,628,814</u>	<u>35,628,814</u>
Total land and land estate rights	92,888,005	92,888,005
Accumulated amortization	<u>(1,778,609)</u>	<u>(537,258)</u>
Land and land estate rights, net	<u>\$ 91,109,396</u>	<u>92,350,747</u>

Estimated amortization expense for the next five years is expected to be: \$1,241,349 in 2009, \$1,241,349 in 2010, \$1,079,870 in 2011, \$1,072,849 in 2012, and \$1,072,849 in 2013.

The Company has several land and submerged land leases that expire through 2093 and, in most cases, provide for renewal options. Generally, the Company is required to pay real estate taxes (where not subject to abatement) and maintain insurance on its leased property. Minimum rent payments under these operating leases are recognized on a straight-line basis over the term of the leases, including any periods of free rent and expected renewal periods. At the time of the acquisition of the various subsidiaries holding these land leases, the fair value of these leases was allocated as part of the purchase price and recorded as land estate rights. Total expenses associated with these leases were \$411,000 and \$367,000 in 2008 and 2007, respectively.

Total future minimum payments due under land leases are as follows:

2009	\$ 654,093
2010	664,779
2011	638,534
2012	652,152
2013	672,032

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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#### (6) Leases

##### (a) Operating Leases

The Company has several noncancelable operating leases, primarily for office space, that expire over the next 11 years. These leases generally contain renewal options for periods ranging up to 10 years and require the Company to pay all executory costs such as maintenance and insurance.

Certain subsidiaries of the Company lease office space from entities owned by executives of a subsidiary. Lease terms range from five to ten years. Total rent expense associated with these leases was \$407,022 and \$180,202 for the years ended December 31, 2008 and 2007, respectively (note 4).

Rental expense under the above-described office space operating leases is recognized on a straight-line basis over the term of the lease including any periods of free rent. Rental expense for operating leases during 2008 and 2007 was \$2,192,580 and \$1,965,159, respectively. Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of December 31, 2008 are:

Year ending December 31:	
2009	\$ 1,260,170
2010	985,420
2011	995,398
2012	816,745
2013	373,782

##### (b) Retail Leases

The Company leases its upland building spaces to retail tenants under operating leases. The leases have remaining terms of up to 10 years and contain standard renewal options. Base rentals are subject to escalation based upon scheduled rent increases within individual leases. One of the Company's subsidiaries leases marina space over an extended term to a yacht owner under an operating lease. The lease expires on December 14, 2012. Base rentals are subject to escalation based upon scheduled rent increases.

A schedule of minimum future base rentals on noncancelable operating leases as of December 31, 2008 is as follows:

Year ending December 31:	
2009	\$ 3,889,829
2010	3,884,060
2011	4,004,986
2012	2,196,241
2013	1,252,648

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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#### (7) Property and Equipment

Property and equipment consisted of the following at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Buildings	\$ 51,429,765	48,937,187
Marina structures	81,661,674	80,460,513
Equipment	10,198,062	8,095,820
Furniture and fixtures	1,251,613	1,545,817
Leasehold improvements	1,229,871	2,254,866
Construction in progress	30,116,299	6,878,544
Total property and equipment	175,887,284	148,172,747
Accumulated depreciation and amortization	(14,610,987)	(6,354,146)
Property and equipment, net	<u>\$ 161,276,297</u>	<u>141,818,601</u>

The Company leases commercial real estate that has a gross book value of \$24,544,937 and accumulated depreciation of \$1,624,907 at December 31, 2008.

During 2007, the Company faced significant development, construction, and start-up challenges at its Yacht Haven and St. Maarten Shipyard (Shipyard) locations. As a result of these challenges, management performed an impairment analysis in accordance with SFAS No. 144 of the long-lived assets at Yacht Haven, Yacht Haven Food and Beverage operations, and Shipyard. Management determined that the future undiscounted cash flows associated with these operations was less than the carrying value of the related assets. Thus, the fair value of these assets was estimated using third-party appraisals based on discounted cash flow models and recent sales and leasing transactions. As a result, the Company recorded an impairment charge of \$126,880,642, relating to the IGYF segment, to reduce the carrying values of the assets to fair value. During 2008, the Company recognized an impairment charge of \$99,226, relating to the IGYS segment, to reduce the carrying value of leasehold improvements at one of its subsidiaries.

#### (8) Fair Value of Financial Instruments

##### (a) Fair Value of Financial Instruments

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

As of December 31, 2008 and 2007, the carrying amounts of the Company's cash, accounts receivable, note receivable and accounts payable approximate their fair values due to the short maturity of these instruments.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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The majority of the Company's notes payable bear interest at floating market rates plus a margin based on property-specific risks. For certain of these notes payable, the Company's management believes the market terms available for such instruments at December 31, 2008 were materially different from those obtained at the time of their origination; thus, the fair value of these notes payable differs from the carrying value. The Company has one fixed rate loan (note 9), the rate of which approximates the market rate at December 31, 2008. The carrying amounts and estimated fair values of the Company's long-term debt at December 31, 2008 is \$177,692,300 and \$164,956,382, respectively.

The fair values of the long-term debt as of December 31, 2008 represent management's best estimates of the amounts that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the liability at the measurement date, the fair value measurement reflects the Company's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the Company based on the best information available in the circumstances.

The fair value of the Company's long-term debt is measured using quoted offered-side prices when quoted market prices are available. If quoted market prices are not available, the fair value is determined by discounting the future cash flows of each instrument at rates that reflect, among other things, market loan to value ratios, market interest rates, and the Company's credit standing. In determining an appropriate spread to reflect its credit standing, the Company considers interest rates currently offered to the Company for similar debt instruments of comparable maturities by the Company's bankers as well as other banks that regularly compete to provide financing to the Company.

**(b) Fair Value Hierarchy**

Effective January 1, 2008, the Company adopted the provisions of SFAS No. 157, *Fair Value Measurements*, for fair value measurements of financial assets and financial liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs for the asset or liability.

The level in the fair value hierarchy within which a fair value measurement in its entirety falls is based on the lowest-level input that is significant to the fair value measurement in its entirety.

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The following table presents assets that are measured at fair value on a recurring basis at December 31, 2008:

	December 31, 2008	Fair value measurements at reporting date using		
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Cash and cash equivalents	\$ 3,992,133	3,992,133	—	—

The fair value of money market mutual funds considered cash and cash equivalents are determined based upon quoted market closing prices, using a market approach.

**(9) Notes Payable and Credit Facilities**

Notes payable and credit facilities consisted of the following at December 31, 2008 and 2007:

	2008	2007
Acquisition line of credit with a commercial bank; expires June 2009. Interest is payable monthly on the outstanding balance at LIBOR plus 2.50% (3.92% and 8.13% at December 31, 2008 and 2007, respectively).	\$ 11,455,000	455,000
Revolving line-of-credit facility with a commercial bank, extended to expire in October 2009. Interest is payable monthly at LIBOR plus 3.25% and 2.50% in 2008 and 2007, respectively (3.69% and 7.50% at December 31, 2008 and 2007, respectively).	2,132,000	1,567,303
Construction loan facility for a total of \$122,000,000 from a syndicate of commercial banks used to finance the development of Yacht Haven; due January 2009. Interest accrues at LIBOR, reset the middle of each month, plus 2.75% (3.63% at December 31, 2008). Interest through August 2008 accrued at LIBOR plus 5.75% or prime plus 1.00% as elected by the Company (7.95% at December 31, 2007).	31,250,000	117,294,816

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	<u>2008</u>	<u>2007</u>
Note payable to a commercial finance company obtained in connection with the acquisition of Cabo Marina. Interest payable monthly through December 2008. Principal and interest payments equal to base monthly payments times seasonal multiplier (as defined in note agreement) payable monthly starting January 2008. Remaining principal and unpaid interest due November 2011. Interest accrues at LIBOR plus 3.50% (5.25% and 8.63% at December 31, 2008 and 2007, respectively).	\$ 26,871,925	27,923,510
Note payable to a commercial bank obtained in connection with the acquisition of American Yacht Harbor (note 11). Interest and principal payable monthly. Remaining principal and unpaid interest due August 22, 2017. Interest accrues at LIBOR plus 2.35% (6.50% and 7.58% at December 31, 2008 and 2007, respectively).	15,025,500	15,246,000
Note payable to a commercial bank obtained in connection with the acquisition of Isle de Sol (note 11). Interest and principal payable monthly. Remaining principal and unpaid interest due July 30, 2014. Interest accrues at LIBOR plus 3.25% (5.25% and 8.38% at December 31, 2008 and 2007, respectively).	21,490,242	21,335,896
Note payable to commercial bank acquired in connection with the acquisition of Simpson Bay (note 11). Interest and principal payable monthly. Remaining principal and unpaid interest due October 31, 2012. Interest accrues at 8.52%.	3,257,403	3,306,657
Construction and acquisition loan for a total of \$47,200,000 from a syndicate of a commercial bank and a commercial finance company for the acquisition and redevelopment of Rodney Bay. Interest accrues during construction at LIBOR (4% minimum) plus 3.40% (7.40% and 8.08% at December 31, 2008 and 2007, respectively). Mandatory principal payment of \$12.5 million on June 30, 2010. Remaining principal and unpaid interest due December 31, 2015.	35,125,559	19,141,000

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	<u>2008</u>	<u>2007</u>
Notes payable to a commercial bank obtained in connection with the acquisition of Montauk Yacht Club (note 11). Interest payable monthly. Principal due April 9, 2010 with 2 one-year extensions available at the Company's option. Interest accrues at LIBOR plus 3.00% (4.20% and 8.03% at December 31, 2008 and 2007, respectively).	\$ 31,025,000	31,025,000
Vehicle and water craft notes payable in monthly principal and interest installments due March 2013 and various dates in 2010.	<u>59,671</u>	<u>99,255</u>
	177,692,300	237,394,437
Less current portion and credit facilities	<u>(10,421,568)</u>	<u>(119,327,825)</u>
Notes payable, excluding current portion	<u>\$ 167,270,732</u>	<u>118,066,612</u>

Proceeds from the notes payable were used to purchase operating marinas, and proceeds from the construction loans were used to develop or redevelop marina properties. These property specific notes are secured by the real and personal property of each borrowing entity and, in certain instances, by the borrowing entity's rights under retail leases and certain cash accounts and accounts receivable of the entity as well as the equity in the borrowing entity. The revolving credit facility of the subsidiary is secured by all personal property of a subsidiary.

At December 31, 2007, Yacht Haven was in default under its construction loan facility totaling \$122 million from a syndicate of commercial banks (the Syndicate), the proceeds of which had been used to fund the development of the marina and upland facilities at Yacht Haven and to fund Yacht Haven's working capital needs. The loan is collateralized by the real property and improvements thereon, Yacht Haven's rights under its retail leases and all cash accounts and accounts receivable of Yacht Haven. Interest on the facility accrued at LIBOR plus 5.75% through August 2008. During 2008, the Syndicate advanced an additional \$1,107,904 to Yacht Haven under a forbearance agreement.

In August 2008, the Company, through a majority-owned subsidiary, YHG Lender LLC (YH Lender), acquired \$92,855,654 of the then outstanding \$124,105,654 due to the construction lender for \$31,000,000 and committed to purchase the remaining balance for \$31,250,000 in January 2009. In connection with the agreement to purchase the debt, all membership interests in Yacht Haven were pledged to the Syndicate. This troubled debt restructuring resulted in a gain of \$61,328,133, after accrual of the interest to be paid on the remaining \$31,250,000 due in January 2009.

The Company experienced funding defaults from certain limited partners and, as a result, was unable to purchase the remaining balance from the Syndicate in January 2009. In June 2009, YH Lender purchased \$3,125,000 of the \$31,250,000 debt leaving a remaining balance of \$28,125,000. IGY, YH Lender and the Syndicate entered into an amended debt purchase agreement whereby YH Lender will purchase the remaining Yacht Haven debt from the Syndicate through 2012. Under the terms of this agreement, \$1,000,000 principal installments each are due June 10, 2010 and June 10, 2011 and a balloon payment of

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\$26,125,000 is due on June 10, 2012. In addition, interest on the outstanding principal is due on a current basis at an interest rate of 4%, 5%, and 6% for periods ending June 10, 2010, 2011, and 2012, respectively.

The Company's debt agreements contain various restrictive financial covenants, including minimum debt service coverage ratios and minimum interest coverage ratios, as well as negative covenants, material adverse change provisions, and other terms and conditions customarily found in loan agreements of this type. The Company was in compliance with the various debt covenants and provisions at December 31, 2008, with the exception of the acquisition line of credit, which had an outstanding balance of \$11,455,000 at December 31, 2008 and the revolving line-of-credit facility, which had an outstanding balance of \$2,132,000 at December 31, 2008.

Under the terms of the construction and acquisition loan for Rodney Bay Marina Limited and Planviron (Caribbean Practice) Ltd. collectively, (Rodney Bay), IGY is required to sell land adjacent to Rodney Bay by June 30, 2010 and to prepay the loan by the greater of \$12,500,000 or 80% of the net sales proceeds.

The Company and a subsidiary have outstanding lines of credit that permit the Company to draw funds for various purposes. Repayment of the \$50,000,000 acquisition line of credit (which had a balance of \$11,455,500 at December 31, 2008) was included in the terms of the Yacht Haven debt purchase and as such, the \$38,545,000 is not considered available at December 31, 2008. In August 2009, IGY reduced the outstanding principal balance by \$3,000,000 to \$8,455,000 and amended the terms of this line of credit. The interest rate was increased from LIBOR plus 2.50% to LIBOR plus 3.00% and IGY provided a cash reserve for debt service equal to 18 months of interest on the facility calculated at a 4% interest rate (or approximately \$507,000). The maturity date was extended to August 1, 2014, with quarterly principal payments of \$343,750 starting November 1, 2012. IGY agreed to prepay the outstanding balance with the proceeds in excess of \$31,250,000 (plus certain additional advances that may be made from and after June 10, 2009) from any sale or refinancing of the Yacht Haven marina (after reduction for transaction costs, debt repayments and certain other uses) subject to a cap of \$5,000,000.

The \$2,250,000 revolving line of credit of a subsidiary had been extended through October 2009. At the time of this report, the subsidiary is in discussions with the commercial bank about an extension or modification of the revolving line of credit through December 31, 2010. No assurances can be made that these discussions will be successful. The table below summarizes amounts available from the outstanding lines of credit as of December 31, 2008:

	<b>Maximum borrowing capacity</b>	<b>Outstanding balance</b>	<b>Excess capacity</b>
Acquisition line of credit	\$ 50,000,000	11,455,000	—
Revolving line of credit	2,250,000	2,132,000	118,000
	<b>\$ 52,250,000</b>	<b>13,587,000</b>	<b>118,000</b>

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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The aggregate maturities of long-term debt for each of the years subsequent to December 31, 2008, after giving effect to adjustments made to recognize agreements negotiated subsequent to year-end but before issuance of this report that extend the debt maturities, are as follows:

Year ending December 31:		
2009	\$	10,421,568
2010		47,755,898
2011		27,550,875
2012		32,094,676
2013		4,097,433
Thereafter		<u>55,771,850</u>
Total	\$	<u><u>177,692,300</u></u>

**(10) Income Taxes**

Total loss before income taxes for the years ended December 31, 2008 and 2007 arose from entities as categorized below:

	<u>2008</u>	<u>2007</u>
Income (loss) from nontaxable entities	\$ 11,836,803	(165,810,660)
Loss from taxable entities	<u>(12,540,196)</u>	<u>(3,098,535)</u>
Loss before income taxes	\$ <u><u>(703,393)</u></u>	<u><u>(168,909,195)</u></u>

Loss from taxable entities consisted of a \$9,337,181 and \$2,043,443 loss incurred in the United States of America and of a \$3,203,015 and \$1,055,092 foreign loss in 2008 and 2007, respectively.

Income tax expense (benefit) for the year ended December 31, 2008 attributable to income after noncontrolling interests from taxable entities consisted of the following:

	<u>Current</u>	<u>Deferred</u>	<u>Total</u>
U.S. federal	\$ (442,220)	(146,707)	(588,927)
State and local	1,434	(134,153)	(132,719)
Foreign	<u>2,121,412</u>	<u>(1,338,816)</u>	<u>782,596</u>
	\$ <u><u>1,680,626</u></u>	<u><u>(1,619,676)</u></u>	<u><u>60,950</u></u>

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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Income tax expense (benefit) for the year ended December 31, 2007 attributable to income from taxable entities consisted of the following:

	<u>Current</u>	<u>Deferred</u>	<u>Total</u>
U.S. federal	\$ 34,966	(229,888)	(194,922)
State and local	15,519	(48,703)	(33,184)
Foreign	<u>1,299,406</u>	<u>(467,174)</u>	<u>832,232</u>
	\$ <u>1,349,891</u>	<u>(745,765)</u>	<u>604,126</u>

Income tax expense attributable to loss from taxable entities was \$60,950 and \$604,126 for the years ended December 31, 2008 and 2007, respectively, and differed from the amount computed by applying the U.S. federal income tax rate of 34% to income before income taxes from taxable entities as a result of the following:

	<u>2008</u>	<u>2007</u>
Computed "expected" tax (benefit) expense	\$ (4,263,667)	(1,053,502)
Increase (reduction) in income taxes resulting from:		
State and local income taxes, net of federal income tax benefit	(86,549)	(37,054)
Increase in valuation allowance	728,096	1,845,721
Differential in foreign rate	(37,341)	(239,256)
Foreign tax concession	(587,685)	—
Nondeductible expenses	23,851	50,788
Nondeductible goodwill impairment charge	4,097,119	—
Other, net	<u>187,126</u>	<u>37,429</u>
Income tax expense	\$ <u>60,950</u>	<u>604,126</u>

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2008 and 2007 are presented below:

	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Accounts receivable principally due to valuation differences	\$ 169,600	230,756
Compensated absences and nonqualified employee benefit plans, principally due to accrual for financial reporting purposes	372,556	306,586
Deferred revenue	129,586	224,742
Net operating loss	2,357,020	1,948,085
Other	<u>57,583</u>	<u>29,748</u>
Total gross deferred tax assets	3,086,345	2,739,917
Less valuation allowance	<u>(2,676,181)</u>	<u>(1,948,085)</u>
Net deferred tax assets	<u>410,164</u>	<u>791,832</u>
Deferred tax liabilities:		
Difference in book and tax depreciation of property and equipment	26,257,572	24,356,464
Adjustment due to change to accrual basis taxpayer	—	211,037
Nondeductible intangible amortization	—	3,686,447
Other	<u>140,700</u>	<u>149,379</u>
Total gross deferred tax liabilities	<u>26,398,272</u>	<u>28,403,327</u>
Net deferred tax liabilities	\$ <u>(25,988,108)</u>	\$ <u>(27,611,495)</u>

Presented in the accompanying consolidated balance sheets as follows:

	<u>2008</u>	<u>2007</u>
Deferred income taxes – current assets	\$ 186,923	258,751
Deferred income taxes – noncurrent liabilities	<u>(26,175,031)</u>	<u>(27,870,246)</u>
Net deferred tax liabilities	\$ <u>(25,988,108)</u>	\$ <u>(27,611,495)</u>

The valuation allowance for deferred tax assets as of January 1, 2008 and 2007 was \$1,948,045 and \$102,364. The net change in the total valuation allowance was an increase of \$728,096 and \$1,845,721, in 2008 and 2007, respectively. In assessing whether deferred tax assets will in fact be realized, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the scheduled reversal of deferred tax liabilities and projections for future taxable income over the periods in which the deferred tax assets are deductible,

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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management believes it is more likely than not that the Company will realize the benefits of these deductible differences net of the existing valuation allowance at December 31, 2008 and 2007. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carry forward period are reduced.

#### (11) Acquisitions

The Company's business plan is centered upon delivering a high level of consistent, premium service to the yachting industry. In order to create a strong market position and leverage the Company brand for future revenue opportunities, the Company has identified strategic real estate and service assets to build its operating platform. The synergies of these various assets are anticipated to allow IGY to charge premium prices in a previously underserved industry with a client base that is willing to pay for such service. The ability to acquire these key assets required that, in certain cases, the Company pay a premium resulting in the recording of goodwill in the purchase price allocation of the entities acquired.

##### (a) *American Yacht Harbor*

On January 18, 2007, the Company acquired substantially all of the assets of American Yacht Harbor, consisting of tangible and intangible assets such as land, buildings, marina docks and related equipment, rights, leases, and slip agreements. The results of American Yacht Harbor's operations have been included in the consolidated financial statements since that date. American Yacht Harbor is a 128-slip marina on St. Thomas, U.S. Virgin Islands (USVI). The aggregate purchase price was \$25,238,326, consisting of \$25,006,665 cash paid and acquisition costs of \$231,661.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

Current assets	\$	141,124
Property and equipment		20,783,949
Land and land estate rights		2,521,000
Intangible assets		1,293,000
Goodwill		946,212
		<hr/>
Total assets acquired		25,685,285
		<hr/>
Current liabilities		(446,959)
		<hr/>
Total liabilities assumed		(446,959)
		<hr/>
Net assets acquired	\$	25,238,326
		<hr/>

The acquired land estate rights and intangible assets, all of which are being amortized, have a weighted average useful life of approximately 8.3 years. The land estate rights consist of a beneficial government lease of the marina basin valued at \$674,000 (4-year useful life). The intangible assets include a favorable fuel contract valued at \$1,156,000 (11.3-year useful life) and net beneficial leasehold assets of \$137,000 (3.5-year useful life).

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

December 31, 2008 and 2007

On May 29, 2007, a 50% passive member interest in American Yacht Harbor was sold to one of IGY's investors for \$12,458,763. The Company recognized a gain on the sale of the 50% interest of approximately \$247,000. Upon obtaining property-level financing, 50% of the loan proceeds, or \$7,508,969, was paid by the lender directly to the noncontrolling interest holder.

**(b) Sun Resorts Marina Portfolio**

During 2007, the Company acquired 100% each of Sun Resorts Inc. (SRI) and Sun Resorts Management Inc., 92% of MOF Simpson Bay L.P. (Simpson Bay) (consisting of 88% of the Class A capital interests in the partnership and 100% of the Class B profit interests), 33% of Village Cay Marina Enterprises Ltd. (Village Cay) and 25% of Virgin Gorda Yacht Harbor Holdings Ltd. (Virgin Gorda). Simpson Bay operates a 122-slip marina in St. Maarten, Netherlands Antilles. Village Cay operates a 106-slip marina and an adjacent 21-room luxury hotel in Tortola, British Virgin Islands (BVI). Virgin Gorda operates a 111-slip marina and boatyard on Virgin Gorda, BVI. This acquisition was achieved in two stages starting on February 6, 2007 and completing on September 26, 2007. The results of the respective operations have been included in the consolidated financial statements since these dates based on the Company's ownership percentage. The aggregate purchase price was \$13,760,990, consisting of \$10,069,831 cash paid, \$2,795,563 of Class B shares issued, and acquisition costs of \$895,596.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

Current assets	\$	631,268
Property and equipment		8,918,285
Land estate rights		741,622
Intangible assets		186,600
Equity investments in affiliated subsidiaries (note 13)		5,210,721
Goodwill		4,629,343
Total assets acquired		<u>20,317,839</u>
Current liabilities		(311,851)
Deferred tax liabilities		(2,831,950)
Long-term debt		(3,348,277)
Noncontrolling interests		(64,771)
Total liabilities assumed		<u>(6,556,849)</u>
Net assets acquired	\$	<u>13,760,990</u>

The land estate rights include a beneficial government lease of the marina basin at Simpson Bay, which has a useful life of 34.0 years. The intangible assets represent management contracts that are amortizable over 1.5 to 15.0 years. Goodwill and the acquired intangible assets are expected to be nondeductible for tax purposes.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

### Notes to Consolidated Financial Statements

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(c) **Montauk Yacht Club Marina and Resort**

On April 2, 2007, the Company acquired substantially all of the assets of Montauk Yacht Club Marina and Resort (Montauk), consisting of tangible and intangible assets such as land, a hotel, buildings, and marina docks and related equipment. The results of Montauk's operations have been included in the consolidated financial statements since that date. Montauk consists of 51 acres of land (including 25.5 acres of submerged land) and includes a 232-slip marina, 84 hotel rooms, 23 villas, 2 restaurants, 2 bars, a banquet facility, 4 tennis courts, 3 pools, a spa, and a private beach. The aggregate purchase price was \$35,034,587, consisting of notes payable of \$31,025,000, cash paid of \$2,616,050, and acquisition costs of \$1,393,537.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

Current assets	\$	160,472
Land		18,666,936
Property and equipment		15,402,423
Intangible asset		543,837
Goodwill		1,087,813
		<hr/>
Total assets acquired		35,861,481
		<hr/>
Current liabilities		(826,894)
		<hr/>
Total liabilities assumed		(826,894)
		<hr/>
Net assets acquired	\$	<u>35,034,587</u>

The acquired intangible asset consists of a trade name and is not amortizable.

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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*(d) Yacht Club at Isle de Sol B.V.*

On June 22, 2007, the Company acquired 100% of the outstanding shares of Hop-Inn Enterprises N.V. (Hop-Inn). The results of Hop-Inn's operations have been included in the consolidated financial statements since that date. Hop-Inn owns 100% of the equity interests in Yacht Club at Isle de Sol B.V. (IDS). IDS is a 45-slip marina on St. Maarten, Netherlands Antilles. The aggregate purchase price was \$34,269,739, consisting of cash of \$33,709,158 and acquisition costs of \$560,581. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

Current assets	\$	859,830
Property and equipment		30,025,539
Land estate rights		1,320,000
Goodwill		12,347,159
		<hr/>
Total assets acquired		44,552,528
		<hr/>
Current liabilities		(1,550,250)
Deferred tax liabilities		(8,732,539)
		<hr/>
Total liabilities assumed		(10,282,789)
		<hr/>
Net assets acquired	\$	<u>34,269,739</u>

The land estate rights consist of two beneficial government leases covering the marina basin and the upland at the marina site. The leases are being amortized using the straight-line method over a useful life of 38 years. Goodwill and the acquired land estate rights are expected to be nondeductible for tax purposes.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

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#### (12) Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill for the years ended December 31, 2008 and 2007 are as follows:

Balance at December 31, 2006	\$	23,349,127
Acquisition of American Yacht Harbor		946,212
Acquisition of Montauk Yacht Club		1,087,813
Acquisition of IDS		12,347,159
Acquisition of Sun Resorts Management Inc.		<u>4,629,343</u>
Balance at December 31, 2007		42,359,654
Impairment of American Yacht Harbor		(946,212)
Impairment of Applied Technology		(6,287,704)
Impairment of Rodney Bay Marina		(3,659,448)
Impairment of CMMC		(239,604)
Impairment of Montauk Yacht Club		(1,087,813)
Impairment of Sun Resorts Management, Inc.		<u>(2,549,541)</u>
Balance at December 31, 2008	\$	<u>27,589,332</u>

Of the goodwill acquired during 2007, \$18,560,535 was allocated to the IGYF segment and \$449,992 was allocated to the IGYS segment (note 15).

Due to the economic downturn experienced during 2008, operating results and cash flows for the Company were lower than expected. Based on that trend, the earnings forecast for the Company was revised. In 2008, an aggregate goodwill impairment loss of \$14,770,322 was recognized because the carrying amount of the certain reporting units was greater than their fair value (as determined using the expected present value of the future cash flows) and the carrying amount of these reporting units' goodwill exceeded the implied fair value of that goodwill. Of the goodwill impairment losses recognized in 2008, \$6,977,300 and \$7,793,022 was allocated to the IGYS and IGYF segment, respectively.

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Notes to Consolidated Financial Statements

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The following table presents certain information regarding the Company's acquired intangible assets as of December 31, 2008:

	<u>Amortization period</u>	<u>Gross carrying amount</u>	<u>Accumulated amortization</u>	<u>Net balance</u>
Indefinite lived intangible asset:				
Trade name		\$ 543,837	—	543,837
Amortizable intangible assets:				
Fuel contract	11.3 years	1,156,000	199,809	956,191
Noncompete agreements	3 – 5 years	259,630	230,782	28,848
Beneficial lease agreement	5 years	2,000,000	933,333	1,066,667
Beneficial retail lease	3.5 years	137,000	76,655	60,345
Total		\$ 4,096,467	1,440,579	2,655,888

The Company also performed an impairment analysis related to amortizable intangible assets at certain subsidiaries and recognized an impairment loss in 2008 of \$634,644, which is included in impairment losses on long-lived assets in the accompanying consolidated statement of operations, relating to the IGYS segment, to reduce the carrying values of these intangible assets to fair value.

The following table presents certain information regarding the Company's acquired intangible assets as of December 31, 2007:

	<u>Amortization period</u>	<u>Gross carrying amount</u>	<u>Accumulated amortization</u>	<u>Net balance</u>
Indefinite lived intangible asset:				
Trade name		\$ 543,837	—	543,837
Amortizable intangible assets:				
Fuel contract	11.3 years	1,156,000	97,779	1,058,221
Customer relationships	6 years	916,000	326,516	589,484
Noncompete agreements	3 – 5 years	544,824	320,199	224,625
Beneficial lease agreement	5 years	2,000,000	533,333	1,466,667
Tradename	5 years	109,000	46,329	62,671
Management contracts	1.5 – 15 years	186,600	47,736	138,864
Beneficial retail lease	3.5 years	137,000	37,512	99,488
Total		\$ 5,593,261	1,409,404	4,183,857

Estimated amortization expense for the next five years is \$570,291 in 2009, \$523,504 in 2010, \$368,968 in 2011, \$102,301 in 2012, and \$102,301 in 2013.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

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On the acquisition of Cabo Marina, IGY did not acquire the related fuel operation, an entity called Combustibles, as the Mexican government prohibits foreign ownership of fuel operations. On September 1, 2006, Cabo Marina entered into a lease agreement with Combustibles, whereby it receives monthly rent of the lesser of 11% of gross revenues or 100% of net operating income of Combustibles. To ensure fuel supply to its marina customers, Cabo Marina entered into an agreement with the entity holding 100% of the outstanding shares of Combustibles on October 31, 2006, which provides Cabo Marina a five-year option to purchase all outstanding Combustibles' shares. Under U.S. generally accepted accounting principles, the option agreement effectively provides control of the operations of Combustibles to Cabo Marina. As such, the results of operations of Combustibles are included in the consolidated financial statements from October 31, 2006 forward, with the net income being allocated to noncontrolling interests. In connection with the option agreement, Cabo Marina advanced \$2,000,000 to the owner of Combustibles. As Cabo Marina does not intend to collect on this advance, the Company has recorded the advance as a beneficial lease intangible asset, which is being amortized over the five-year term of the option agreement.

#### (13) Investments in Affiliated Companies

Investments in affiliated companies accounted for under the cost method at December 31, 2008 consist of a 10% interest in Lamda Technol Flisvos Holdings, S.A. (LTFH), a Greek company controlled by Lamda Development S.A. (Lamda), a Greek conglomerate. IGY acquired its interest in LTFH on February 6, 2008. LTFH owns approximately 77.5% of Lamda Technol Flisvos Marina, S.A., which in turn owns the Flisvos Marina, a 239-slip mega-yacht marina and upland that includes commercial and restaurant facilities, located in Athens, Greece. IGY paid an aggregate purchase price of €2,255,000 (approximately \$3,300,000 at the exchange rate in effect at the closing date) for its interest in LTFH. On July 18, 2008, IGY, under the terms of the purchase agreement, invested an additional €20,000 (approximately \$31,764 as of the date of payment) to meet its capital contribution obligations for various working capital needs. On January 23, 2009, IGY sold its interest in LTFH back to Lamda for €2,480,500 (\$3,150,979 net of \$124,025 in transfer taxes, at the current exchange rate in effect at the closing date). Investments in affiliated companies accounted for under the cost method at December 31, 2007 consisted of a \$5,000,000 indirect passive investment in the successor company to Kerzner International Limited. The Company sold this investment in January 2008 for \$6,431,026, resulting in a gain of \$1,431,026.

Investments in affiliated companies accounted for under the equity method consist of a 33% interest in Village Cay, 25% interest in Virgin Gorda, a 50% interest in Interisle Holdings Ltd. (Interisle), a 50% interest in Interisle Development Ltd. (IDL), a 25% interest in Nautical Center Prgin and its affiliate (NCP) and a 15% interest in Altamer LLC (Altamer).

The equity interests in Village Cay and Virgin Gorda, both operating marinas, were acquired in the acquisition of the Sun Resorts Marina Portfolio discussed in note 11. A wholly owned subsidiary of the Company, which holds the 33% interest in Village Cay, has guaranteed, on a joint-and-several basis with the majority partner, a \$6,400,000 million loan secured by the property. The Company provided marina management services to Village Cay and to Virgin Gorda through September 2009. Fees charged to these operating marinas are set at the level of fees that the Company charges to unrelated parties. Marina management revenues earned from Village Cay and Virgin Gorda during the period the Company held the equity investments totaled \$314,397 and \$110,000 in 2008 and 2007, respectively.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

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Interisle is a joint venture of which IGY owns 50%. On April 9, 2007, Interisle acquired a 50% interest in Quorum Island (BVI) Limited (Quorum). Quorum owns approximately 650 acres of undeveloped property at Beef Island, BVI and plans to develop the property for marine, residential, leisure, and commercial use. Interisle is party to a note payable of \$13,000,000, of which \$2,500,000 was due April 9, 2008 and \$10,500,000 is due December 15, 2009, to Quorum. If Interisle fails to fund this note, which has no recourse to IGY, it will forfeit the ratable portion of its 50% interest in Quorum. IDL has contracted with Quorum to provide development and management services. No development or management revenue was earned from Quorum in 2008 or 2007. The April 2008 payment was made in a timely manner. At the time of this report, Quorum has received a deferral on the December 2009 payment.

On September 16, 2008, IGY acquired a 25% equity interest in NCP's existing Mandalina Marina located in Sibenik, Croatia for a purchase price of €6,250,000 (\$8,856,000). IGY commenced management and branding of this facility under the terms of a separate marina management agreement. It is currently contemplated that IGY would, under the terms of an executed marina development agreement, expand Mandalina Marina to include a mega yacht extension. The Mandalina Marina currently has a 30-year concession. The existing marina facility has approximately 350 berths, and the new mega yacht extension would feature approximately 65 mega yacht berths. IGY has placed a total valuation of €25,000,000 (\$35,500,000) on the existing marina and mega yacht extension opportunity, not including the development and construction cost of building such extension. Total estimated development and construction costs for the Mandalina mega yacht extension are approximately €19,500,000 (\$27,690,000). It is contemplated that an additional equity partner may be sought in connection with the development of the mega yacht extension, although there can be no assurance that any such equity partner will be willing to invest in the development on terms favorable to IGY or at all. It is currently contemplated that the development of the Mandalina mega yacht extension would commence in the second quarter of 2009 and be completed in 2010. No assurance can be given that this development project will commence or be completed as currently projected.

Altamer owns 55 acres of developable land and water on Anguilla, British West Indies, and plans to develop the property for marine, residential, and commercial use. Altamer is seeking financing for the development of the property. IGY has contracted with Altamer to provide upland and marina development and marina management services. No development or management revenue has been earned from Altamer in 2008 and 2007.

The excess of cost over the Company's share of net assets of the affiliated companies is \$18,162,922 and \$4,564,477 at December 31, 2008 and 2007, respectively. In accordance with SFAS No. 142, this equity-method goodwill is not amortized; however, the investment is analyzed for impairment in accordance with APB 18.

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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The following table details activity in investments in affiliated companies for the years ended December 31, 2008 and 2007:

	<u>Cost method investments</u>	<u>Equity method investments</u>	<u>Total investments</u>
Balance at December 31, 2006	\$ 5,000,000	—	5,000,000
Investment in Village Cay	—	2,869,589	2,869,589
Investment in Virgin Gorda	—	2,341,132	2,341,132
Investment in Interisle	—	4,115,804	4,115,804
Investment in Altamer	—	9,635,137	9,635,137
Income from equity affiliates	—	71,592	71,592
Balance at December 31, 2007	5,000,000	19,033,254	24,033,254
Sale of investment in Kerzner	(5,000,000)	—	(5,000,000)
Investment in Interisle	—	1,126,829	1,126,829
Investment in Croatia	—	11,525,457	11,525,457
Investment in Lamda	3,655,512	—	3,655,512
Loss from equity affiliates	—	(779,180)	(779,180)
Balance at December 31, 2008	\$ <u>3,655,512</u>	<u>30,906,360</u>	<u>34,561,872</u>

The summary of combined unaudited financial information for the investee companies as of and for the year ended December 31, 2008 is as follows:

	<u>2008</u>	<u>2007</u>
Financial position:		
Current assets	\$ 4,879,016	18,521,089
Property, plant, and equipment, net	137,610,125	139,407,894
Other assets	11,127,422	14,086,661
Total assets	\$ <u>153,616,563</u>	<u>172,015,644</u>
Current liabilities	\$ 54,965,848	7,998,387
Long-term debt	27,104,665	59,256,802
Total liabilities	82,070,513	67,255,189
Owners' equity	71,546,050	104,760,455
Total liabilities and owners' equity	\$ <u>153,616,563</u>	<u>172,015,644</u>
Results of operations:		
Sales	\$ 14,160,240	9,902,574
Operating income	1,160,937	4,530,730
Net (loss) income	(1,540,796)	633,686

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

**(14) Share-Based Compensation**

On December 29, 2006, the board of directors (the Board) of the Company adopted the Island Global Yachting Ltd. 2006 Share Option Plan (the Plan). The Plan is administered by the Board. Under the Plan, the Board has complete discretion (subject to the provisions of the Plan) to grant employees, consultants, and nonemployee directors of the Company and its affiliates and subsidiaries nonqualified share options to purchase authorized but unissued Class B Shares of the Company. Share options covering a maximum of 5% of the outstanding shares of the Company on a fully diluted basis at any time, other than Class B Shares issued or issuable pursuant to the Plan, may be issued pursuant to the Plan. Options shall have an exercise price determined by the Board at the time of the grant and may be granted with an exercise price less than, equal to, or greater than the share's fair market value at the date of the grant. Grants have terms fixed by the Board, provided that no share option shall be exercisable more than 10 years after the date the share option is granted. Shares will vest according to the schedule set forth in the individual agreements provided to eligible recipients. The Company expects to issue new shares upon an exercise of options.

During 2008 and 2007, pursuant to the authority granted to it under the Plan, the Board granted eligible recipients 159,886 and 376,000 options at a weighted average grant date fair value of \$10.75 and \$8.43 per share option, respectively. As the Company is private and transaction activity in the Company's shares is infrequent, the exercise prices were set by the Board using recent closed and pending transactions utilizing the Company's shares. All awards have 10-year terms. For the 159,886 share options granted in 2008 and 351,000 of the share options granted in 2007, the awards have a 3-year vesting period. Fifty percent of these grants will vest over the respective terms; the balance will only vest upon a liquidity event, as defined under the Plan. For the remaining 25,000 share options granted during 2007, 66.67% of the share options vested on November 30, 2007; the balance will only vest upon a liquidity event as defined by the Plan.

A summary of option activity as of December 31, 2008 and 2007 and the changes during the years then ended December 31, 2008 and 2007 is presented below:

	<u>Number of shares</u>	<u>Weighted average exercise price</u>	<u>Weighted average remaining contractual life (years)</u>	<u>Weighted average grant date fair value</u>
Outstanding at December 31, 2007	837,133	\$ 17.25		
Granted during the year	159,886	20.00		
Forfeited during the year	(270,345)	17.27		
Outstanding at December 31, 2008	<u>726,674</u>	<u>\$ 17.84</u>	<u>8.58</u>	<u>\$ 7.88</u>
Exercisable at December 31, 2007	143,342	\$ 15.58	9.05	\$ 6.13
Exercisable at December 31, 2008	220,911	16.30	8.21	6.55

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

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The fair value of the share options at the grant date was estimated using the Black-Scholes option pricing model using the weighted average assumptions in the following table and is being amortized over the option's requisite service periods using the straight-line method in accordance with SFAS No. 123(R):

	<u>2008</u>	<u>2007</u>
Assumptions:		
Expected dividend yield	None	None
Expected volatility	49.92%	33.81%
Risk-free interest rate	4.92%	4.95%
Expected life (in years)	6.00	5.95

The assumptions were determined based upon the following factors:

Expected dividend yield was based upon management's expectation that no dividends will be paid during the contractual life of the share options.

Expected volatility was derived using the estimated historical volatility of a sample of comparable companies.

Expected life was determined using the simplified method of estimating useful life as defined in Staff Accounting Bulletin No. 107 (SAB 107), *Share-Based Payment*. SAB 107 was issued on March 29, 2005 by the Securities and Exchange Commission (SEC) to express views of the staff regarding the interactions between SFAS No. 123(R) and certain SEC rules and regulations regarding share-based payments. Under SAB 107, a company may conclude that its historical option exercise experience does not provide a reasonable basis upon which to estimate expected life. The simplified method defines the expected life as the mid-point between the vesting and expiration of the share options.

The risk free interest rate for the expected term of the option is based upon the U.S. Treasury yield curve in effect at the time of the grant with a term equal to the expected life of the options.

As of December 31, 2008 and 2007, there was approximately \$1,368,000 and \$2,148,000, respectively, of unrecognized compensation cost related to nonvested share based compensation arrangements with a service condition granted under the Plan. That cost is expected to be recognized over a weighted average period of 2.08 years. Additionally, as of December 31, 2008, there was approximately \$2,633,000 of unrecognized compensation cost related to share based compensation arrangements that only vest upon a liquidity event. Total share based compensation expense for the years ended December 31, 2008 and 2007 was \$718,843 and \$1,086,136, respectively.

As required by SFAS No. 123(R), in calculating share option compensation expense, the Company estimates forfeitures of employee share options and recognizes compensation cost only for those awards expected to vest. Forfeiture rates for 2008 and 2007 were estimated based upon actual forfeitures from the grant date through the financial statement issuance date. Estimated forfeitures will be adjusted to actual forfeiture experience as needed.

**ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

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**(15) Segment Information**

The Company has identified two segments for reporting purposes, IGYS and IGYF. IGYS provides design, development, management, and consulting services. IGYF is dedicated to ownership and investment in real estate properties and marina facilities.

	<u>IGYS</u>	<u>IGYF</u>	<u>Total</u>
2008:			
Total revenues	\$ 54,632,173	67,060,635	121,692,808
Operating loss	(32,760,451)	(19,705,879)	(52,466,330)
Goodwill	—	27,589,332	27,589,332
Total assets	32,030,709	336,006,685	368,037,394
2007:			
Total revenues	\$ 16,980,326	57,298,684	74,279,010
Operating loss	(36,631,692)	(147,186,346)	(183,818,038)
Goodwill	6,977,300	35,382,354	42,359,654
Total assets	29,266,173	324,543,109	353,809,282

Geographically, the Company's operations are concentrated in the United States of America, the Caribbean, Mexico, and Europe/Middle East:

	<u>United States of America</u>	<u>The Caribbean</u>	<u>Mexico</u>	<u>Europe/ Middle East</u>	<u>Total</u>
2008:					
Total revenues	\$ 24,623,511	42,515,255	15,984,612	38,569,430	121,692,808
Operating (loss) income	(44,493,470)	(21,863,959)	3,997,124	9,893,975	(52,466,330)
Total assets	100,491,694	193,484,006	67,471,126	6,590,568	368,037,394
2007:					
Total revenues	\$ 23,875,613	34,153,853	15,134,996	1,114,548	74,279,010
Operating (loss) income	(35,149,201)	(150,458,739)	3,390,245	(1,600,343)	(183,818,038)
Total assets	84,013,217	192,144,496	68,799,446	8,852,123	353,809,282

**(16) Commitments**

***Fuel Purchase Contracts***

Certain of the Company's subsidiaries are party to fuel purchase agreements under which they have committed to buy their gasoline and diesel fuel from a single vendor at a fixed differential above a common index. The subsidiaries are required to purchase a minimum quantity per month, and there is no limit to the quantity they can purchase. The agreements expire through 2018. In the event the agreements are terminated, the Company would be obligated to purchase the fueling equipment from the respective vendor at its original installed cost less depreciation to date. During 2008 and 2007, the Company purchased \$4,315,973 and \$3,499,626, respectively, of fuel under the agreements.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

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A schedule of future minimum payments under the agreements based on gasoline and diesel prices expected to be in effect during 2009 is as follows:

2009	\$	1,580,000
2010		1,580,000
2011		1,580,000
2012		1,580,000
2013		1,580,000
2014		1,580,000
Total	\$	<u>9,480,000</u>

#### (17) Subsequent Events

##### (a) *Equity Offering*

On October 22, 2008, Island Global Yachting Directives LLC (IGYD), which is also the general partner of IGY1, IGY2, IGY3, and IGY4, closed its third round of equity financing with \$75,000,000 of capital commitments from a single subscriber, which would have provided that Island Global Yachting V L.P. (IGY5) would hold Class B nonvoting shares of the Company. No capital was called from IGY5 and, pursuant to a settlement agreement in May 2009 described below, the subscriber was released from all of its capital commitments.

##### (b) *Capital Call Defaults and Settlements*

IGY4 had called all \$224,000,000 in capital commitments as of April 30, 2009. Between October 2008 and April 2009, five limited partners representing approximately \$32.7 million in aggregate capital commitments had defaulted on their capital call obligations. IGYD, acting on behalf of IGY4, negotiated and has settled with each of the five defaulting limited partners. The limited partners forfeited an aggregate of 5,268,208 shares in the Company with a contributed value \$105,305,013. As of October 30, 2009, IGY4 has received a total of \$211,376,251 of capital contributions and owns 10,568,813 shares of the Company.

In May 2009, the Company concluded a settlement agreement not related to the defaults noted above, with two limited partners and certain of their affiliates, in which the limited partners transferred all of their units in IGY1 and IGY2 to a subsidiary of the Company. In exchange, all long-term master development and marina management agreements among these limited partners and their affiliates were terminated and all outstanding receivable claims by the subsidiary were considered settled in full. The parties have no remaining obligations to one another, except for minor claims retained by such subsidiaries for certain claims for engineering and certain management fees.

Giving effect to the forfeitures and settlements, the Company will have 8,500,000 Class A Shares and 13,094,426 Class B Shares outstanding.

## ISLAND GLOBAL YACHTING LTD. AND SUBSIDIARIES

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(c) ***Mandalina Marina and Mandalina Mega-Yacht Extension***

In July 2009, Dogus Holdings (Dogus) entered into agreements with IGY NCP to acquire minority interests in two joint ventures established by IGY and NCP in September 2008 that hold a marina concession and adjacent waterfront upland concession in the Dalmatian Coast town of Sibenik, Croatia. Dogus simultaneously acquired from IGY a 50% interest in entities through which the marina is managed and a marina extension and adjacent upland that will be developed. Dogus is a leading Turkish conglomerate with diversified interests including two significant existing marina facilities in Turkey.

Upon the July 2009 transaction closing, Dogus paid IGY €1,250,000 for 5% of Mandalina Marina and €3,750,000 to NCP for an additional 15% interest. As a result, Mandalina Marina is owned: (a) 20% by Dogus; (b) 20% by IGY; and (c) 60% by NCP. Dogus acquired its 20% interest in Mandalina Marina based on a total valuation of €25 million for the existing marina and mega-yacht extension opportunity, not including the development and construction cost of building such extension, which is the same valuation utilized at the time IGY made its investment in September 2008. Preliminary estimated development and construction costs associated with the Mandalina Marina mega-yacht extension approximate €25 million though such preliminary plan may be further reviewed and altered prior to any actual commencement of construction. It is contemplated that the development of the Mandalina Marina mega-yacht extension could commence as early as late 2009 or early 2010 and be completed in mid-2011. If the parties agree to pursue the development, and obtain the requisite third-party financing, IGY and Dogus would be the developer through a development joint venture under the terms of a fee-based development agreement that has been negotiated as part of IGY's and Dogus' investment in the existing marina. No assurance can be given that this development project will commence or be completed as currently projected.

(d) ***Sale of Dubai Operations***

On October 7, 2009, the Company entered into a Transfer and Transition Agreement with G-Marin Consulting Limited (G-Marin) pursuant to which (i) IGYF agreed to transfer all of its Dubai-based employees and all furniture and equipment to a subsidiary of G-Marin, (ii) G-Marin agreed to assume substantially all severance-related obligations related to the Dubai-based employees (after January 31, 2010), (iii) G-Marin is taking over the Dubai operations of IGY (except for certain management services in relation to Dubai Festival City), (iv) IGYF agreed to transfer the shares in a fully licensed Dubai entity, Island Global Yachting DMCCO, and (v) G-Marin and IGYF agreed to certain revenue sharing arrangements for certain existing clients of IGY. An affiliate of G-Marin also entered into an Advisory Services and Trademark Licensing Agreement with IGYS pursuant to which G-Marin and IGYS agreed to create a co-brand that would be used exclusively in the Middle East, North Africa, and parts of South Asia. IGYS also agreed to provide advisory services to an affiliate of G-Marin. The term of the Licensing Agreement is ten years and G-Marin agreed to pay a mobilization fee in the amount of \$350,000 and a monthly fee during the term in the agreement. The fee for years 1 to 3 is \$75,000 per month, \$60,000 per month for years 4 and 5 and \$50,000 per month for years 6 to 10. Licensing fees of \$499,000 were paid in advance.