

Advisory

Project Poseidon

Phase 2 - monitoring (May 2018 results)

*Strictly Private
and Confidential*

15 August 2018

pwc

**Scottish Government
Scottish Procurement
5 Atlantic Quay
150 Broomielaw
Glasgow G2 8LG**

Dear Sirs

We report on Ferguson Marine Engineering Limited (the “Company” or “FMEL”) in accordance with our agreement dated 27 November 2017.

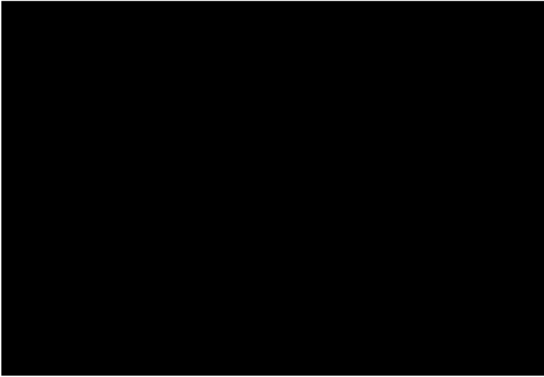
This report has been prepared in connection with the set out purpose as stated in the engagement letter. All sections of the report should be read together.

Save as described in the agreement or as expressly agreed by us in writing, we accept no liability (including for negligence) to anyone else or for any other purpose in connection with this report, and it may not be provided to anyone else.

Yours faithfully


PricewaterhouseCoopers LLP

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Information

The table opposite sets out the monitoring information that management is required to provide under the loan agreement, together with our comment on whether it has been received.

Info. received	Mar-18	Apr-18	May-18
Personnel changes	Y	Y	Y
Profit & loss	Y	Y	Y
Balance sheet	*	*	Y
Cash flow statement	Y	Y	Y
P&L comparison v budget	Y	Y	Y
BS comparison v budget	*	*	Y
CF comparison v budget	*	*	Note 1
801/2 build report	*	Y	Y
801/2 cost over runs	*	Y	Y
Permitted fees	Y	Y	Y

* Please see the relevant monthly report for our comments on the differences between the information requested and the information received.

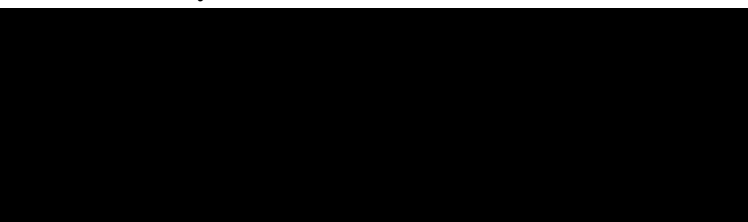
Note 1 – The reporting pack does not include a comparison against budget or monthly cash flow results. Only YTD actuals have been provided.

Conclusion

- This is the monitoring report for May 2018. It is being submitted at this time for SG's records only. As you are aware, we were engaged to carry out contingency planning work on a range of options for FMEL from March to June 2018. These reports involved regular work with FMEL and SG was kept apprised of FMEL's position. Due to this work and its own planning work, FMEL was unable to provide the accounting

information and respond to our monitoring queries within the required timescale.

- Clearly the business has moved significantly since these accounts were produced. Please see our June reporting pack for the latest available commentary.
- The accounts continue to reflect a business that has been stressed; resulting in trading behind budget. These problems should begin to be addressed following the agreement of the £30m loan facility.
- The creditors balance continues to be significant, and it will be important that management looks to pay this down at the earliest opportunity. Management has stated its intentions to pay the majority of this balance following the receipt of the first tranche of the Scottish Government loan.
- We asked management to provide an updated 10 week cash flow forecast to reflect the first tranche of the loan facility, however, it did not provide this as it does not believe this is a requirement for monitoring purposes. The most recent short term cash flow forecast was received on 8 August 2018. Please see our June monitoring paper for the most up to date commentary on this.



- There were no other key personnel changes noted by management in the month.

Profit and loss account

The table opposite compares the actual profit and loss account for May 2018 to the build forecast provided by management.

Profit & loss account: May 2018

£ in 000s	Note	Actual	Forecast	Movement
801/2 revenue	1	1,000	3,600	(2,600)
Other revenue	2	200	353	(153)
Gross margin	3	(240)	-	(240)
Selling, general and administrative		(185)	(197)	12
Addback depreciation		84	84	-
EBITDA		(341)	(113)	(228)
Exceptional items		(100)	(100)	-
Interest		(200)	(172)	(28)
Depreciation		(84)	(84)	-
Net profit		(505)	(469)	(36)

1. Revenue – The cash constraints resulted in 57% less productive hours being booked in the month, primarily due to a lower staff headcount. Revenue is therefore significantly behind forecast in the month as the slippage in the build of 801/2 has resulted in spend on materials still sitting as a prepayment on the balance sheet. This will be reversed once the materials have been installed on the vessels.

3. Gross margin – The reduced productive man hours in the month has resulted in an overall reduction in recovery of overhead costs of £0.2m in the month. There is no material impact of this with gross margin in line with budget for year to date.

Medium term cash flow

The table opposite summarises the indirect cash flow of FMEL for May 2018.

* Original milestone date – as per the IBR of August 2017

** Revised milestone date – are based on FMEL's updated projection provided on 11 May 2018.

Cash flow May 2018

£ in 000s	Note	Actual YTD
EBITDA (excluding exceptionals)		(1,500)
Exceptionals [Redacted]		■
Cash from trading		(2,000)
Movement in working capital	1	(8,200)
Operating cash flow		(10,200)
Purchase of fixed assets	2	(400)
Release from Escrow (Held by Sureties)		10,500
Increase/(decrease) in cash and cash equivalents		100
		-
Opening balance		2,900
Closing balance		2,800

Summary of milestones not achieved

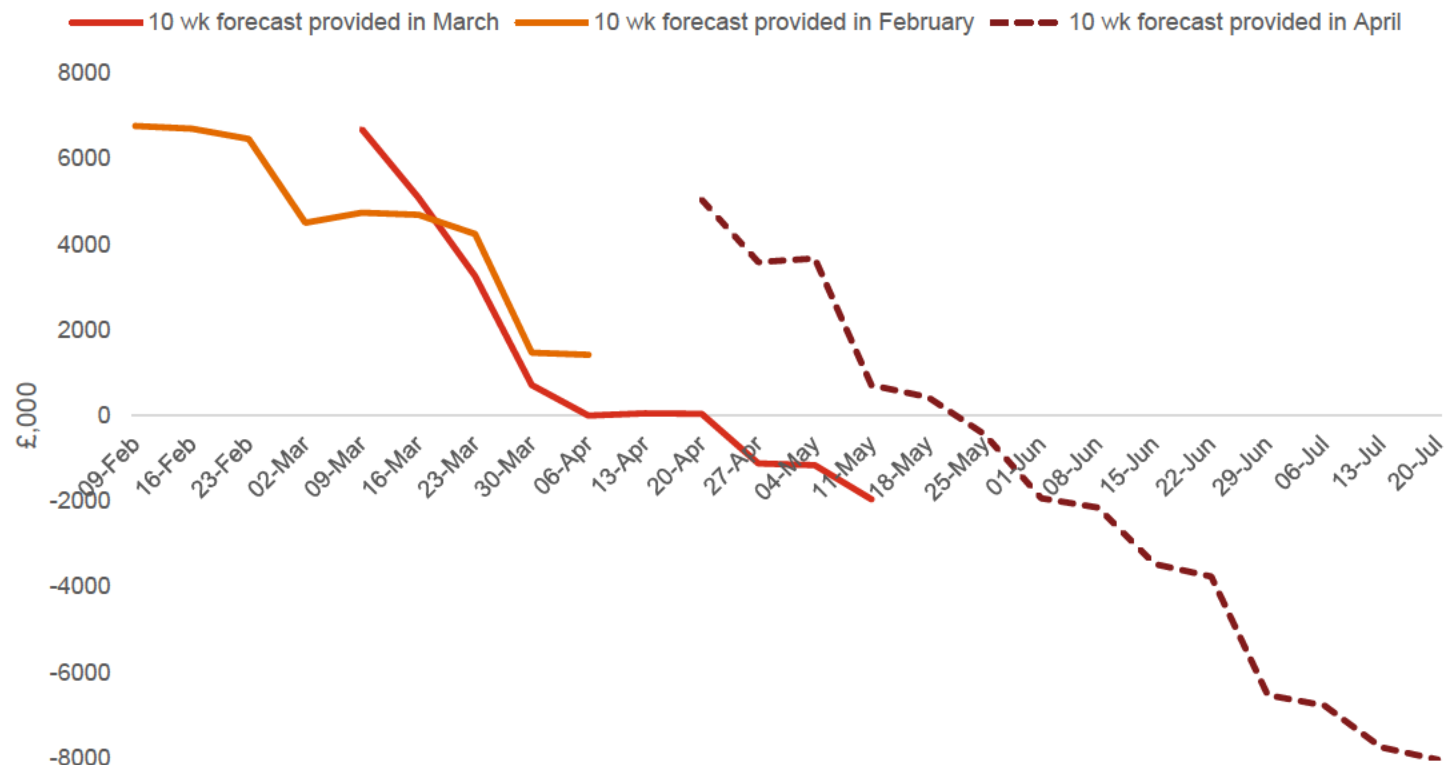
Milestone	Amount (£000)	Original milestone date*	Revised milestone date**	Received per cash flow
801 100% fabrication	1,200	Nov-17	Apr-18	Y (Apr-18)
801 Launch	4,850	N/A	Jun-19	N
802 75% fabrication	1,200	Oct-17	Apr-18	Y (Apr-18)
802 Hull inspection prior to paint	1,200	Nov-17	Mar-19	N
802 100% fabrication	1,200	Nov-17	Mar-19	N
802 Berth join up	1,200	Nov-17	May-19	N
802 major items	625	Oct-17	June-18	N
Total	11,475			

We have only been provided with actual YTD cash flow results for the Company and as such have limited scope to comment. We have asked management to provide further information in the future reporting packs, similar to previous months.

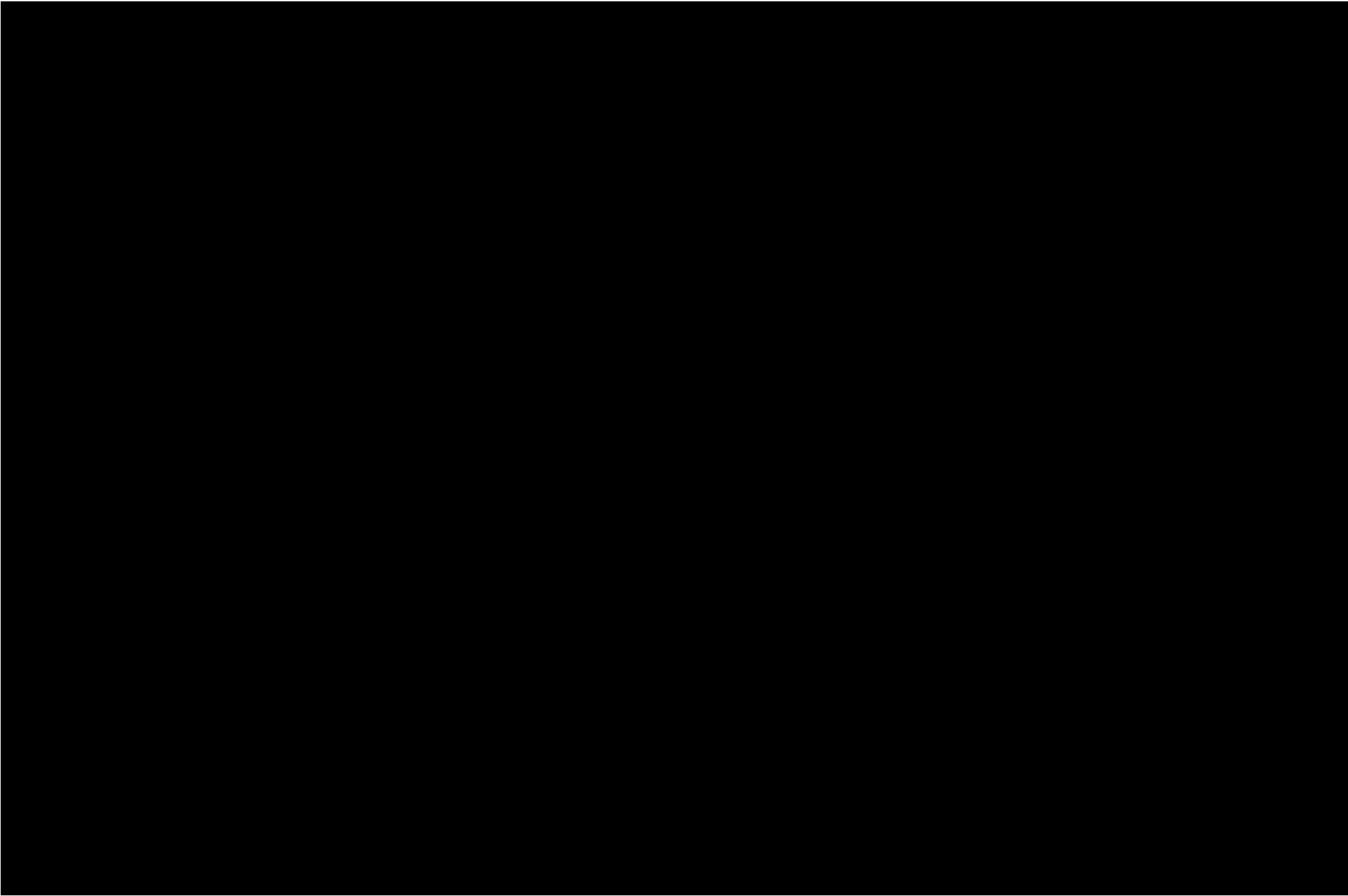
- 1. Movement in working capital** – £8.2m is made up of £0.5m trade receivables, £0.5m accruals/other creditors and £6.2m of net contract WIP. Management confirmed no costs were reclassified between fixed assets and WIP in the month.
- 2. Purchase of fixed assets** - We were not provided with a balance sheet for May 2018 so are unable to comment on whether all fixed assets purchased were capitalised.
- 3. Other** - £625k of 802 major items was forecast to be received in May 2018. This was delayed and subsequently received in June 2018.

Short term cash flow

The graph to the right compares the cash flow forecasts provided by management in February, March and April 2018.



Management provided a more recent short term cash flow forecast on 8 August 2018, comparing the forecast with and without the additional £30m loan funding provided by Scottish Government. Please see our June monitoring paper for our most recent commentary on this.



Appendix 1

The table opposite sets out the monitoring information that management is required to provide under the loan agreement for all months we have prepared a monitoring report.

Info. received	Sep-Nov 17	Dec-17	Jan-18	Feb-18	Mar-Apr-18	May-18
Personnel changes	Y	*	*	N	Y	Y
Profit & loss	Y	Y	Y	Y	Y	Y
Balance sheet	Y	Y	N	*	*	Y
Cash flow statement	Y	Y	N	N	Y	Y
P&L comparison v budget	Y	Y	Y	Y	Y	Y
BS comparison v budget	*	N	N	N	*	Y
CF comparison v budget	*	N	N	N	*	*
801/2 build report	Y	*	*	N	*	Y
801/2 cost over runs	N	*	*	N	*	Y
Permitted fees	Y	Y	N	N	Y	Y

* Please see the relevant monthly report for our comments on the differences between the information requested and the information received.