Advisory

Project Poseidon
Phase 2 - monitoring (October results)

Strictly Private and Confidential

18 December 2017

pwc

[redacted]

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 [date] (see Appendix 1).

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

PricewaterhouseCoopers LLP
141 Bothwell Street, Glasgow, G2 7EQ
T: +44 (0) 141 355 4000
F: +44 (0) 141 355 4005

Contents

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.

Information received	Sept	Oct	Nov
Personnel changes	Y	Y	
Profit & loss	Y	Y	
Balance sheet	Y	Y	
Cash flow	Y	Y	
P&L comparison v budget	Y	Y	
BS comparison v budget	Note 1		
CF comparison v budget	Note 2		
Commentary	Note 3		
801/2 build report	Y	Y	
801/2 cost over runs	Note 4		
Permitted fees	Y	Y	

The following were also noted in the September monitoring report:

Note 1 – the projections did not include a monthly balance sheet.

Note 2 – the reporting pack does not include a comparison against budget.

Note 3 – Management has provided some commentary but we believe that more detail could be provided.

Note 4 – No cost over runs have been noted.

Conclusion

The overall tone set by the reporting pack is similar to last month, with management remaining confident of current pipeline and the future of the business.

However, management has not flagged any additional costs despite further delays in the launch and delivery of both 801 and 802. Management acknowledges this is potentially inconsistent and is working on a revised build programme for both vessels to re-forecast the cost and resource requirements.

Despite the fact management remains confident of future work, these have yet to crystallise and new work wins continue to be behind target.

The information provided shows that a funding requirement is approaching in early February and hence planning for the solution should be addressed urgently.

Profit and loss account

The table opposite compares the actual profit and loss account for October 2017 to the forecast.

Profit & loss account: October 2017

£ in 000s	Note	Actual	Forecast	Movement
801/2 revenue	1	1,513	6,639	(5,126)
Other revenue	2	38	167	(129)
Gross margin	**3**	**(59)**	**81**	**(140)**
Selling, general and administrative	4	(174)	(184)	10
Addback depreciation		75	75	-
EBITDA		**(158)**	**(28)**	**(130)**
Exceptional items	5	(234)	(222)	(12)
Interest	6	(88)	-	(88)
Depreciation		(75)	(75)	-
Net profit		**(555)**	**(325)**	**(230)**

1. **Revenue** – management expects the actual to forecast variance to continue until the amended build plan in completed in January. Management continues to remain confident of the current pipeline, and continue to be actively looking for additional work, however there have been no new future orders.

[redacted]

3. **Gross margin** – management states a large part of the variance is due to an under recovery of production overheads as less have been incurred than forecast (£150k). Management is reviewing the build programme for 801 and 802 to re-forecast the resource requirements and an updated financial forecast reflecting this is to be provided in the coming weeks. The re-forecast requirements will help reduce the under recovery variance on production overheads in actual against forecast going forward.

4. **SGA costs** – SGA costs are £10k less than forecast as the amortisation of the SE grant was excluded from the forecast. There is no cash impact and we expect a variance each month going forward. The variance was £58k in the previous month and management has confirmed the previous month's figure was an adjustment for the prior 6 months.

[redacted]

6. **Interest** – this is the interest on the Scottish Government loan is in line with our interest estimate provided with our September monitoring report.

Medium term cash flow

The table opposite summarises the indirect cash flow of FMEL for October 2017 and management's reconciliation to forecast as at 31 October.

Cash flow: October 2017 £ in 000s	Note	Sep Actual	Oct Actual
EBITDA (excluding exceptionals)		(201)	(160)
Exceptionals [redacted]		[redacted]	[redacted]
Cash from trading		**(402)**	**(394)**
Movement in working capital	1	(5,092)	(25)
Operating cash flow		**(5,494)**	**(419)**
Purchase of fixed assets	2	(616)	(934)
New loans drawn	3	6,000	3,500
Increase/(decrease) in cash and cash equivalents		**(110)**	**2,147**
Opening balance		1,585	1,445
Closing balance		1,445	3,592

Management's reconciliation to forecast at 31 October £ in 000s	Sep	Oct
Closing balance noted above	1,445	3,592
Closing per forecast	(4,324)	(10,829)
Difference	5,769	14,421
Cash Collateral pushed out to launch	(5,200)	(5,200)
Milestones not achieved	(8,250)	(11,275)
SG loan	6,000	9,500
Capex not spent	1,284	1,554
Overdue AP	6,200	2,000
Spend pushed out	5,735	17,842
Difference	**-**	**-**

1. **Movement in working capital:** Management has not provided an analysis.

[redacted]

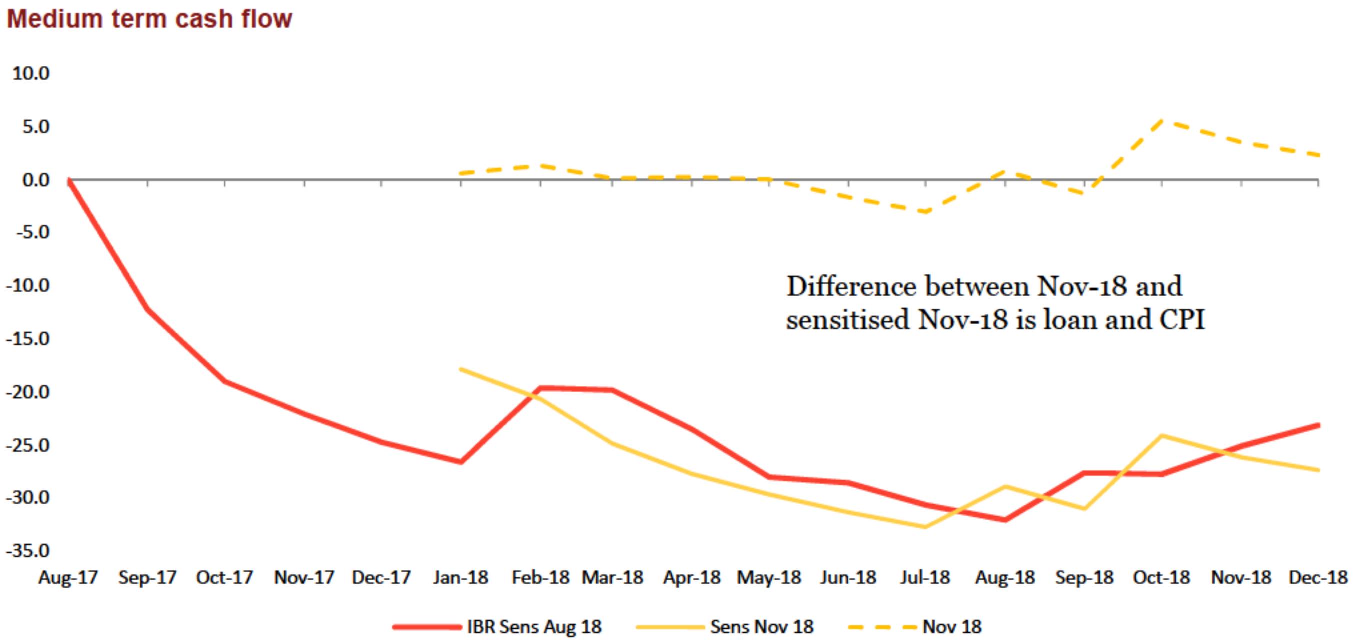
3. **New loans drawn:** £3.5m of the Scottish Government loan was drawn down in the month.

Summary of milestones not achieved

To August	Amount	Achieved in Nov
801 100% fabrication	£1,200k	No
801 Berth Join Up	£1,200k	Yes
801 Launch	£1,200k	Yes
Total Aug	**£3,600k**	
September		
801 CPIs	£1,725k	No
802 CPIs	£1,200k	No
802 CPIs	£1,725k	No
Total Sept	**£4,650k**	
October		
802 75% fabrication (Sep)	£1,200k	No
802 major items	£625k	No
802 100% fabrication	£1,200k	No
Total Oct	**£3,025k**	
Total	**11,275k**	

Medium term cash flow

The table opposite compares the medium term cash flow in the IBR to the medium term cash flow re-forecast in November.

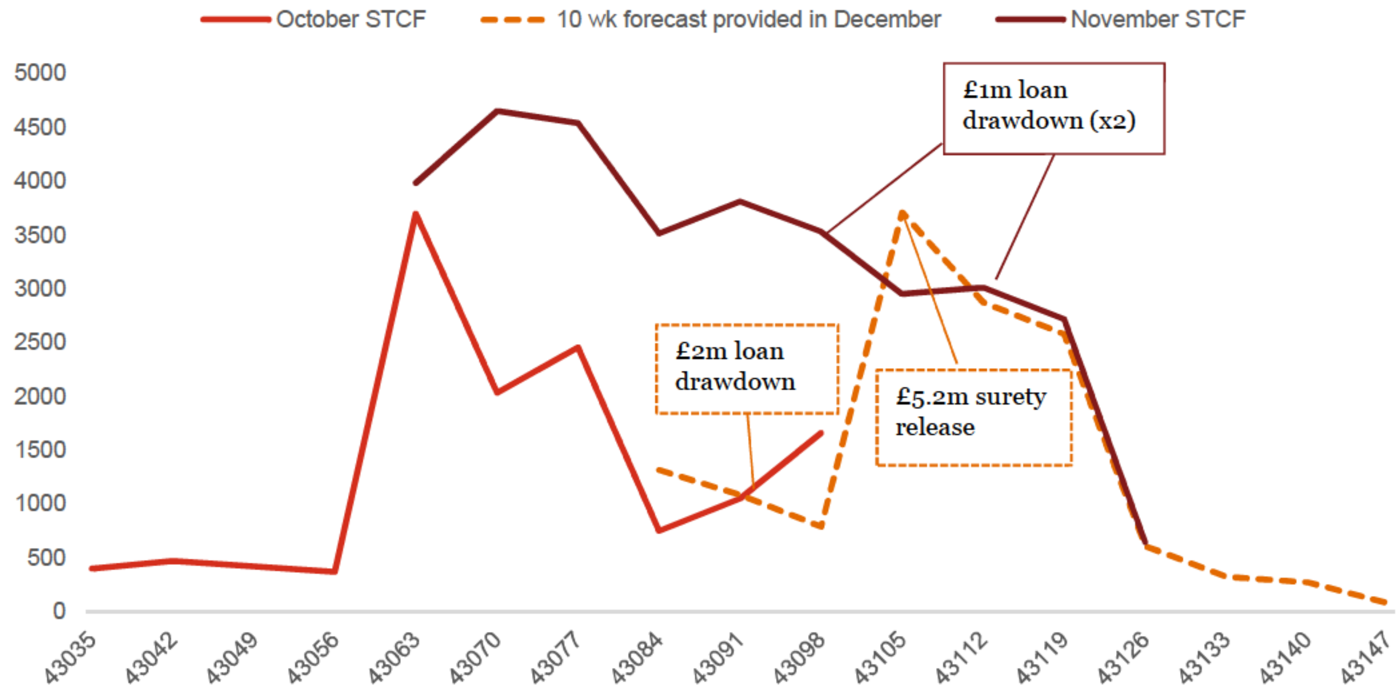


The sensitised November 2018 medium term cash flow ("MTCF") includes the loan provided by the Scottish Government (£15m fully drawn down) and includes contract price increases for the 802 vessel. Neither of these were originally forecast in the IBR or Nov-18 MTCFs.

It can be seen from the graph that without the SG loan, the Company would have been cash negative from August-17. Even with the loan, they are forecast to become cash negative in June-18 and it is therefore clear that further funding is required unless the Company secure future, significant, orders.

Short term cash flow

The graph opposite shows the 17 week cash flow forecast, the November STCF and the 10 week STCF and the 10 week forecast provided on 14 December.



[redacted]

The 10 week forecast includes a £2m loan drawdown in the week ending 22 December 2017. This was previously forecast to be taken in two £1m tranches per the November STCF. This drawdown was consolidated in the forecast to prevent any delay over the Christmas holidays.

The graphs do not show an increased requirement for future funding in the immediate term but the revised figures to be provided in January will show if there is any future funding need.

Additional comments

The table to the right compares the contract costs in September to October.

Vessel contract costs

	Sep Total £'000	Oct Total £'000
Total Contract Costs paid to date	77,240	79,250
Total costs to completion	34,468	32,458
Total Contract Costs	**111,708**	**111,708**
Paid to date	77,469	77,469
Payments to completion	20,531	20,531
CPIs	14,736	14,736
Total payments	**112,736**	**112,736**

Total contract costs incurred to 31 October 2017 have increase by £2m from 30 September 2017 but only £1.5m of revenue was recognised in October and management has noted that this is due to certain costs being held on the balance sheet pending release to the P&L

There are no other changes to the total payments and contract costs to complete.

Comment	Time frame
Liz Ditchburn and Jim McColl are meeting to discuss the plans of the business going forward and any potential future funding requirements	Pre Christmas, with the output of the meeting communicated to all parties in the New Year.
Management acknowledges that the vessel contract costs to complete will increase and is therefore re-forecasting the costs to complete	To be provided in early January, with an aim to providing the revised budget in full by the end of January 2018.