Advisory

Project Poseidon
Phase 2 - monitoring

Strictly Private
and Confidential
Draft

2 November 2017

pwc

[redacted]

[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 [ ].

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

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

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

Significant changes identified from the information provided that amend our view as set in our previous reports:

- None.

PwC comments

- [redacted]
- The SG loan of £15m has clearly reduced the funding gap. The residual funding gap of £17m, being £32m less £15m, is likely to increase, for example due to the interest on the SG loan.
- We remain of the view that FMEL will have a cash requirement in early 2018 beyond it's existing facilities. SG should request cash flow forecasts for that period to understand timing and quantum of any additional support that will be required. This can then be used to facilitate a discussion at the time of the next monitoring review at the end of November.
- There are no signs of significant creditor pressure.

Profit and loss account

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

Profit & loss account: September 2017

£ in 000s	Note	Actual	Forecast	Movement
801/2 revenue	1	945	9,102	(8,157)
Other revenue	2	-	167	(167)
Gross margin	**3**	**(148)**	**89**	**(237)**
Selling, general and administrative	4	(128)	(186)	58
Addback depreciation		75	75	-
EBITDA		**(201)**	**(22)**	**(179)**
Exceptional items	5	(201)	(214)	13
Interest	6	(59)	-	(59)
Depreciation		(75)	(75)	-
Net profit		**(536)**	**(311)**	**(225)**

1. **Revenue** is recognised based on costs incurred. Management states no materials have been recognised as added to 801/2 in September (forecast: £7.3m). Labour costs were £0.9m (forecast: £1.8m). Management attributes both variances to the delay in 801 launch. Management expects these variances will be reversed prior to the revised launch date of 21 November 2017.

[redacted]

3. **Gross margin:** The variance of £237k can be analysed:

- £166k – management recognises overhead costs on a standard cost model and, due to the delay of the 801 vessel, there was a under recovery of overheads.
- £43k – there has been an increase in hourly labour costs for the month due to fewer productive hours being booked due to the delay of 801 launch.
- £25k – this is the margin on the “other” revenue for the month.

The gross margin variance for September reverses the over recovery of overheads booked in the August management accounts.

4. **SGA costs** are £58k less than forecast as the amortisation of the SE grant was excluded from the forecast. There is no cash impact and we expect the same variance each month going forward.

[redacted]

6. **Interest:** This is the interest on the Scottish Government loan. We have provided our interest estimate to management for comment.

Medium term cash flow

The table opposite summarises the indirect cash flow of FMEL for September 2017.

Cash flow September 2017

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

Management cash flow reconciliation 30 September 2017

£ in 000s	
Closing balance noted above	1,445
Closing per forecast	(4,324)
Difference	5,769
Cash Collateral pushed out to launch	(5,200)
Milestones not achieved	(8,250)
SG loan	6,000
Capex not spent	1,284
Overdue AP	6,200
Spend pushed out	5,735
Difference	**-**

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

[redacted]

3. **New loans drawn:** £6m of the Scottish Government loan was drawn down on 6 September 2017.

Summary of milestones not achieved

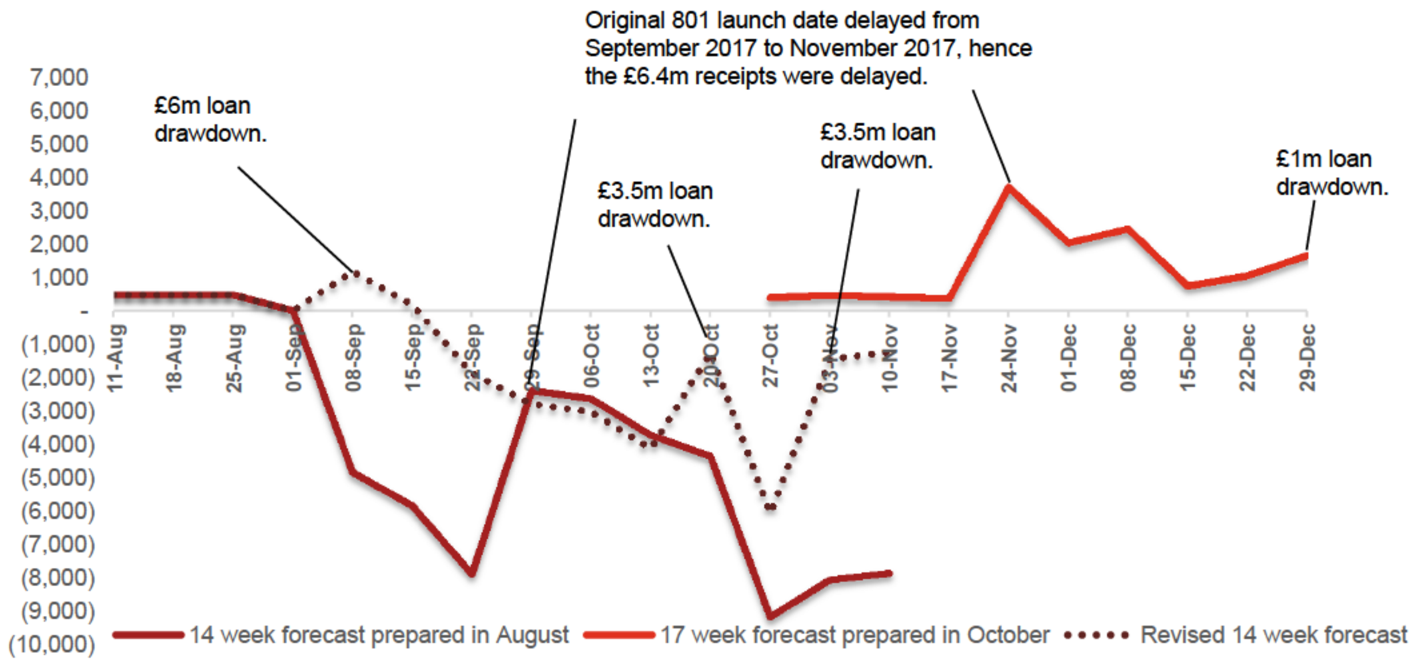
To August

801 100% fabrication	£1,200k
801 Berth Join Up	£1,200k
801 Launch	£1,200k
September	
801 CPIS	£1,725k
802 75% fabrication	£1,200k
802 CPIs	£1,725k

Short term cash flow

The graph opposite shows the original IBR 14 week cash flow forecast and the latest 17 week cash flow forecast.

We have included an additional line to compare the original 14 week cash flow amended for the missed launch payments and SG loans.



We do not have an actual cash balance for the period to date.

The latest cash flow forecast shows management is forecasting that FMEL will continue to have a positive cash balance to 29 December 2017.

It would be possible to reconcile the dotted line to the current forecast at any particular week, as demonstrated by management's reconciliation shown on the previous page. However such a task would require significant time from management and is likely to be a variation of the reconciliation provided as at 30 September 2017.

Additional comments

Pipeline

Management remains confident of the current pipeline, however, there are currently no new future orders. Management has a focus on Ministry of Defence contracts and is actively pursuing a number of leads. The Company has hired a new Head of Quality Control & Governance who is viewed as essential for the Company pitching for MoD opportunities.

Recruitment

The Company has three new staff joining in the coming weeks. All three are known to be vastly experienced and management are positive about the impact which they could make. The roles are:

- Head of Sales (to start Jan-18),
- Head of Production (to start 6 Nov-17) and
- Head of Quality Control & Governance (to start Jan-18).

[redacted]

[redacted]

[redacted]

Refund Guarantee

Management noted that SG had said any amendments would not be possible and so it had not considered this option further.

Other information requested by SG

A revised medium term cash flow forecast was not received.

Other information requested by PwC

We noted to management that we could not reconcile the forecasts stated in the management accounts to the forecast results in October but we have yet to receive an explanation.