

Advisory

Project Poseidon

Phase 2 - monitoring (March and April 2018 results)

*Strictly Private
and Confidential*

15 August 2018



**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	Feb-18	Mar-18	Apr-18
Personnel changes	N	Y	Y
Profit & loss	Y	Y	Y
Balance sheet	*	Note 1	Note 2
Cash flow statement	N	Y	Y
P&L comparison v budget	Y	Y	Y
BS comparison v budget	N	Note 3	
CF comparison v budget	N	Note 4	
801/2 build report	N	Note 5	Y
801/2 cost over runs	N	Note 5	Y
Permitted fees	N	Y	Y

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

Note 1 – We were not provided with a balance sheet at March as management had not yet implemented their new accounting system to provide this.

Note 2 – We have provided detailed commentary on the aged creditors listing on page 7 of this report.

Note 3 – The reporting pack does not include a monthly balance sheet.

Note 4 – The reporting pack does not include a comparison against budget.

Note 5 – Management did not note any cost over runs or a build report for March.

Conclusion

- This is the monitoring report for March and April 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 it's own planning work, FMEL was unable to provide the accounting information and respond to our monitoring queries within the required timescale.
- Please see our June reporting pack for the latest available commentary
- We have combined the March and April results into one pack following the incorporation of a new accounting system by management.
- The management reporting pack for April and for future months has returned to the full pack following this implementation.
- Given the length of time to receive a response from management on questions regarding the March and April information, the commentary around the cash position is out of date.
- The cash flow forecast FMEL to run out of cash in the week commencing 21 May. However, the £30m loan has prevented the Company from running out of cash.

Profit and loss account

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

Profit & loss account: March & April 2018

£ in millions	Note	Actual		Forecast		Movement	
		April	March	April	March	April	March
801/2 revenue	1	2.4	6.2	3.4	7.4	(1.0)	(1.2)
Other revenue	2	0.3	-	0.4	-	(0.1)	-
Gross margin	3	(0.2)	(0.1)	(0.1)	-	(0.1)	(0.1)
Selling, general and administrative costs		(0.2)	(0.2)	(0.2)	(0.2)	-	-
Addback depreciation		0.1	0.1	0.1	0.1	-	-
EBITDA		(0.3)	(0.2)	(0.2)	(0.1)	(0.1)	(0.1)
Exceptional items	4	(0.1)	(0.1)	(0.1)	(0.1)	-	-
Interest	5	(0.2)	(0.2)	(0.2)	(0.2)	-	-
Depreciation		(0.1)	(0.1)	(0.1)	(0.1)	-	-
Net profit		(0.7)	(0.6)	(0.6)	(0.5)	(0.1)	(0.1)

3. Gross margin – Management states adverse weather in both months resulted in less productive man hours than forecast. Additionally, cash constraints has reduced the planned manpower, which we expect to have a knock on effect on the delivery of 801/2. Management has not provided details on this potential impact.

5. Interest – This is in line with our expectations for interest due on the Scottish Government loan.

Short term cash flow

The table opposite summarises the indirect cash flow of FMEL for April 2018 and compares the balances to the budget model provided by management in February 2018.

No cash flow was provided for March 2018.

Cash flow April 2018

£ in 000s	Note	Actual	Budget model (Base case, provided Feb-18)	Difference
EBITDA (excluding exceptionals)		(1,092)	(216)	(876)
Exceptionals				
Cash from trading		(1,442)	(292)	(1,150)
Movement in working capital	1	(6,744)	2,596	(9,340)
Operating cash flow		(8,186)	2,304	(10,490)
Purchase of fixed assets	2	(354)	(167)	(187)
Release from Escrow (held by Sureties)	3	10,492	-	10,492
New loans drawn		-	-	-
Increase/(decrease) in cash and cash equivalents		1,952	2,137	(185)
Opening balance		2,931	2,349	582
Closing balance		4,883	4,486	397

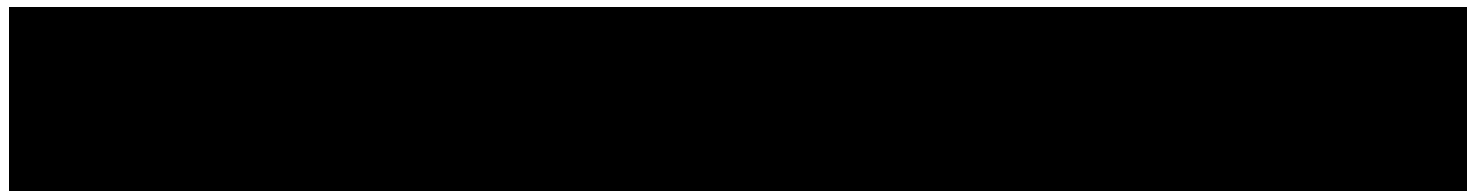
It is clear there are some significant differences in various line items in the cash flow between actual and budget for April 2018, however, the actual opening and closing cash balances are closely aligned to forecast. The early release of Escrow funds of £10.4m was the contributing factor to this which alleviated significant cash flow problems for the business.

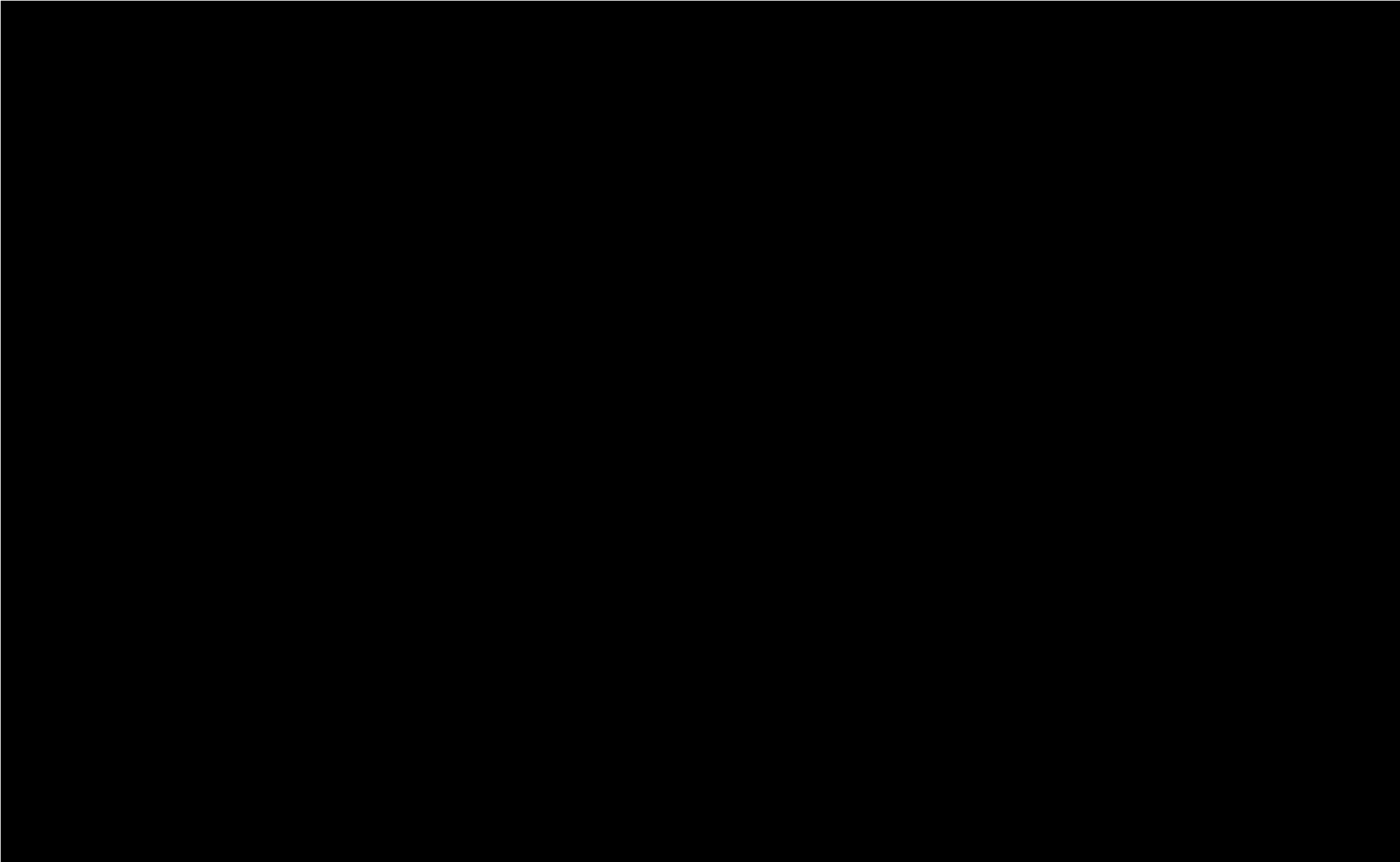
1. Movement in working capital

£6.7m is made up of £0.3m trade receivables, £2.4m accruals/other creditors and £4.0m of net contract WIP. Management confirmed no costs were reclassified between fixed assets and WIP in the month. Management states the significant net contract WIP balance is due to costs incurred not yet being expensed through the P/L. Page 7 of this report provides further commentary on the trade creditors balance.

2. Purchase of fixed assets

We were not provided with a balance sheet for March 2018 so are unable to comment on whether all fixed assets purchased were capitalised.



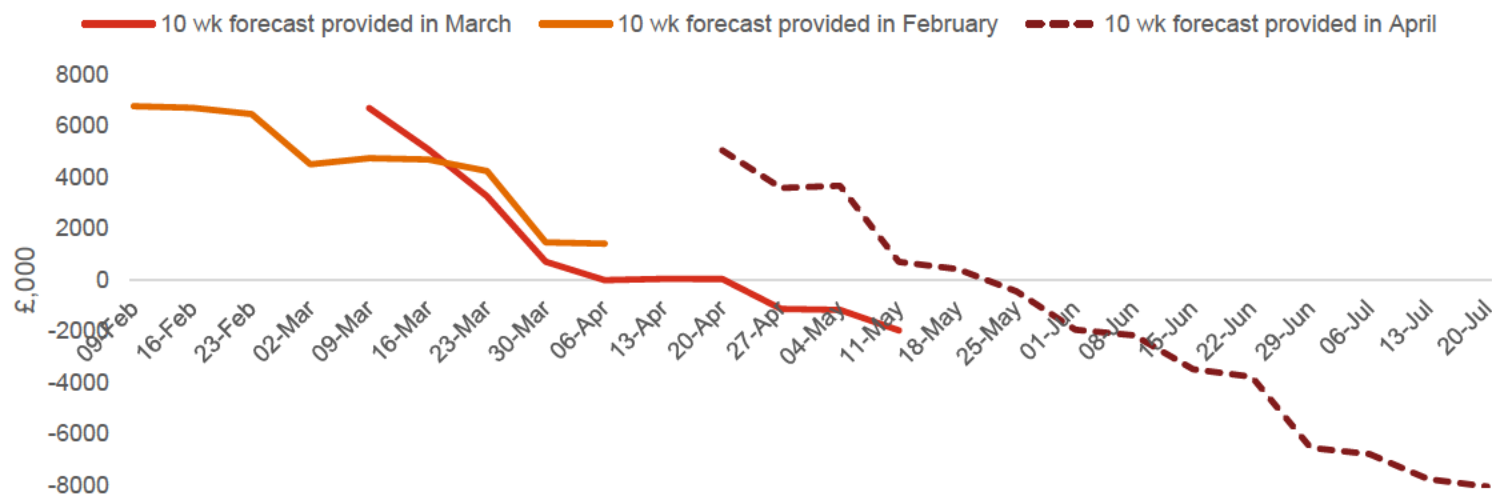


Short/Medium term cash flow

FMEL forecast to run out of cash in the week ending 21 May 2018.

The cash position was critical at the time the financial information was received.

Given the length of time for management to provide answers to queries on the financial information, the position is no longer critical due to the £30m funding provided by Scottish Government.



Management did not renew the contracts of c.100 sub-contractors at the end of April and have continued to manage supplier payments by only making the critical payments required to sustain the business in the short term. They have forecast to have run out of cash and we expect them to now be running in a net deficit position. The cash position was critical at the time the financial information was provided by management.

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	N
802 75% fabrication	1,200	Oct-17	Apr-18	N
802 Hull inspection prior to paint	1,200	Nov-17	Oct-18	N
802 Berth join up	1,200	Nov-17	Oct-18	N
802 major items	625	Oct-17	May-18	Y (June-18)
Total	5,425			

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

** Revised milestone date – are based on FMEL's updated two year projection provided in February 2018.

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
Personnel changes	Y	*	*	N	Y
Profit & loss	Y	Y	Y	Y	Y
Balance sheet	Y	Y	N	*	*
Cash flow statement	Y	Y	N	N	Y
P&L comparison v budget	Y	Y	Y	Y	Y
BS comparison v budget	*	N	N	N	*
CF comparison v budget	*	N	N	N	*
801/2 build report	Y	*	*	N	*
801/2 cost over runs	N	*	*	N	*
Permitted fees	Y	Y	N	N	Y

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