

Advisory

Project Poseidon

Phase 2 - monitoring (January results)

*Strictly Private
and Confidential*

16 March 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

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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.

Information received	Sep – Nov 2017	Dec	Jan
Personnel changes	Y	Note 1	
Profit & loss	Y	Y	Y
Balance sheet	Y	Y	N
Cash flow	Y	Y	N
P&L comparison v budget	Y	Y	Y
BS comparison v budget		Note 2	
CF comparison v budget		Note 3	
801/2 build report	Y	Note 4	
801/2 cost over runs	N	Note 5	
Permitted fees	Y	Y	N

member monitoring report, a [REDACTED], started in February 2018 a contributing factor to a significant increase in tender opportunities. No further personnel changes were noted for the month.

Note 2 – The projections did not include a monthly balance sheet.

Note 3 – The reporting pack does not include a comparison against budget.

Note 4 – The updated build report is factored in to this report, with the January results compared against the revised forecast which will be the benchmark for results going forward.

Note 5 - Management did not note any cost over runs for the month.

Conclusion

The information and forecasts provided are based on the updated build forecast provided by management in January 2018.

The forecasts indicate that FMEL will run out of cash in April 2018. When we met with management on 7 March 2018 they were clear that they are seriously considering their directors responsibilities given the cash position. The directors stated they want to have visibility on the solution by the end of March. FMELs only solution appears to be through agreement of CPIs, which appears challenging given our understanding of CMALs view.

There is a funding requirement that increases in the course of the year to c.£30m.

We understand FMEL has instructed and received a report that supports its case for CPIs. We have requested a copy of the report but FMEL has responded saying it will liaise directly with SG on this point.

We appreciate that conversations are ongoing for Scottish Government to take active steps to protect their position as CBC has not put forward a deliverable funding solution.

The cash position is critical again. We recommend urgent SG interaction with FMEL and other stakeholders to avoid an uncontrolled insolvency.

Profit and loss account

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

Profit & loss account: January 2018

<u>£ in o00s</u>	<u>Note</u>	<u>Actual</u>	<u>Forecast</u>	<u>Movement</u>
801/2 revenue	1	1,717	1,797	(80)
Other revenue	2	-	-	-
Gross margin	3	(264)	(217)	(47)
Selling, general and administrative		(193)	(196)	3
Addback depreciation		84	84	-
EBITDA		(373)	(329)	(44)
Exceptional items	4	(78)	(76)	(2)
Interest	5	(197)	(197)	-
Depreciation		(84)	(84)	-
Net profit		(732)	(686)	(46)

The updated build report provided by management is used as the revised forecast and will be the benchmark for results going forward.

- Revenue** – As expected, actual revenue is closer to forecast now the updated build report is incorporated in to the results. The £80k variance is broken as under recovery of labour (£38k), under recovery of production overhead (£14k) and a change in time of spend on materials (£25k).

[REDACTED]

[REDACTED]

- [REDACTED]

- [REDACTED]

- [REDACTED]

[REDACTED]

Management now expects revenue to be recognised in April 2018.

- Gross margin** – External labour was used in the month to cover staff absences, resulting in an increased labour cost of £20k in the month.

[REDACTED]

[REDACTED]

[REDACTED]

- Interest** – £197k of interest was accrued on the fully drawn down Scottish Government loan. This is in line with our expectations.

Medium term cash flow

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

We have not been provided with actual results.

Cash flow January 2018

£ in 000s	Note	Budget
EBITDA (excluding exceptionals)		(329)
Exceptionals		
Cash from trading		(404)
Movement in working capital	2	(2,054)
Operating cash flow		(2,458)
Purchase of fixed assets	3	(167)
Cash collateral release	4	10,900
Increase/(decrease) in cash and cash equivalents		8,275
Opening balance		3,344
Closing balance		11,619

2. Movement in working capital – the budget cash flow for the month expects an outflow of working capital of £2,054k. We have not been provided with a breakdown of this, but examples of why working capital will result in such an outflow include further 801/2 costs having been incurred and not expensed or from more creditors being paid than incurred.

3. Purchase of fixed assets - We do not have an analysis of the fixed asset expenditure in the month.

As per our December monitoring, we asked management to explain the reconciliation of the tangible fixed assets balance on the balance sheet to what we would have expected following the reclassification of WIP to fixed assets. Management believes this exercise may not be necessary but it will investigate options.

4. Cash collateral release – Management forecast to receive the £10.9m escrow funds in January, however, these funds were received in February 2018.

Summary of milestones not achieved

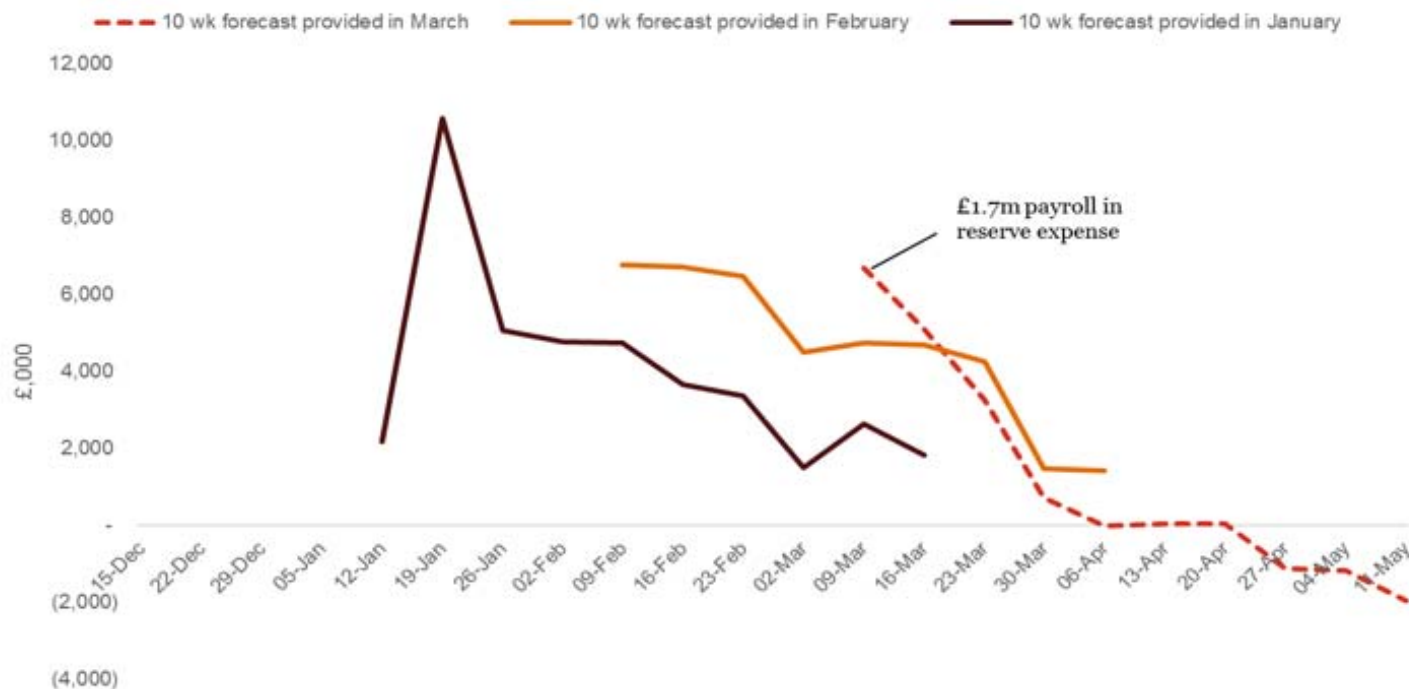
Milestone	Amount (£000)	Original milestone date*	Revised milestone date**
801 100% fabrication	1,200	Nov-17	Apr-18
802 75% fabrication	1,200	Oct-17	Apr-18
802 Hull inspection prior to paint	1,200	Nov-17	Oct-18
802 Berth join up	1,200	Nov-17	Oct-18
802 major items	625	Oct-17	May-18
Total	5,425		

* 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.

Short term cash flow

The graph opposite compares the 10 week cash flow forecasts provided by FMEL in January 2018, February 2018 and March 2018.



The latest 10 week cash flow forecast shows management is forecasting that FMEL will have no cash in the week ending 6 April 2018.

