Àrd-stiùiriche na h-Eaconomaidh
Director-General Economy
Liz Ditchburn

Scottish Government
Riaghaltas na h-Alba
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[redacted]

Gerry Marshall
Ferguson Marine Engineering Limited
By e-mail

2 August 2019

Dear Sirs

Ferguson Marine Engineering Limited ("FMEL") and Ferguson Marine Engineering (Holdings) Limited ("FMEHL") (together the "Group")

I refer to your letter of the afternoon of 1 August 2019.

As you are aware, I have written to you regularly and last wrote to you on 31 July 2019 setting out our latest position. I undertook to update you on 2 August 2019. I believe that we have been active in our correspondence especially in the context where there are many stakeholders involved in this situation and it is necessary to progress matters on several fronts. It is unfortunate that the media has also been briefed erroneously. This has contributed additional unhelpful commentary on the position which is not constructive and undermines our efforts to focus on saving the business through a solvent solution.

As we have previously stated, we recognise the difficult position you are in as directors, and we are earnestly investing a great deal of effort and resources to achieve a rescue. We note your comments on potential wrongful trading risk and the Enforcement Notice from HCCI which I address further below.

Diligence

Thank you for your cooperation here. We completed our brief diligence work in a restricted timescale and ahead of the date we set out. This exercise has assisted us with our strategy as, despite not being able to obtain all the information we would expect, including the lack of medium and longer term cash flow forecasts, we were able to gain insight into the financial position, particularly the liabilities.

Secured creditors

CBC suggested in a letter to me on 12 July 2019 that we repay their remaining loan in FMEHL in order that we (Scottish Ministers) may "implement the desired strategy for the

business without any restrictions". Subject to receiving guarantees to the contrary from CBC, we must read this as a veiled threat of disruption should we provide and implement a solvent solution which does not involve a repayment of their £3m loan in full.

[redacted]

You again refer to your concern that our approach is the reason that HCCI has taken action. HCCI have confirmed to us at a meeting of 30 July 2019 that this is not the case. HCCI's position as first ranking secured creditor clearly has a bearing on any solution, be it solvent or otherwise, and I'm sure that your advisors will have explained this to you. The solution involving them is however not an absolute requirement of us deploying a solvent solution.

CBC continue to put forward their proposal which has not changed as far as we are aware despite reports to the contrary circulating. We have now confirmed on several occasions that we will not be taking it forward unless there is a significant positive change in the offer. From a commercial perspective any CBC solution needs them to contribute a material sum of cash into the business to be commercially credible.

Clarity on the financial position of the business

In all circumstances we believe it is important that there is clarity on the financial position of the business.

Within your letter of 1 August you state that we have not responded to your correspondence. As I mentioned above, I believe we have been responding to you in the timescales as the circumstances allowed. In this regard however, I would like to draw your attention again to our correspondence of 9 July. As far as I am aware you are yet to respond. That letter clearly sets out a request that you confirm whether FMEL is insolvent (unable to pay its debts as they fall due) or otherwise explain.

Financial position of FMEL

Because of your lack of response previously and the claims made by your ultimate shareholder, we must again seek clarity on the position of whether the company is able to pay its debts as they fall due without further support from Scottish Government.

Cash flow - FMEL has provided a short term cash flow forecast (STCFF) set out at Appendix A that shows total cash of £4.6m across the Group, £0.4m being in FMEHL. FMEL has excluded £1.0m of Group funds from its cash flow on the basis that these funds relate to other contractual commitments.

The total net cash balance is forecast to reduce from £3.6m as at 9 July 2019 to £0.3m at 6 October 2019. We are not aware of any further funds outside of those reflected in the STCFF that will be received to increase this balance.

During this period, to our best understanding, there is no provision for payments to at least some [redacted] as at 30 June 2019. [redacted] but no explanation has been given for non-payment of the other balances that were payable by 28

July 2019, as set out in Appendix B. The total sums due by FMEL as at 28 July 2019 amount to £1.23m.

Balance sheet - FMEL has provided a balance sheet set out at Appendix C that shows total net liabilities of £53.6m. We note this is based on a contract loss of £51.3m (assuming FMEL completes 801 and 802) but also note that CBC has provided information (CBC email of 28 June 2019) stating that the contract loss may be in excess of £100m.

We also note that FMEL may not be in a position to complete the current 801 or 802 contracts in the event that CMAL terminates the 801 contract prior to expiry of the refund guarantee. In this event, whilst the refund guarantee with HCCI may mitigate the sums payable to CMAL, HCCI would step into the shoes of CMAL and therefore their full £82.5m would still be payable by FMEL to HCCI/CMAL as appropriate. It is our understanding that FMEL does not (and would not) have the funds to pay this prospective/contingent liability.

We also understand that the balance sheet does not include disputed contingent claims from suppliers, [redacted]

Payment of Debts Currently Due

As highlighted in the meeting of 8 July 2019 and within our unanswered letter of 9 July 2019, representatives of your board have stated that "in the absence of additional funding by Scottish Government, the Group would be technically insolvent."

Based on all of the above, it is our conclusion that (without further support from the Scottish Ministers) FMEL is insolvent and unable to pay its debts as they fall.

We are willing to consider any robust evidence from FMEL that supports an alternative conclusion to the above but, without such evidence being made available to us by 12 noon on 5 August 2019, we will have no alternative but to conclude that without Scottish Ministers' support FMEL is indeed insolvent and unable to pay its debts as they fall due in terms of section 123 of the Insolvency Act 1986.

With such a confirmation and the support of all relevant stakeholders, we may wish to proceed to execute our option to acquire the share capital of the group for £1. Should we decide to execute this option it would fulfil your request for a solvent solution for the company.

Alternative Solution

In the absence of such confirmation and support, we have considered in great depth the situation as it presents itself and summarise the position as follows:

1. During our diligence process FMEL provided a cash flow forecast that shows it will not have sufficient liquidity to make payments to even essential creditors beyond 6 October 2019
2. CBC have refused to meet their contractual requirement to invest in the business
3. CBC have refused to invest to fund losses on the 801/2 contract despite their confidence in their position regarding the dispute with CMAL
4. We have obtained an independent view on the dispute [redacted]

5. Our diligence work identified liabilities in excess of those disclosed in the accounts of FMEL
6. The performance bonds are due to expire on 31 August 2019 and this may require CMAL to cancel the contracts significantly in advance of this to realise value
7. HCCI have notified their intention to take enforcement action
8. We have already provided commercial loans totaling £45m to the business

[redacted]

10. The proposal set out by CBC cannot be delivered in a lawful manner.

Taking the above matters into consideration, and absent constructive discussion between all secured creditors to reach common ground, we are unable to confirm unconditionally to you, or indeed satisfy ourselves, that executing a solution that maintains FMEL's solvency can be justified at present as significant uncertainty and risk remains. We reiterate, this is despite our willingness and best efforts.

We believe that we continue to be able to offer a solution to allow the business, if not the company, to be able to trade, including satisfying valid trade credit balances, but we are not willing or able to allow material leakage to shareholders who were fully aware of the investment risks they were taking and have not fulfilled their investment obligations.

In our role as secured creditor, we are prepared to continue discussions with you, other secured creditors and key stakeholders to establish if there is a way to rescue the business and possibly even the company with a view to preserving jobs, completing the vessels in the yard and finding the best solution for the wider stakeholder group.

We are willing and able to meet with you and your advisors to discuss the best way to resolve this situation whilst liming the impact on the yard and its employees. I look forward to hearing from you.

Yours faithfully

[redacted]

LIZ DITCHBURN

Appendix A

Summary as at 9th July 2019								
Account	Euro	Investment	Sterling	Hyseas III	Payroll	Holding	Total £K	
Bank Balance £K	1	1	2,337	1,030	230	428	4,636	Per Bank Account
Hyseas III net of cash owed to FMEL				-903				
Holding net of cash owed to FMEL						-155		
Net cash sitting in major projects :								
803 - Net Position			-343					
804 - Net Position			-349					
805 - Net Position			532					
Overheads			736					
Net Position [illegible]			41					
Balance in Banks Accounts not belonging to Proj	1	1	2,337	127	230	273	3,578	

Week Beginning	08/07/2019	15/07/2019	22/07/2019	29/07/2019	05/08/2019	12/08/2019	19/08/2019	26/08/2019	02/09/2019	09/09/2019	16/09/2019	23/09/2019	30/09/2019
Opening Available Cash	3,578	3,463	3,437	2,742	3,022	3,081	2,966	2,541	1,826	1,711	1,596	1,171	456
VAT Repayments				320									
Payroll (Net Pay)			-600					-600				-600	
Payroll (Taxes / Pension etc)		-301					-310				-310		
Matchtec (Sub Contractors)	-40	-40	-40	-40	-40	-40	-40	-40	-40	-40	-40	-40	-40
Accounts Payable													
Procurement													
Outstanding Invoices on Debtors Ledger :													
Linkspan 2				75									
803		390			174								
804													
Others			20										
Overheads (Rent / Rates / Utilities CDC Fees etc)	-75	-75	-75	-75	-75	-75	-75	-75	-75	-75	-75	-75	-75
Ending Cash	3,463	3,437	2,742	3,022	3,081	2,966	2,541	1,826	1,711	1,596	1,171	456	341
	08/07/2019	15/07/2019	22/07/2019	29/07/2019	05/08/2019	12/08/2019	19/08/2019	26/08/2019	02/09/2019	09/09/2019	16/09/2019	23/09/2019	30/09/2019
803/4/5 / Payroll Contribution		100	250				100	250			100	250	
Cumulative	0	100	350	350	350	350	450	700	700	700	800	1,050	1,050
Accounts Payable at 9th July 2019	2,008,985.22												
Wartsila	421,362.98												

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Appendix C

Ferguson Marine Engineering Limited	
Jun-19	
Balance Sheet	
	Actual Jun-19 £m
Intangible Assets	0.2
Tangible Fixed Assets	5.2
Total Non-Current Assets	**5.4**
Inventory	0.0
Trade Accounts Receivable (net of provisio	0.6
Contract WIP : Contract WIP - POC	13.1
Deferred Revenue	(14.5)
Other WIP	0.9
Prepayments and Other Debtors	1.7
Trade Accounts Payable	(2.9)
Accruals & Other Creditors	(14.5)
Net Working Capital	**(15.6)**
Total Net Assets (before funding i	**(10.2)**
Funding and Debt	
Cash and Cash Equivalents	4.6
Scottish Government Loans	(52.5)
Cash Collateral	4.5
Total Net Debt	**(43.4)**
Total Net Assets	**(53.6)**
Capital and Reserves	
Share Capital	2.2
Share Premium	19.8
Hedge Reserve	0.0
Retained Losses	(75.6)
Total Net Equity	**(53.6)**

Yours faithfully

[redacted]

LIZ DITCHBURN