

## Philly Shipyard ASA (OSE: PHLIY) Q3 2019 and First Nine Months 2019 Results

29 October 2019

### Key Events

- ✓ On 2 July 2019, Philly Shipyard was awarded a contract to perform modernization, repair and maintenance work on the FSS *Antares*, a government cargo ship
- ✓ Third quarter and first nine months 2019 operating revenues and other income of USD 3.7 million and USD 22.7 million, respectively, compared to USD 26.5 million and USD 109.8 million in the same periods in 2018
- ✓ Third quarter and first nine months 2019 EBITDA of negative USD 7.4 million and negative USD 12.3 million, respectively, compared to negative USD 28.9 million and negative USD 30.1 million in the same periods in 2018
- ✓ Third quarter and first nine months 2019 net losses of USD 9.0 million and USD 15.2 million, respectively, compared to net losses of USD 30.8 million and USD 36.4 million in the same periods in 2018
- ✓ Total cash and cash equivalents of USD 50.8 million at 30 September 2019, excluding USD 69.3 million of restricted cash

### Subsequent Events

- ✓ On 3 October 2019, Philly Shipyard was awarded a contract to perform modernization, repair and maintenance work on the FSS *Pollux*, a sister-ship to the FSS *Antares*

### Operations

Following the delivery of the second containership to Matson (Hull 030) on 28 March 2019, there has been no further shipbuilding activity at the shipyard. However, since late July 2019, there has been maintenance and repair activity related to the contract for drydocking of the FSS *Antares*, a government cargo ship. Maintenance and repair activity will continue into 2020 as a result of the award of a second contract for drydocking of the FSS *Pollux*, a sister-ship of the FSS *Antares*. Both vessels are owned by the U.S. Department of Transportation's Maritime Administration (MARAD) and managed by TOTE Services, LLC (TOTE Services).

These recent awards by TOTE Services, as ship manager, have allowed Philly Shipyard to begin the recall of some of its laid-off workers to support the drydocking contracts. Additionally, Philly Shipyard continues to maintain a core group of employees to focus on efforts to secure new orders and transition the shipyard into a mix of commercial and government work. As of the end of Q3 2019, there were approximately 230 direct and contract employees working at the shipyard.

#### **Health, Safety, Security and Environment (HSSE)**

Philly Shipyard's 12-month trailing average for its Lost Time Incident Frequency Rate (LTIFR), based on lost time incidents (as defined by the Occupational Safety and Health Administration (OSHA)) per 200,000 hours, at the end of Q3 2019 was 0.34 compared to 0.13 at the end of Q3 2018. The last lost-time incident occurred in Q4 2018. There have been no lost-time incidents in 2019 year-to-date. Philly Shipyard's 12-month trailing average for its other Recordable Incident Frequency Rate, based on recordable incidents (other than lost time incidents) per 200,000 hours, at the end of Q3 2019 was 2.04 compared to 3.61 at the end of Q3 2018.

Philly Shipyard continues to proactively approach safety no differently than before delivery of the second containership to Matson (Hull 030). Philly Shipyard is working to improve several key safety processes in anticipation of workers returning to the shipyard, which includes an overhaul to its training programs and policies intended to improve overall worker safety.

## Financial Information

### *Third Quarter 2019 Results*

Operating revenues and other income for the third quarter of 2019 were USD 3.7 million compared to operating revenues and other income of USD 26.5 million for the third quarter of 2018. In Q3 2019, there were no shipbuilding activities but there was ship maintenance and repair work on the FSS *Antares* whereas in Q3 2018 operating revenues and other income were driven mainly by the continued progress on the two Matson vessels (Hulls 029-030).

EBITDA, defined as earnings before interest, taxes, depreciation and amortization, is considered a relevant earnings indicator for Philly Shipyard as it measures the operational performance of the shipyard.

EBITDA for the third quarter of 2019 was negative USD 7.4 million compared to EBITDA of negative USD 28.9 million in the third quarter of 2018. EBITDA for Q3 2019 was driven primarily by (a) under-recovered overhead costs (i.e., overhead expenses incurred and not allocated to projects) while awaiting the next ship award, (b) SG&A costs, and (c) a forecasted loss on the first ship repair and maintenance project, FSS *Antares*, as the shipyard adjusts to a new line of business. EBITDA for Q3 2018 was driven primarily by (a) an impairment charge of USD 17.3 million due to the write-off of the full amount of the work-in-process assets pertaining to a pair of containerships (Hulls 031-032) upon the cancellation of the project to build those vessels, (b) an additional loss of USD 7.3 million incurred and recognized on the Matson project, and (c) under-recovered overhead costs (i.e., overhead expenses incurred and not allocated to projects) while awaiting the next ship award.

Net loss for Q3 2019 was USD 9.0 million compared to net loss of USD 30.8 million for Q3 2018. The net loss for Q3 2019 was driven primarily by (a) EBITDA loss of USD 7.4 million, (b) depreciation in the amount of USD 1.8 million, and (c) the positive impact of 0.2 million for net financial items. The net loss for Q3 2018 was driven by (a) EBITDA loss of USD 28.9 million, (b) depreciation in the amount of USD 2.0 million, and (c) net financial items and tax benefit of USD 0.1 million.

### *Year-to-Date 2019 Results*

Operating revenues and other income in the first nine months of 2019 ended at USD 22.7 million compared to operating revenues and other income of USD 109.8 million in the first nine months of 2018. September 2019 year-to-date operating revenues and other income were primarily driven by the remaining progress on the second Matson vessel (Hull 030) and ship maintenance and repair work on the FSS *Antares* whereas September 2018 year-to-date operating revenues and other income were primarily driven by the continued progress on the two Matson vessels (Hulls 029-030). Operating revenues and other income in the first nine months of 2018 were also partially impacted by the implementation of the new International Financial Reporting Standards (IFRS) 15 standard (IFRS 15) leading to a reduction in both accumulated revenue and cost of USD 38.4 million in Q1 2018 and recognition of these amounts as an opening equity adjustment at IFRS 15 implementation date of 1 January 2018.

EBITDA for the first nine months of 2019 was negative USD 12.3 million compared to EBITDA of negative USD 30.1 million in the same period of 2018. Based on the successful recovery and receipt of certain amounts from its suppliers for the cancelled CV3700 project, approximately USD 2.2 million of previously incurred cancellation costs that were written-off and charged as impairment costs in 2018 were reversed in Q2 2019.

Net loss for the first nine months of 2019 was USD 15.2 million compared to net loss of USD 36.4 million in the same period of 2018.

### *Statement of Financial Position*

Total assets were USD 166.8 million at 30 September 2019 compared to USD 190.0 million at 31 December 2018.

Total interest-bearing debt was USD 59.8 million at 30 September 2019 compared to USD 59.6 million at 31 December 2018. The Welcome Fund loan, which matures in March 2020, was reclassified from non-current debt to current debt in Q1 2019.

Cash and cash equivalents (excluding restricted cash) were USD 50.8 million at 30 September 2019 compared to USD 49.6 million at 31 December 2018. The increase of USD 1.2 million was primarily due to the liquidation of the equity-accounted investments in Philly Tankers of USD 44.6 million mostly offset by (1) operational spending and (2) a net increase of USD 24.7 million of restricted cash consisting of (a) USD 20.2 million deposited into a collateral account to secure the Welcome Fund loan, (b) USD 4.4 million deposited into escrow accounts established as holdbacks for guarantees, deficiencies and disputed items for Hull 030, (c) USD 0.7 million of interest income earned on the restricted cash, and (d) USD 0.6 million released from escrow accounts

established as holdbacks for guarantees, deficiencies and disputed items for Hulls 029 and 030. Of the USD 20.2 million deposited into a collateral account to secure the Welcome Fund loan, USD 13.1 million was required by the Welcome Fund lender in connection with the liquidation of Philly Tankers. The remaining USD 7.1 million was made by Philly Shipyard to defease and fully cash collateralize the Welcome Fund loan in exchange for the release of substantially all loan covenants, including all financial covenants. The Matson restricted cash deposits were required by Matson as holdbacks in connection with the deliveries of Hulls 029 and 030.

Restricted cash as of 30 September 2019 amounted to USD 69.3 million, of which USD 60.6 million is related to the collateral account securing the Welcome Fund loan, USD 4.3 million is related to holdbacks for guarantees, deficiencies and disputed items for Hull 029 and USD 4.4 million is related to similar holdbacks for Hull 030. The restricted cash amount for the Welcome Fund loan is expected to be used for repayment of the Welcome Fund loan at its maturity in March 2020. The restricted cash amounts for the holdbacks are expected to be released within the next 12 months. Accordingly, the entire restricted cash amount was reclassified from a non-current asset to a current asset in Q1 2019. For further details on the Welcome Fund loan, see note 8.

Right-of-use assets in the amount of USD 13.4 million at 30 September 2019 represents the net book value of the assets that Philly Shipyard's landlord, Philadelphia Shipyard Development Corporation (PSDC), purchased from Philly Shipyard in 2011. These assets were reclassified from property, plant and equipment to right-of-use assets per the new IFRS 16 lease standard (IFRS 16), which took effect 1 January 2019. For further details on IFRS 16, see note 4.

Total equity decreased to USD 96.3 million at 30 September 2019 from USD 111.5 million at 31 December 2018 due to the net loss of USD 15.2 million.

### ***Financing***

The Company has a secured five-year term loan for up to USD 60.0 million from PIDC Regional Center, LP XXXI through the Welcome Fund loan program. The loan matures in March 2020. The entire USD 60.0 million amount was drawn under this facility as of 30 September 2019. As of 30 September 2019, the loan was defeased and fully cash collateralized. Substantially all loan covenants, including all financial covenants, have been released.

### ***Shareholder Distributions***

The PHLY Board has decided to continue to suspend payment of dividends. The PHLY Board will revisit the Company's dividend policy and dividend plan when it has more clarity about the Company's new order situation and related capital requirements.

## **Outlook**

### ***Shipbuilding and Repair, Maintenance, Modernization and Conversion Work***

As of 30 September 2019, Philly Shipyard had no order backlog for ship newbuild programs. Philly Shipyard continues to pursue a mix of ship newbuild and repair opportunities in the commercial and government markets. Securing contracts to build new vessels is the key to unlocking Philly Shipyard's potential for sustained operations and profitability. Due to the under-recovery of overhead costs (i.e., overhead costs incurred and not allocated to projects), Philly Shipyard expects it will continue to incur losses in 2019, even if the shipyard receives orders to build new vessels.

In the near term, Philly Shipyard's main focus continues to be the pursuit of the opportunity to build National Security Multi-Mission Vessels (NSMV) for the U.S. Department of Transportation's Maritime Administration (MARAD). The NSMV program seeks to replace as many as five of the aging vessels that serve as training ships for the state maritime academies in the United States. The contract for the vessel construction manager (VCM) for the NSMV program was awarded to TOTE Services, LLC (TOTE Services) on 22 May 2019, National Maritime Day. Award of the construction contract to the successful shipyard is still anticipated within Q4 2019. The U.S. Congress has appropriated USD 600 million in funding for the first two vessels (i.e., NSMV 1 and NSMV 2). Additional funding of USD 300 million for a third vessel (i.e., NSMV 3) has been appropriated, but this is subject to final approval of the FY2020 budget by Congress. MARAD's objective is still to receive the lead vessel within Q4 2022.

In addition, Philly Shipyard is pursuing additional opportunities for new construction projects for U.S.-built vessels, mainly work for the medium-term and long-term horizons. Among other endeavors, Philly Shipyard is engaged in discussions across a broad array of prospects and bidding both commercial projects and government programs. Philly Shipyard is also exploring potential partnerships that can enhance its prospects to secure new work into the shipyard and create value for the Company and its shareholders.

Additionally, Philly Shipyard is aggressively pursuing several possibilities for short-term work to have some activity in the shipyard before a production start of a potential new shipbuilding project. In particular, Philly Shipyard is pursuing opportunities for steel work and repair, maintenance, modernization and conversion jobs to utilize idle capacity in its fabrication shops and dry-docks. In support of this, Philly Shipyard has submitted to the U.S. Navy a Master Ship Repair Agreement and is in the process of having its two drydocks certified to Naval Sea Systems Command (NAVSEA) requirements.

On 2 July 2019, Philly Shipyard was awarded its first repair and maintenance contract for the FSS *Antares*, a large MARAD vessel that is managed by TOTE Services. The vessel arrived at the end of July with the repair and maintenance effort expected to last into December. On 3 October 2019, Philly Shipyard was awarded its second repair and maintenance contract for the FSS *Pollux*, another large MARAD vessel that is managed by TOTE Services. Work on the FSS *Pollux* is planned to commence after completion of work on the FSS *Antares*, and is expected to last approximately three months.

Philly Shipyard's objective remains to secure a mix of government and commercial newbuild contracts, while also winning repair and maintenance contracts that allow the yard to continuously utilize its drydocks. Philly Shipyard's strategy and outlook for combining government and commercial work remains unchanged since the 2018 annual report.

Philly Shipyard continues its work on the industry studies for the Common Hull Auxiliary Multi-Mission Platform (CHAMP) program. On 29 May 2019, Philly Shipyard was one of four shipyards awarded a prime contract to conduct industry studies for the CHAMP program. Philly Shipyard is teaming with Vard Marine to conduct these studies for the U.S. Navy. The CHAMP program is a multi-phase effort that involves design studies, preliminary design, and detail design and construction (DD&C) to ultimately recapitalize the Military Sealift Command (MSC) fleet of aging ships. The demand for the CHAMP program could approach 60+ vessels. The CHAMP vessels are not combatants, and are more commercially oriented, which fits the structure of Philly Shipyard's facility. It is anticipated the shipyards will ultimately compete for the DD&C contract, with award in 2023 and acquisition occurring over the next decade.

### **Shipping**

Since the liquidation of Philly Tankers was completed in Q1 2019, Philly Shipyard has no shipping assets. Going forward, in line with its business strategy, Philly Shipyard will continue to evaluate opportunities to participate in the post-delivery economics of the commercial ships that it constructs.

### **Risks**

Philly Shipyard's revenue is derived primarily from contracts awarded on a project-by-project basis. It is difficult to predict whether or when Philly Shipyard will be awarded a new contract due to, among other things, the complex bidding and selection processes, potential for contract award protests and challenges, changes in existing or forecast market conditions, governmental regulations and uncertainty regarding the timing of budget appropriations. Because Philly Shipyard's revenue is derived from contract awards, the Company's revenues, results of operations and cash flows can fluctuate materially from period to period.

At this time, Philly Shipyard has no order backlog for ship newbuild programs. Philly Shipyard faces significant risks if it is unable to secure new orders and/or financing for major commercial or government shipbuilding programs such as the NSMV program. There can be no assurance that Philly Shipyard will obtain new orders or financing for vessels. Furthermore, even if Philly Shipyard obtains new orders or financing for vessels, it will not fully cover the estimated under-recovered overhead costs (i.e., overhead costs incurred and not allocated to projects) in its 2019 forecast.

The delay Philly Shipyard has experienced in securing new orders and financing has interrupted its building program, resulting in the idling of all production activities in its facility except for those associated with ship drydock and repair efforts, and a decrease of more than 80% of its workforce (including direct employees and subcontracted personnel) since the beginning of 2018. If this delay continues, then it will further interrupt Philly Shipyard's building program and increase the costs and risks faced by Philly Shipyard, including challenges related to attracting and retaining skilled workers and increases in under-recovered overhead costs (i.e., overhead costs incurred and not allocated to projects).

The longer the delay in securing new orders continues, the more expensive and challenging it becomes for Philly Shipyard to win new orders and resume shipbuilding operations. In particular, the extended gap in production activities increases the risk that the Company is unable to mobilize the shipyard's workforce and retain and raise sufficient capital to support future shipbuilding projects. Moreover, under these circumstances,

there is a risk that the going concern assumption will no longer apply for Philly Shipyard and, as such, Philly Shipyard would need to do an impairment charge against its fixed assets. A going concern qualification would make it very challenging to secure new orders and/or financing. For further details regarding the going concern assumption, see note 2 below.

Philly Shipyard depends on unionized labor for construction of vessels. Work stoppages or other labor disturbances could have a material adverse effect on the Company's business, results of operations and financial condition. In order to mitigate this risk, Philly Shipyard has signed a four-year collective bargaining agreement with the Unions which is effective through January 2023. The collective bargaining agreement includes a no-strike clause.

Philly Shipyard's success also depends to a great degree on the abilities of its key management personnel, particularly its executives and other key employees who have significant experience within Philly Shipyard's industry. The loss of the services of one or more of these individuals could adversely affect Philly Shipyard.

Philly Shipyard further depends upon a 99-year lease agreement for the shipyard facility and the future operations of the yard will accordingly be dependent upon Philly Shipyard fulfilling its obligations under this lease agreement. Failure to maintain certain employment levels may result in early termination of this lease. For more details regarding this lease, see note 14.

The Shipyard is dependent upon having access to construction financing facilities and other loans and debt facilities to the extent its own cash flow from operations and milestone payments from customers are insufficient to fund its operations and capital expenditures. In turn, the Shipyard must secure and maintain sufficient equity capital to support debt facilities. Additionally, the Shipyard may be required to obtain bonding capacity in case there is need for payment or performance bonds, or to furnish letters of credit, refund guarantees or other forms of security, to support major commercial or government shipbuilding programs such as the NSMV program. Philly Shipyard may not be able to obtain sufficient debt facilities or bonding capacity or furnish sufficient security if and when needed with favorable terms, if at all.

In 2019, there has been increased activity to obtain waivers under the Jones Act and legislation to repeal the Jones Act has been proposed. The Company is closely monitoring the situation.

Philly Shipyard's operations historically focused primarily on construction of new vessels for the U.S. Jones Act market. Philly Shipyard is continuing to develop and implement the policies and procedures required to be a fully compliant U.S. Government contractor. Philly Shipyard is aggressively pursuing U.S. Government opportunities for future ship design and construction programs, as well as vessel maintenance, modernization, conversion and repair projects. Entry into, or further development of, lines of business in which the Company has not historically operated may expose Philly Shipyard to business and operational risks that are different from those it has experienced historically.

Philly Shipyard has entered the ship drydocking and repair market. Philly Shipyard is continuing to adjust its estimating and planning methods and operating processes in order to be cost competitive and profitable in this market segment. The lessons it learns from the first ship drydock and repair contract should result in improved performance on the second and any subsequent ship drydock and repair contracts. However, there is risk that Philly Shipyard will face additional challenges as it bids on and performs maintenance and repair work on the future ships.

For a further analysis of risks, please refer to the Company's 2018 annual report.

**CONDENSED CONSOLIDATED INCOME STATEMENT**

Amounts in USD millions (except number of shares and earnings per share)	Q3		9 Months Ended 30 Sept.		Full Year 2018 *
	Unaudited 2019	2018	Unaudited 2019	2018	
Operating revenues and other income	3.7	26.5	22.7	109.8	129.2
Operating expenses	(11.1)	(55.4)	(35.0)	(139.9)	(145.0)
<b>Operating loss before depreciation - EBITDA</b>	<b>(7.4)</b>	<b>(28.9)</b>	<b>(12.3)</b>	<b>(30.1)</b>	<b>(15.8)</b>
Depreciation	(1.8)	(2.0)	(5.3)	(5.9)	(7.8)
Reversal of impairment of assets/(impairment of assets)	-	-	2.2	-	(17.6)
<b>Operating loss - EBIT</b>	<b>(9.2)</b>	<b>(30.9)</b>	<b>(15.4)</b>	<b>(36.0)</b>	<b>(41.2)</b>
Net financial items	0.2	(0.1)	0.2	(0.5)	(0.6)
<b>Loss before tax</b>	<b>(9.0)</b>	<b>(31.0)</b>	<b>(15.2)</b>	<b>(36.5)</b>	<b>(41.8)</b>
Tax benefit/(expense)	-	0.2	-	0.1	(2.3)
<b>Loss after tax **</b>	<b>(9.0)</b>	<b>(30.8)</b>	<b>(15.2)</b>	<b>(36.4)</b>	<b>(44.1)</b>
Weighted average number of shares	12,107,901	12,107,901	12,107,901	12,107,901	12,107,901
<b>Basic and diluted loss per share (USD)</b>	<b>(0.74)</b>	<b>(2.55)</b>	<b>(1.25)</b>	<b>(3.01)</b>	<b>(3.64)</b>

**CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME**

Amounts in USD millions	Q3		9 Months Ended 30 Sept.		Full Year 2018 *
	Unaudited 2019	2018	Unaudited 2019	2018	
Loss after tax	(9.0)	(30.8)	(15.2)	(36.4)	(44.1)
Other comprehensive income, net of income tax	-	-	-	-	-
<b>Total comprehensive loss for the period **</b>	<b>(9.0)</b>	<b>(30.8)</b>	<b>(15.2)</b>	<b>(36.4)</b>	<b>(44.1)</b>

**CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION**

Amounts in USD millions	Unaudited 30 Sept. 2019	31 Dec. 2018 *
<b>Assets</b>		
<b>Non-current assets</b>		
Property, plant and equipment	25.7	44.1
Right-of-use assets	13.4	-
Restricted cash	-	44.6
Equity-accounted investments	-	44.6
Other non-current assets	0.2	0.3
<b>Total non-current assets</b>	<b>39.3</b>	<b>133.6</b>
<b>Current assets</b>		
Cash and cash equivalents	50.8	49.6
Restricted cash	69.3	-
Income tax receivable	-	3.3
Other current assets	7.4	3.5
<b>Total current assets</b>	<b>127.5</b>	<b>56.4</b>
<b>Total assets</b>	<b>166.8</b>	<b>190.0</b>
<b>Equity and liabilities</b>		
<b>Total equity</b>	<b>96.3</b>	<b>111.5</b>
<b>Non-current liabilities</b>		
Deferred tax liability	1.5	1.5
Interest-bearing long-term debt	-	59.6
<b>Total non-current liabilities</b>	<b>1.5</b>	<b>61.1</b>
<b>Current liabilities</b>		
Interest-bearing short-term debt	59.8	-
Trade payables, accrued liabilities and provisions	8.6	16.0
Income tax payable	0.2	0.2
Customer advances, net	0.4	1.2
<b>Total current liabilities</b>	<b>69.0</b>	<b>17.4</b>
<b>Total liabilities</b>	<b>70.5</b>	<b>78.5</b>
<b>Total equity and liabilities</b>	<b>166.8</b>	<b>190.0</b>

\* Annual 2018 financial information is derived from audited financial statements.

\*\* All attributed to the equity holders of PHL.

**CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

Amounts in USD millions	9 Months Ended 30 Sept.	
	Unaudited	
	2019	2018
As of beginning of period	111.5	155.6
Total comprehensive loss for the period *	(15.2)	(36.4)
<b>As of end of period</b>	<b>96.3</b>	<b>119.2</b>

**CONDENSED CONSOLIDATED CASH FLOW STATEMENT**

Amounts in USD millions	9 Months Ended 30 Sept.	
	Unaudited	
	2019	2018
Net cash used in operating activities	(22.9)	(28.5)
Investment in property, plant and equipment	(0.3)	(1.8)
Dividend received from equity-accounted investments	44.6	2.2
Investment in equity-accounted investments	-	0.7
Net cash from investing activities	44.3	1.1
Portion of interest-bearing debt held in escrow	(20.2)	(26.3)
Repayment of capital lease	-	(0.2)
Net cash used in financing activities	(20.2)	(26.5)
<b>Net change in cash and cash equivalents</b>	<b>1.2</b>	<b>(53.9)</b>
Cash and cash equivalents at beginning of period	49.6	110.1
<b>Cash and cash equivalents at end of period</b>	<b>50.8</b>	<b>56.2</b>

\* All attributed to the equity holders of PHLI.

## Notes to the condensed interim consolidated financial statements for the 3rd quarter and year-to-date 2019

### 1. Introduction – Philly Shipyard ASA

Philly Shipyard ASA (PHLY) is a company domiciled in Norway. The condensed interim consolidated financial statements for the three-month and nine-month periods ended 30 September 2019 and 30 September 2018 are comprised of PHLY and its direct and indirect wholly-owned subsidiaries (collectively referred to herein as the Group), including Philly Shipyard, Inc. (PSI).

This interim report has not been subject to audit or review by independent auditors.

The audited consolidated financial statements of PHLY as of and for the year ended 31 December 2018, which include a detailed description of accounting policies and significant estimates, are available at [www.phillyshipyard.com](http://www.phillyshipyard.com).

### 2. Basis of preparation

These condensed interim consolidated financial statements reflect all adjustments, in the opinion of PHLY's management, that are necessary for a fair presentation of the results of operations for the period presented. Operating results for the three-month and year-to-date periods are not necessarily indicative of the results that may be expected for any subsequent quarter or year.

#### *The going concern assumption*

The interim consolidated financial statements have been prepared on a going concern basis which contemplates continuity of normal business activities and realization of assets and settlement of liabilities in the normal course of business. The ability of the entity to continue as a going concern is dependent upon continuing shipbuilding operations and securing a customer order. While the Group is actively working on securing new orders, there is inherent uncertainty and no assurance that the Group will successfully secure a customer order.

The following conditions indicate a material uncertainty that may cast a significant doubt on the Group's ability to continue as a going concern:

- The Group does not have contracted customer order backlog for ship newbuild programs. The delay Philly Shipyard has experienced in securing new orders and financing has interrupted its building program, resulting in the idling of all production activities in its facility other than ship maintenance and repair work and a decrease of more than 80% of its workforce (including direct employees and subcontracted personnel) since the beginning of 2018. If this delay continues, then it will further interrupt Philly Shipyard's building program and increase the costs and risks faced by Philly Shipyard, including challenges related to attracting and retaining skilled workers and increases in under-recovered overhead costs (i.e., overhead costs incurred and not allocated to projects).
- The longer the delay in securing new orders continues, the more expensive and challenging it becomes for Philly Shipyard to resume shipbuilding operations. In particular, the extended gap in production activities increases the risk that the Company is unable to mobilize the shipyard's workforce, and to retain and raise sufficient financing to support future shipbuilding projects.
- Pursuant to the Shipyard Lease between PSI and its landlord, Philadelphia Shipyard Development Corporation (PSDC), if PSI fails to maintain an average of at least 200 full-time employees at the shipyard for 90 consecutive days, then the lease term (i.e., a 99-year lease with 79 years remaining including options) is automatically converted to month-to-month and PSDC has the right to terminate the lease, subject to the right of PSI to complete work-in-process projects and a one-time, limited cure right which allows PSI to restore the lease to a five-year term under certain circumstances. Due to a forecasted breach of this condition caused by the gap in shipbuilding activity following the delivery of Hull 030, which breach would have occurred in Q1 2019, Philly Shipyard obtained a temporary conditional waiver of this minimum employment condition until 31 December 2019. If PSI obtains a new order during this waiver period, the waiver of the minimum employment condition will continue until PSI reaches the 200 full-time employee requirement.

The Group acknowledges the material uncertainty in being able to continue ordinary shipbuilding operations and secure new contracted customer backlog in order to comply with the shipyard lease minimum employment condition without obtaining additional waivers to continue operations beyond 31 December 2019. However, the Directors are confident that this is achievable through a combination of the following:

- Philly Shipyard's main focus is the pursuit of the opportunity to build National Security Multi-Mission Vessels (NSMV). The NSMV program seeks to replace as many as five of the U.S. state maritime academy training ships. The award of this shipyard contract is anticipated to be announced within Q4 2019 with a delivery of the first vessel targeted within Q4 2022. If PSI is successful in its bid for this NSMV program, the Group is dependent upon having access to construction financing facilities and other loans and debt facilities to the extent its own cash flow from operations and milestone payments from customers are insufficient to fund its operations and required capital expenditures. Additionally, the Shipyard may be required to obtain bonding capacity in case there is need for payment or performance bonds, or to furnish letters of credit, refund guarantees or other forms of security, to support this project. PSI may not be able to obtain sufficient debt facilities or bonding capacity or furnish sufficient security if and when needed with favorable terms, if at all.
- In addition, Philly Shipyard is aggressively pursuing several possibilities for short-term work to have some activity in the shipyard before a production start of a potential new shipbuilding project. In particular, Philly Shipyard is pursuing possibilities for steel work and repair, maintenance, modernization and conversion jobs to utilize idle capacity in its fabrication shops and dry-docks.
- In the event that Philly Shipyard is in breach of the shipyard lease condition to maintain an average of at least 200 full-time employees at the shipyard for 90 consecutive days, the Group has the intention to request an additional waiver beyond 31 December 2019; however, the success of obtaining this waiver from PSDC is uncertain.

Should the Group be unsuccessful in continuing ordinary shipbuilding operations and securing contracted customer backlog, or unsuccessful in complying with the shipyard lease minimum employment condition without obtaining additional waivers, there is a material uncertainty that exists that may cast significant doubt as to whether the Group will be able to continue as a going concern. In this scenario, the Group may elect to undergo an orderly liquidation process. Therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business at their stated net book values in the interim consolidated financial statements, resulting in the impairment of property, plant and equipment assets; termination payments relating to PSI's multi-employer union selected pension plan; and the potential acceleration of debt repayments.

Despite the material uncertainties above, the Board's assessment is that it is appropriate to apply the going concern assumption. The Board anticipates that the Group can continue its shipbuilding activities, and will have the financial resources to apply the going concern principle as the basis for the financial statements. The Board's assessment is unchanged from the Board's year-end 2018 assessment included in the 2018 annual report, with no material changes in the assumptions described therein.

### 3. Statement of compliance

These condensed interim consolidated financial statements have been prepared in accordance with IFRS as adopted by the European Union IAS 34 *Interim Financial Reporting* (IAS 34). They do not include all of the information required for full annual financial statements, and should be read in conjunction with the audited consolidated financial statements of PHLI as of and for the year ended 31 December 2018.

### 4. Significant accounting principles

The accounting policies applied by PHLI in these condensed interim consolidated financial statements are substantially the same as those applied by PHLI in its audited consolidated financial statements as of and for the year ended 31 December 2018, with the exception of implementation of the IFRS 16 lease standard described below.

#### **IFRS 16 Leases**

IFRS 16 *Leases* (effective from 1 January 2019). The IFRS 16 lease standard (IFRS 16) replaces IAS 17 *Leases* and the related interpretations. The new standard introduces a single, on-balance sheet lease accounting model for lessees, with optional exemptions for short-term leases and leases of low value items. A lessee recognizes a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

The Company has applied IFRS 16 initially on 1 January 2019, using the modified retrospective approach. Based on this, a potential cumulative effect of adopting IFRS 16 will be recognized as an adjustment to the opening balance of retained earnings as of 1 January 2019, with no restatement of comparative information. There has been no such adjustment of retained earnings as of 1 January 2019, following the implementation of IFRS 16.

As part of the 2011 Authorization Agreement, PSI's landlord, Philadelphia Shipyard Development Corporation (PSDC), purchased certain shipyard assets from PSI for a purchase price of USD 42.0 million with funds provided by the Commonwealth of Pennsylvania. PSI leases back those same assets from PSDC subject to the terms of its shipyard lease and the Authorization Agreement. For accounting purposes, the transaction was accounted for as a sale/leaseback, and no adjustments were made to the accounting value of the assets at closing.

The net book value of assets under financial leasing agreements recorded in the statement of financial position at 30 September 2019 amounts to USD 13.4 million. From 1 January 2019, the net book value of the assets PSDC purchased from PSI in 2011 has been reclassified from property, plant and equipment to right-of-use assets.

The operating leases are for facilities, vehicles and printing and copying equipment. These leases consist of smaller amounts for printers and copiers, and leases that are up to 12 months for a training facility and a vehicle. Based on this, and no material impact from these leases, no right-of-use asset or lease liability has been recorded when the new IFRS 16 lease standard became effective 1 January 2019.

The building lease for PSI's plate priming facility has been extended on a month-to-month basis. The base rent is USD 16 thousand per month. This amount is not included in the operating lease rentals recorded above. Due to the short term of the lease, on a month-to-month basis, no right-of-use asset or lease liability has been recorded as of 1 January 2019. This treatment will be revisited if the shipyard signs a contract or contracts that secures long-term activity.

PSI operates on land leased from PSDC under a 99-year lease with 79 years remaining including options. PSI has options to renew the lease for three consecutive periods of 20 years each and one final period of 19 years. At expiration of the first lease period in 2018, the lease was renewed for the first of the three 20-year option periods. PSI can acquire the land for USD 1 after the expiration of all renewal periods. Annual payments under the lease agreement include rent, taxes and operating expenses (operating expenses are subject to an annual revision based on PSDC's operating expenses). Lease payments for rent due under the finance lease are USD 1 per year.

The shipyard lease is treated as a government grant under IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* (IAS 20). On transition to IFRS 16, the shipyard has continued to use this policy to record the government grant under IAS 20 against the investment. This gives a USD 0 balance for the right-of-use assets and the lease liability at 1 January 2019, as the grant is deducted to arrive at the carrying amount of the right-of-use assets. For more details regarding the shipyard lease, see note 14.

## 5. Use of estimates

The preparation of condensed interim consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from these estimates.

The most significant judgments made by management in preparing these condensed interim consolidated financial statements in applying PHL's accounting policies, and the key sources of estimation uncertainty, are the same as those that are applied to the audited consolidated financial statements as of and for the year ended 31 December 2018 unless described elsewhere in this report.

The Company has estimated the recoverable amount using the value-in-use method determined by discounted future cash flows as per 31 December 2018. No impairment of property, plant and equipment balances was recorded in 2018. The key assumption applied in this assessment is dependent on the ability of the Company to successfully obtain shipbuilding contracts (at historically consistent margins) beyond the delivery of Hull 030, which was delivered in Q1 2019. Whilst the Company is actively working on securing new orders there can be no assurance that Philly Shipyard will successfully obtain new orders. Further details on determination of recoverable amounts and impairment testing can be found in note 8 of the 2018 annual report. In Q2 2019, the Company estimated the recoverable amount using the value-in use method determined by discounted future cash flows following the same model as per 31 December 2018. No impairment of property, plant and equipment balances was recorded in Q2. In Q3, the Company has made an assessment of the assumptions in the impairment model. Through the end of Q3 2019, no major changes have been identified. As there are no new indicators, an impairment test has not been prepared.

## 6. Tax estimates

Income tax expense is recognized in each interim period based on the best estimate of the expected annual income tax rates.

## 7. Share capital and equity

At 30 September 2019 and 30 September 2018, PHL Y had 12,107,901 ordinary shares (excluding 466,865 own shares) at a par value of NOK 10 per share. There were no share issuances or repurchases for the quarters and year-to-date periods ended 30 September 2019 and 30 September 2018. Accordingly, 12,107,901 ordinary shares was used in the calculation of earnings per share for the quarters and year-to-date periods ended 30 September 2019 and 30 September 2018.

## 8. Interest-bearing debt

The following shows changes in interest-bearing debt during 2019:

Amounts in USD millions	Non-current debt	Current debt	Total interest-bearing debt
<b>Balance 31 December 2018</b>	<b>59.6</b>	-	<b>59.6</b>
Repayment of debt	-	-	-
Reclass of debt	(59.6)	59.8	0.2
<b>Balance 30 September 2019</b>	<b>-</b>	<b>59.8</b>	<b>59.8</b>

PSI has a secured term loan of up to USD 60.0 million (USD 59.8 million on the statement of financial position which is the secured term loan amount net of unamortized loan fees) with PIDC Regional Center, LP XXXI, a partnership between CanAm Enterprises and the Philadelphia Industrial Development Corporation (PIDC). The loan has a fixed interest rate of 2.625% per annum through maturity. The loan has a five-year term and matures in March 2020. This loan was made through the Welcome Fund loan program, a source of low-cost capital generally available to commercial, retail, industrial and non-profit firms that create significant job growth and are located in or planning to locate to the City of Philadelphia. The loan was defeased in June 2019 and is secured by a first lien on USD 60.6 million of restricted cash to cover all remaining debt service, including repayment in full at maturity. Substantially all loan covenants, including all financial covenants, have been released in connection with the defeasance of the loan. USD 60.0 million is drawn under this term loan at 30 September 2019.

PSI had an unsecured three-year revolving credit facility for up to USD 10.0 million from TD Bank, N.A. The facility expired in Q2 2019. The loan accrued interest at 30-day LIBOR plus 2.50% per annum as defined in the credit agreement.

## 9. Related party transactions

Aker Capital AS, a wholly-owned subsidiary of Aker ASA, is the majority shareholder of PHL Y, owning 57.6% of its total outstanding shares as of 30 September 2019. In addition, Kristian Røkke, the Deputy Chairman of the Board of Directors of PHL Y, is a Board member of TRG Holding AS, which owns 66.7% of the total outstanding shares of Aker ASA as of 30 September 2019.

Philly Shipyard has service agreements with Aker ASA and certain of its affiliates which provide specified consulting, tax, financial and administrative services. All payables under these agreements are paid within the normal course of business. Philly Shipyard believes that related party transactions are made on terms equivalent to those that prevail in arm's length transactions.

Related administrative costs and financial statement amounts for the three-month period ending 30 September 2019 were USD 28 thousand (USD 30 thousand for the same period in 2018) and for the nine-month period ending 30 September 2019 were USD 88 thousand (USD 90 thousand for the same period in 2018).

PSI entered into an administrative services agreement with Philly Tankers LLC (PTLLC) whereby PSI supplied certain administrative services to PTLLC. As part of the liquidation of Philly Tankers, this administrative services agreement was assigned by PTLLC to Philly Tankers AS (PTAS) on 31 May 2018 and was terminated on 31 December 2018. Related revenues for the three-month period ending 30 September 2019 were USD 0 (USD 30 thousand for the same period in 2018) and for the nine-month period ending 30 September 2019 were USD 0 (USD 90 thousand for the same period in 2018).

## 10. Capitalized interest

Amounts in USD millions	Q3		9 Months Ended 30 Sept.	
	2019	2018	2019	2018
Interest expense	(0.4)	(0.5)	(1.2)	(1.4)
Interest capitalized on construction contracts	-	-	-	-
<b>Net interest expense</b>	<b>(0.4)</b>	<b>(0.5)</b>	<b>(1.2)</b>	<b>(1.4)</b>

## 11. Construction contracts

The order backlog for ship newbuild programs is USD 0 at 30 September 2019. Order backlog consists of future contract revenues and is subject to adjustment based on change orders as defined in the construction contracts.

Amounts in USD millions	Order backlog 30 Sept. 2019	Order intake 9 months to 30 Sept. 2019	Order backlog 31 Dec. 2018
	-	0.3	17.4

The loss recognized on long-term contracts (Hulls 029-030) as of 30 September 2019 is as follows:

Amounts in USD millions	Actual 30 Sept. 2019
Contract revenue recognized to date	408.8
Less: contract expenses recognized to date	(418.3)
<b>Loss recognized to date (Hulls 029-030)</b>	<b>(9.5)</b>

Typical variable consideration elements identified in the Company's contracts with customers include liquidated damages, performance guarantees and warranties. Under the Matson contract for Hulls 029-030, liquidated damages were considered variable consideration, whereas performance guarantees and warranties were not categorized as variable consideration.

Contract revenue and loss recognized to date includes revenue and loss for Hulls 029-030 since the contract for these vessels was accounted for using the principle-over-time revenue recognition method according to IFRS 15.

As of 30 September 2019, the Company had no more contracts in place. In Q1 2019, PSI delivered Hull 030, the second of two containerships that the Company was building for Matson. Philly Shipyard recognized contract revenues and expenses for the two-containership order from Matson as one project. As of 30 September 2019, the Matson project is 100% complete. The contract loss was provided for as of Q3 2019.

Customer milestone payments as of 30 September 2019 and 31 December 2018 totaled USD 0 and USD 391.8 million, respectively. Customer milestone payments from the customer are made at intervals that are intended to be cash neutral, and as such are not representative of a significant financing component present in the contract.

Customer advances, net as of 30 September 2019 and 31 December 2018 totaled USD 0.4 million and USD 1.2 million, respectively. Customer advances, net represents the difference between cash advances received from the customer and costs incurred for those vessels. For Q3 2019, the USD 0.4 million consists entirely of customer advances, net, received under contract for ship repair and maintenance.

As of 30 September 2019, PSI has non-cancellable purchase commitments for materials and equipment (unpaid liabilities) of approximately USD 2.2 million for the construction of various ships, primarily Hulls 029 and 030.

## 12. Operating revenues and other income

Amounts in USD millions	Q3		9 Months Ended 30 Sept.	
	2019	2018	2019	2018
Shipbuilding	-	27.4	19.0	110.5
Ship repair and maintenance	3.7	-	3.7	-
Loss in equity-accounted investments (Hulls 025-028)	-	(0.9)	-	(0.7)
<b>Operating revenues and other income</b>	<b>3.7</b>	<b>26.5</b>	<b>22.7</b>	<b>109.8</b>

No shipbuilding revenue was recognized in Q3 2019 as Hull 030, the last vessel under construction, was delivered in March 2019. Ship repair and maintenance revenue reflects the first drydocking contract, FSS *Antares*, which is scheduled for completion in December 2019. Loss in equity-accounted investments (Hulls 025-028) represents the Company's 53.7% share of the total comprehensive loss of Philly Tankers, which for the nine months ending 30 September 2019 and 30 September 2018 amounted to USD 0 and negative USD 0.7 million, respectively, as the liquidation of Philly Tankers was completed in Q1 2019.

## 13. Financial instruments

As of 30 September 2019, the Company had no forward exchange contracts or other financial instruments.

## 14. Commitments and contingencies

Pursuant to the shipyard lease between PSI and PSDC, if PSI fails to maintain an average of at least 200 full-time employees at the shipyard for 90 consecutive days, then the lease term (i.e., a 99-year lease with 79 years remaining including options) is automatically converted to month-to-month and PSDC has the right to terminate the lease, subject to the right of PSI to complete work-in-process projects and a one-time, limited cure right which allows PSI to restore the lease to a five-year term under certain circumstances. Due to a forecasted breach of this condition caused by the gap in shipbuilding activity following the delivery of the last vessel in its order backlog (Hull 030) in Q1 2019, Philly Shipyard has obtained a temporary conditional waiver of this minimum employment condition until 31 December 2019. If PSI obtains a new order during this waiver period that will result in a significant increase in employment at the shipyard, the waiver of the minimum employment condition will continue until PSI reaches the 200 full-time employee requirement.

## 15. Subsequent events

On 3 October 2019, Philly Shipyard was awarded a contract to perform modernization, repair and maintenance work on the FSS *Pollux*, a government cargo ship.

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