Philly Shipyard

2018 ANNUAL REPORT

Contents

In review

Performance 2018

Our organization and governance

Financial calendar 2019

2018 annual report	15 March
Annual general meeting	5 April
Interim report Q1 2019	6 May
Interim report Q2 2019	15 July
Interim report Q3 2019	29 October

Dates are subject to change.

Philly Shipyard is a leading U.S. shipbuilder that is presently pursuing a mix of commercial and government work. It possesses a state-of-the-art shipbuilding facility and has earned a reputation as a preferred provider of ocean-going merchant vessels with a track record of delivering quality ships, having delivered around 50% of all large ocean-going Jones Act commercial ships since 2000.

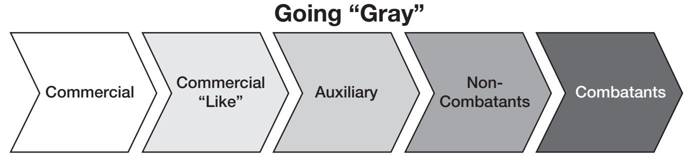
Philly Shipyard ASA is a holding company with headquarters in Oslo, Norway, and an operating subsidiary in Philadelphia, PA, USA.

Philly Shipyard ASA was listed on Oslo Axess in December 2007. Aker Capital AS, a wholly-owned subsidiary of Aker ASA, is the majority shareholder, holding 57.56% of the shares as of 31 December 2018.

Elements contributing to success:

- State-of-the-art shipyard with modern equipment
- Access to global shipbuilding and design expertise through agreements with partners in Asia and Europe
- A solid track record demonstrated by the delivery of 29 quality vessels (5 containerships, 22 product tankers and 2 aframax tankers) through 2018
- Skilled workforce consisting of direct and contracted employees with a strong HSE mindset and culture of improvement
- Opportunistic investment approach with respect to the post-delivery economics of the vessels that it builds
- Proven history of promoting new vessel owners

Going "Gray"



The U.S. Jones Act market

U.S. coastwise law, commonly referred to as the Jones Act, requires all commercial vessels transporting merchandise between ports in the United States to be built in the United States, owned, operated and manned by U.S. citizens and registered under the U.S. flag. The Jones Act market encompasses all water-borne transportation between U.S. ports, including between the mainland U.S. and non-contiguous areas of Alaska, Hawaii and Puerto Rico, as well as shuttle tankers in the Gulf of Mexico.

The U.S. Government market

The U.S. Government market for ship design, construction and repair work is expansive and cuts across multiple government agencies. Government customers include the U.S. Navy, the Military Sealift Command (MSC), the Maritime Administration (MARAD), the U.S. Coast Guard, the U.S. Army Corps of Engineers and others. The U.S. Navy's fleet of 285 ships is to increase to a goal of 355 ships over the next 30 years at an annual cost of USD 29 billion in 2018 dollars.

THE HISTORY

1997

Founded by public-private partnership between U.S. government agencies and the Kvaerner Shipbuilding Division

2000

Construction began on first two container vessels

2003 - 2006

Delivered four container vessels to Matson (Hulls 001-004)

2005: Aker American Shipping formed and publicly listed on Oslo Børs

2005: Initiated construction program of ten product tankers

2007 - 2011

Delivered 12 product tankers to AMSC and OSG (Hulls 005-016)

2007: Two additional product tankers ordered for conversion to shuttle tankers

2007: Aker American Shipping split into ship owning and shipbuilding companies and Aker Philadelphia Shipyard listed on Oslo Axess

2011: Signed contracts with SeaRiver Maritime for two aframax tankers

2012 - 2013

Delivered two product tankers to Crowley (Hulls 017-018)

2013: Signed contracts with Matson for two CV3600 container vessels

2013: Signed joint venture agreement with Crowley for four product tankers

2014 - 2016

Delivered two aframax tankers to SeaRiver Maritime (Hulls 019-020), four product tankers to Crowley (Hulls 021-024) and one product tanker to Kinder Morgan (Hull 025)

2014: Established Philly Tankers as pure-play Jones Act shipping company

2014-2015: Signed contracts with Philly Tankers for four product tankers

2015: Philly Tankers agreed to sell product tanker contracts to Kinder Morgan

2015: Signed agreement with Marathon Petroleum to sell Crowley joint venture interests

2015: Re-branded as Philly Shipyard

2017 - 2018

2017: Delivered three product tankers to Kinder Morgan (Hulls 026-028)

2018: Delivered first CV3600 container vessel to Matson (Hull 029)

2018 highlights

Hull 029 naming ceremony

Philly Shipyard celebrated its first containership built for Matson in over a decade. The christening ceremony for Hull 029, the *Daniel K. Inouye*, took place on 30 June with dignitaries from the Navy, MARAD and local government, along with representatives from Matson and Philly Shipyard.

Delivered first Matson vessel

On 31 October, Philly Shipyard delivered Hull 029, the *Daniel K. Inouye*, to Matson, the first CV3600 container vessel in the two-vessel series for Matson, and the largest containership ever built in the United States.

Investment highlights

1 A leading U.S. shipyard

- State-of-the-art facility with more than USD 650 million invested since founding
- Built around 50% of all large ocean-going Jones Act commercial ships since 2000
- Highly skilled workforce with integrated, fully flexible subcontracting. Union agreement extended to January 2023
- On track for delivery of last vessel despite challenging situation with reduction in workforce

2 Successful track record in vessel ownership

- 10 of the 29 vessels built since start-up with some ownership or participation by the shipyard
- All stakes in post-delivery economics of vessels have been successfully divested
- PSI benefits from being early mover and initiating projects before positive segment development is fully visible
- PSI is exploring potential partnerships that can create a stronger entity to secure new orders and create value

3 Combination of commercial and government work

- Opportunities within specialty and high-end segments of the Jones Act market
- Very promising outlook for high activity in the government sector next 5-10 years
- Philly Shipyard has already taken substantial steps to build up its government contracting resources and systems
- Seeking to secure near term steel fabrication, repair and dry docking work in 2019 and sign contract for newbuilding order

4 Prepared for period with lower activity

- Retain key personnel to be able to resume normal shipbuilding operations
- Solid cash position enables shipyard to manage through periods with low activity
- Strong balance sheet and low net debt reduce financial risk
- Take advantage of ability to give full focus and start on a new project immediately

Philly Shipyard recent deliveries and order backlog

Customer	Vessel	Delivery
Crowley	023 PT	15 Apr. 2016
Crowley	024 PT	12 Aug. 2016
Philly Tankers	025 PT	30 Nov. 2016
Philly Tankers	026 PT	29 Mar. 2017
Philly Tankers	027 PT	26 July 2017
Philly Tankers	028 PT	20 Nov. 2017
Matson	029 Containership	31 Oct. 2018
Matson	030 Containership	Q1 2019

Vessels built by Philly Shipyard from inception through today

5 **container vessels**

22 **product tankers**

2 **aframax tankers**

Vision: To be - and be recognized as - a leading shipyard in America that delivers on its commitments, every time.

Our CORE values

Philly Shipyard's CORE values were designed as a reflection of who we are, and who we aspire to be, as a shipyard, as an organization and as individuals.

They capture the pride, passion and commitment behind each action we take and decision we make. They are not words on a page, but our stand – a united commitment to conquer all challenges and build long lasting relationships. For years to come we will be united by these values, that give us the platform to deliver on our commitments, every time.

Caring

Working as family

We are a shipbuilding family, a unique group comprised of many backgrounds and ethnicities, teams and departments; but at the end of the day, we have a healthy respect and a natural need to protect each other.

One shipyard

Selfless for every customer

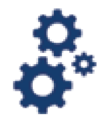
Customers are all around. From ship owner to process owner, we are all powerfully united to deliver. That means decisions are made in the best interest of the company, rather than oneself, or one team. We are strongest when we act together.

Responsible

Treat it like you own it

If you're responsible for it, you own it, so treat it like it's yours. This means taking the utmost care for tools and equipment, making decisions based on the impact to your bottom line, and simply doing the right thing. Success is in our hands.

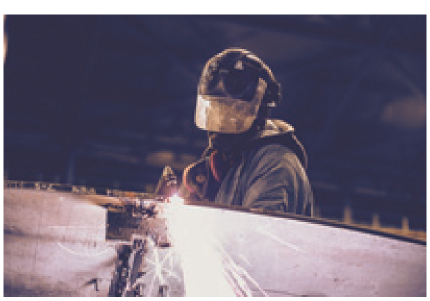
Efficient



Being better than yesterday

A healthy dissatisfaction for the status quo lives within us. It fuels the need to challenge ourselves, and each other, to find a better way. Being efficient keeps our costs down, while driving our competitive edge up.

Caring in action



At Philly Shipyard, the way in which we achieve growth and profitability is as important as the achievements themselves. Our overriding corporate responsibility is concern for the communities that we are a part of. We strive to provide products and services in a safe, environmentally sound, ethical and socially responsible manner.

More information regarding the Company's corporate social responsibility efforts can be found on pages 19-20 of the Board of Directors' report.

HSE 2018: A Year of Renewed Focus

Through collaborative efforts and continuous monitoring of best-in-class safety initiatives of the shipbuilding industry, Philly Shipyard strives to achieve zero incidents.

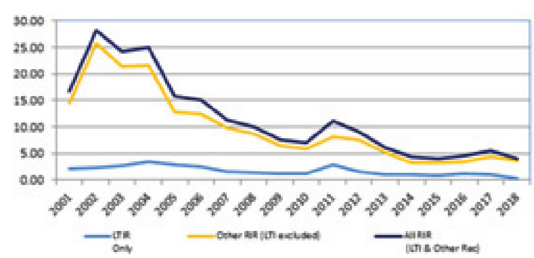
At Philly Shipyard, safety is personal and our credo is clear: We fundamentally believe that all incidents are preventable and safety is everyone's responsibility; and we promise to be relentless in our pursuit of an injury-free workforce by creating and maintaining safe working conditions and never compromising safety for anyone, anywhere, at any time.

2018 was a challenging year for safety at Philly Shipyard due to the significant reductions in workforce. It is critical our workers maintain their mental focus when they come to work each day, so keeping our workers engaged during difficult times was a primary concern.

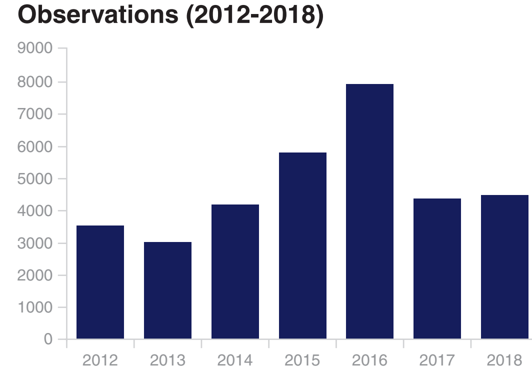
Entering 2018, we set high expectations for our safety goals, including reducing both our Lost Time Incident Frequency Rate (LTIFR) and our Other Recordable Incident Frequency Rate (ORIFR) from 2017. We achieved both of those goals. In 2018, we reduced our annual LTIFR from 0.98 to 0.23 per 200,000 hours and our annual ORIFR from 4.43 to 3.63 per 200,000 hours. In addition, Philly Shipyard set a company record of 294 consecutive days without a Lost Time Incident (LTI), shattering our prior high mark of 125 consecutive days without an LTI established 2013. As we look ahead, we foresee many opportunities to build upon the strong safety culture we are developing here at Philly Shipyard.

In addition to our strong focus on improving health and safety performance, Philly Shipyard takes its environmental responsibilities seriously, beginning with the vessel design. The industrial nature of our activities requires the use of significant amounts of energy, both electrical and gas, as well as the release of particulate and VOC emissions. Philly Shipyard will continue to address the environmental impact of our operations by reducing waste, emissions and discharges and by using energy efficiently.

All incident frequency (2001-2018)



Observations (2012-2018)



DANIEL K. INOUYE

DIMENSIONS

Length	260 m
Beam	35 m
Depth	21 m
Deadweight	51,000 t
Capacity	3,600 teu
Speed	23.5 knots

Steinar Nerbøvik aboard Hull 029, the *Daniel K. Inouye*, the largest containership ever built in the United States. This ship was delivered in Q4 2018 and was designed for West Coast to Hawaii trade with gas ready notation for future LNG conversion.

Philly Shipyard: Challenges and Determination

Philly Shipyard closed 2018 with the delivery of the largest container vessel ever built in the United States and continued progress on its sister vessel. While the shipyard is on target to deliver the second container vessel this month, we are facing the challenge of no new orders being secured at this point. It is extremely difficult to see our tremendous workforce decline to fewer than 400 workers, down from about 1,200 workers at the beginning of the year. I remain committed and determined to overcome our order book challenges in 2019 and lay a solid foundation for the future.

Ironically, the success that Philly Shipyard achieved since 2003 is a main catalyst for our current situation. Since the early 2000s, three shipyards have delivered 62 large ocean-going commercial ships in the United States, which represents almost a total recapitalization of the Jones Act fleet. Of these 62 vessels, Philly Shipyard has built 29 of them, which is nearly equal to the combined output of the other two shipyards. After we deliver the second container vessel to Matson, there will be only four large ocean-going commercial vessels under construction in the United States with few, if any, new orders for similar sized ships from Jones Act operators seen in the near-term.

Going “Gray”

Our track record of building high quality complex vessels has put us in a strong position to seek opportunities building and repairing U.S. Government (“gray”) vessels. Since Philly Shipyard’s inception, we have maintained an “all commercial” focus, and our historically dominant position in the market validated that approach. In anticipation that commercial opportunities might decline, Philly Shipyard has been preparing for the past few years to strategically pursue U.S. Government projects, such as the National Security Multi-Mission Vessel (NSMV) program and the U.S. Navy Common Hull Auxiliary Multi-Mission Platform (CHAMP) program. Each of these programs involves multiple vessels and spans multiple years, with detail design and construction contracts currently expected to be awarded for the NSMV program in Q2 2019 and the CHAMP program in 2023.

Government contracting is very different from commercial work in terms of oversight by the customer, record keeping requirements and contracts management. We have added expertise in the area of government contracts; begun engaging directly with the U.S. Navy and other government agencies to introduce them to Philly Shipyard’s history and capabilities; and are taking all the necessary steps to make Philly Shipyard qualified to win government work. We believe our interactions with the U.S. Navy and other government agencies have been constructive and we are poised for Philly Shipyard to be ready to compete for these opportunities and, if awarded, perform with the same level of excellence that has marked our commercial programs.

We are intensively focused on the NSMV program, which will replace as many as five of the aging vessels that serve as training ships for the state maritime academies in the United States. The U.S. Congress has appropriated USD 600 million in funding for the first two NSMVs and a contract award is expected in Q2 2019. The oldest vessel in the current fleet was launched in 1961, and the U.S. Maritime Administration (MARAD) urgently needs the first replacement vessel as soon as possible. The vessel will be built to commercial “like” standards and MARAD requires that the shipyard has demonstrated experience in the construction of large, ocean-going commercial vessels. Because of our successful track record, and worldwide relationships with top-tier vessel design organizations and supplier networks, we believe that Philly Shipyard is a leading candidate for this program and can provide MARAD with the highest quality vessel at the most competitive price in the shortest period of time. We view this program as the critical bridge that will enable Philly Shipyard to rebuild its workforce and compete for future commercial and U.S. Government opportunities that are expected in the next several years.

Initial acquisition activities for the CHAMP program are underway, and Philly Shipyard recently submitted a proposal as a prime contractor to participate in the design studies for this program. These ships will begin the recapitalization process for the entire U.S. Navy auxiliary fleet, which provides transport of supplies and critical support to U.S. forces abroad. Unless this fleet is recapitalized, it is estimated that by 2028, the U.S. Navy will not be able to support U.S. forces deployed around the world. These vessels will be built to a commercial design standard, and there appears to be growing support to accelerate the program to begin acquisition of the first vessels as early as 2021. Philly Shipyard will be a very strong competitor for these vessels, given its history and experience, state-of-the-art facilities and reputation for quality.

In order to secure some much-needed short term backlog, Philly Shipyard has also been in discussions with the U.S. Navy and other U.S. Government ship owners about the utilization of Philly Shipyard facilities for vessel maintenance and repair and vessel modifications and conversions. The U.S. Navy has a critical need for dry dock capacity, and because of our state-of-the art facilities, skilled workforce and large dry docks available in 2019 and 2020, there is a growing awareness among U.S. Government ship owners to bring ships to Philly Shipyard for maintenance and repair operations. 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.

The transition from a singular focus on commercial work to pursuit of government work is not without its challenges, but thus far, our team has responded to these challenges, and we are striving to achieve the same level of success in the government markets as our tremendous record of accomplishment in the commercial world. We are determined to make this the next chapter in our history.

Container vessel status | CV3600 project

On October 31, 2018, Philly Shipyard delivered the *Daniel K. Inouye* (Hull 029) to Matson Navigation Company (Matson). It is the largest container vessel ever built in the United States and, by all accounts, our customer is very satisfied with the ship. Work is proceeding on its sister vessel, the *Kaimana Hila* (Hull 030), which is in the final stages of testing and commissioning. Sea trials were successfully completed (another “clean sweep”!) and we are preparing for delivery later this month. We are extremely proud of our workforce and are grateful to Matson for placing their confidence and trust in Philly Shipyard to build them these magnificent vessels.

Shipping investment status | Divestment completed

The liquidation process for Philly Tankers, our majority-owned Jones Act shipping company, is complete and Philly Shipyard received its liquidating distribution from Philly Tankers earlier this year. This wrapped-up Philly Shipyard’s successful investment in a series of eight Jones Act product tankers with a total contract value of approximately USD 1.0 billion through its joint venture with Crowley and establishment of Philly Tankers, and we will continue to evaluate similar opportunities to participate in the post-delivery economics of commercial ships that we build.

Market outlook

Although the near-term outlook in the commercial market for blue-water vessels is weak, there remain a number of large Jones Act vessels that will likely need replacement in the medium-term and long-term, and Philly Shipyard is in regular contact with their owners discussing potential designs, likely schedules for deliveries and incorporation of new technologies such as LNG propulsion into those designs. There is no doubt that Philly Shipyard is well qualified to build these vessels when they are ordered, given our tremendous success and history building container vessels, aframax tankers and product tankers. However, it is anticipated the market opportunities for large Jones Act ocean-going vessels in the next 5-10 years will be cyclical and will not produce a steady and predictable stream of work.

Because of this uncertain outlook, following our last Jones Act vessel order in 2015, Philly Shipyard began planning to combine commercial and government ship construction in order to best achieve continuous operations and a balanced portfolio. Philly Shipyard has already taken significant steps to build-up its government contracting resources and systems to make sure that it is fully prepared to successfully manage government projects, and the opportunities for the next 5-10 years in the government sector are robust. As its first significant step, Philly Shipyard participated in the government-funded industry study and prepared a bid as a major subcontractor for the U.S. Coast Guard’s next generation of Heavy Polar Icebreaker (now known as the Polar Security Cutter) program. Although unsuccessful, this exercise provided Philly Shipyard exposure and valuable lessons learned to the government bidding process.

Philly Shipyard faces many challenges and risks, but we believe Philly Shipyard can capitalize on future newbuild opportunities in the commercial and government sectors that create value for our shareholders. Philly Shipyard remains committed to constructing the most cost-efficient and environmentally friendly vessels in the Jones Act market and believes it will win its fair share of new orders when they are placed. Additionally, Philly Shipyard intends to provide the U.S. Government with a new, high quality, cost-effective solution to help fulfill its vessel program needs.

Striving for operational excellence

Our accomplishments in shipbuilding are the result of an unrelenting focus on operational excellence throughout the entire organization. This can be measured in several key areas:

- ✓ **HSE** – In 2018, we implemented significant changes to our HSE action plan with specific targets and increasing the accountability of management as well as our workers, and constant reinforcement to every person working in the shipyard that safety is their foremost responsibility. As a result of these efforts, and the renewed commitment to safety by everyone, I am pleased to report that each of our HSE goals was met in 2018. Our Lost Time Incident Frequency Rate and Other Recordable Incident Frequency Rate both decreased and our Near Hurt Observations increased, which demonstrates a heightened safety mindset and awareness. We will work relentlessly to continue this improvement in 2019.

✓ **People** – As always, the primary reason for our success, resilience and quality is the men and women who work in this shipyard. Each of our customers praises the high quality of the ships that we build and the positive experience of working with Philly Shipyard, and their satisfaction is evident in the repeat orders that we have received. This is testament to the dedication, professionalism and skills of our workforce, which makes the current situation so difficult for us all. I fully recognize the impact that reductions in force have on our workers and their families which only serves to drive me and our management team to work harder to obtain new orders as soon as possible. As evidence of our strong relationship, Philly Shipyard's unions recently ratified a new, four-year labor agreement which shows the belief our workers have in the future of Philly Shipyard.

✓ **Financial results** – From our best year ever in 2017 with net income of USD 67.2 million, we ended up with a net loss of USD 44.1 million for 2018. The negative result was driven by several factors: a loss recognized in 2018 on the Matson project (compared to USD 0 recognized in 2017 on the Matson project), under-recovered overhead costs due to diminished shipbuilding activity in 2018, an impairment charge due to the write-off of the full amount of the work-in-process assets in connection with cancellation of the CV3700 project for TOTE Maritime, as well as a net impairment of deferred tax asset since Philly Shipyard did not have an order backlog after delivery of Hull 030 at year-end 2018.

Our strategic focus

Our entire management team is keenly focused on navigating through the significant challenges we are facing ahead. Our immediate priority is the successful and timely delivery of Hull 030, with the same quality and workmanship as the other ships we have built here. I am immensely proud of our employees who, under these very difficult circumstances, are finishing this ship with the same level of enthusiasm, pride and skill as they did on every other ship. They are real professionals and are an asset to this shipyard.

We have multiple initiatives underway, including seeking and evaluating potential partnerships that can create a stronger entity to secure new work into the shipyard and create value for our shareholders. We are dynamically talking with potential customers on an ongoing basis. We have focused on our engagements with government agencies, and we are gaining visibility as a potential new supplier for their vessels. We are in the process of obtaining U.S. Government certification for our facilities which will qualify us to accept U.S. Navy vessels for repair work and dry-docking services. Hopefully, these efforts will bring new work into our backlog in 2019 and 2020.

Building the future

I would like to thank all of our employees for their faith and confidence in us and their tremendous dedication and pride in their work, despite the difficult times they face. It is because of their steadfast commitment, that we, the management team, have the drive, dedication and single-minded focus to win new work to enable this shipyard to resume production activities as soon as possible. Finally, I would like to thank our shareholders, suppliers and other partners for their support, confidence and terrific collaboration over the past year.

We are looking forward to meeting the challenges of 2019 and are dedicated to success. We have demonstrated to the world that shipbuilding can be successful in Philadelphia, and we can build the highest quality ships in this country. That is the foundation of my commitment and confidence that we can overcome all obstacles.

Steinar Nerbøvik
President and CEO

Philadelphia, March 5, 2019


FR17
FR20

Board of Directors' report 2018

Philly Shipyard ASA and its subsidiaries (referred to herein as a group as the "Group", the "Company" or "Philly Shipyard") is a leading shipbuilder in the U.S. Jones Act market that is presently pursuing a mix of commercial and government work. Aker Capital AS, a wholly-owned subsidiary of Aker ASA, is the majority shareholder in Philly Shipyard ASA.

Key Events

- ✓ **Philly Shipyard placed the TOTE Maritime containership project on hold in January 2018 and ultimately canceled it in October 2018**
- ✓ **Philly Shipyard idled its facilities and reduced its workforce in line with its order backlog**
- ✓ **Philly Shipyard delivered the first vessel (Hull 029) in the two-containership order for Matson in October 2018**
- ✓ **Philly Shipyard enhanced its government contracting resources and systems to prepare the business to compete for and handle government work**
- ✓ **As of 31 December 2018, Philly Shipyard had an order backlog of USD 17.4 million with the last delivery in Q1 2019**
- ✓ **Philly Shipyard's EBITDA was negative USD 15.8 million in 2018, compared to USD 105.1 million in 2017**
- ✓ **Philly Shipyard recorded an impairment charge of USD 17.6 million as a result of the canceled containership project**

Activities

The main entities in Philly Shipyard are the Norwegian holding company, Philly Shipyard ASA (referred to herein as "PHLY"), and its U.S. operating subsidiary, Philly Shipyard, Inc. (referred to herein as "PSI" or the "Shipyard"), a leading U.S. commercial shipyard that is presently pursuing a mix of commercial and government work. PHLY is located in Oslo, Norway, while PSI is located in Philadelphia, Pennsylvania, USA. At year-end 2018, Philly Shipyard owned 53.7% of the outstanding shares of Philly Tankers AS (referred to herein as "Philly Tankers"), a Jones Act shipping company which was liquidated in February 2019.

As of 31 December 2018, PSI's workforce consisted of 453 people, with a breakdown of 253 direct employees and 200 subcontracted personnel.

Philly Shipyard's business strategy for PSI is to build vessels for operation in the U.S. Jones Act and U.S. Government markets and to opportunistically participate in the post-delivery economics of the commercial vessels that it builds. At the end of 2018, PSI was building one containership remaining under contract with Matson (Hull 030).

Safe, cost efficient and cost competitive construction of new vessels is critical for the success of Philly Shipyard's business model. There are several factors that position Philly Shipyard to capitalize on this market: a state-of-the-art shipyard with modern equipment; access to global shipbuilding and design expertise with partners in Asia and Europe; a solid track record demonstrated by the delivery of 29 quality vessels (5 containerships, 22 product tankers and 2 aframax tankers) through 2018; a skilled workforce consisting of direct and contracted employees with a strong HSE mindset and culture of improvement; an opportunistic investment approach with respect to the post-delivery economics of the vessels that it builds; and a proven history of promoting new vessel owners.

The Jones Act market

The U.S. Jones Act generally restricts the marine transportation of cargo and passengers between points in the United States to vessels built in the United States, registered under the U.S. flag, manned by predominately U.S. crews, and 75% owned and controlled by U.S. citizens. The ability of the Company to win contracts is in part dependent on its unique ability to construct vessels that are eligible for U.S. Jones Act trades, and the Jones Act requirement for construction of the vessels in the United States limits competition for future contracts by excluding foreign shipyards. Since the Company is not a U.S. citizen for purposes of the Jones Act, the Company's ability to maintain an economic interest in the vessels it constructs depends on compliance with certain Jones Act rules and interpretations.

The U.S. Government market

The U.S. Government market for ship design, construction and repair work is expansive and cuts across multiple government agencies. Government customers include the U.S. Navy, the Military Sealift Command (MSC), the Maritime Administration (MARAD), the U.S. Coast Guard, the U.S. Army Corps of Engineers and others. The U.S. Navy's fleet of 285 ships is to increase to a goal of 355 ships over the next 30 years at an annual cost of USD 29 billion in 2018 dollars. The goal begins with a five-year acquisition goal (FY 2019-FY 2023) of 54 new ships, a 28% increase in ship acquisition plans from a year ago. These 54 new ships include vessels operated by the MSC, which has announced its long-term goal of recapitalizing its fleet of 66 support vessels. MARAD is seeking to replace up to five training vessels and the U.S. Coast Guard continues with its acquisition of a variety of Cutters.

The Master Agreement, Shipyard Lease and Authorization Agreement with PSDC

PSI currently operates its shipyard under a 99-year lease with Philadelphia Shipyard Development Corporation (PSDC), a government-sponsored non-profit corporation. A Master Agreement, a Shipyard Lease and an Authorization Agreement govern PSI's relationship with PSDC and the various governmental parties that have contributed to the establishment of the Shipyard.

Under the Master Agreement, the governmental parties have provided approximately USD 438 million for the renovation and modernization of the facility and training of the workforce. PSI was required to make certain qualified infrastructure investments totaling USD 135 million, which have been fully satisfied. PSI was also required to match government funding for certain training costs totaling USD 50 million, which has been fulfilled.

Pursuant to the Shipyard Lease, 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), which is scheduled 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, the waiver of the minimum employment condition will continue until PSI reaches the 200 full-time employee requirement.

Pursuant to the Authorization Agreement, PSDC purchased certain shipyard assets from PSI in 2011 for a purchase price of USD 42 million, with funds provided by the Commonwealth of Pennsylvania. PSI is leasing back those same assets from PSDC subject to the terms of the Shipyard Lease and the Authorization Agreement.

Strategy

Philly Shipyard will, through its unique partnerships and experience obtained during construction of tankers and containerships, strive to be the most efficient shipyard in the U.S. Jones Act and government markets for production of ocean-going vessels. Philly Shipyard is seeking to diversify its business beyond the traditional vessels it has built for the commercial market. In order to be able to maintain continuous shipbuilding activities, the Shipyard is pursuing opportunities to expand its base for operations also into new long-term projects for non-commercial end users. Philly Shipyard expects its powerful resume to facilitate possibilities for profitable construction of vessels within existing and new market segments, including government work. PSI will also pursue fabrication and vessel maintenance, modernization, conversion and repair opportunities outside of traditional shipbuilding where its core competencies in steel fabrication, heavy lifting and project management are advantageous.

Going forward, Philly Shipyard will remain opportunistic in its approach with respect to investing in the post-delivery economics of the commercial vessels that it builds.

Philly Shipyard's research and development activities are primarily related to two areas. The first area is the development of PSI's building methodology and working methods to ensure that PSI takes maximum benefit of the learning curve and produces each grand block and each vessel more efficiently than the previous one. The second area is work related to the development of new vessels. Ordinarily, PSI will attempt to identify and license existing best-in-class designs and cooperate with the owners of such designs to make such modifications as are necessary. However, when existing designs are unavailable or unsuitable, PSI will develop new designs to meet the needs of the market.

Key events 2018

Until early 2018, Philly Shipyard had been working on a project to build up to four state-of-the-art, cost-effective and environmentally-friendly containerships (CV3700 vessels) for delivery to TOTE Maritime in 2020 and 2021. However, in January 2018, this project was placed on hold and the Letter of Intent between Philly Shipyard and TOTE Maritime for the construction and sale of these vessels expired in accordance with its terms following the withdrawal by TOTE Maritime of its plans to enter the U.S. mainland to Hawaii containership service. During much of 2018, Philly Shipyard explored alternatives in order to secure contracts and financing for these containerships, but without success. Based on the new order prospects, market conditions and other circumstances, in October 2018, Philly Shipyard canceled the CV3700 project and, in connection therewith, wrote off work-in-process assets totaling approximately USD 17.6 million.

While Philly Shipyard actively sought new orders and the capital necessary to build vessels after Hull 030, it adjusted its operations and workforce in line with its order backlog. Currently, the only shipbuilding activity is in one of the two graving docks at the shipyard; all other production facilities are idle. Today, Philly Shipyard's workforce (including direct employees and subcontracted personnel) totals approximately 350 people, down from approximately 1,200 people at the beginning of 2018.

On 31 October 2018, Philly Shipyard delivered Hull 029, the *Daniel K. Inouye*, the first vessel in the two-containership order for Matson. This vessel is the largest containership ever built in the United States.

During 2018, Philly Shipyard gradually increased its efforts and took substantial steps to build-up its government contracting resources and systems to ensure it is prepared to compete for and handle government work. PSI entered into the competition for U.S. Government-related ship design, construction and repair work by preparing a proposal for the construction of the first vessel for the Heavy Polar Ice Breaker (HPIB) Program (as a subcontractor), after having worked on design studies for the HPIB vessel since early 2017. This proposal, submitted to a U.S. Government prime contractor, was unsuccessful. However, the act of developing the proposal required PSI to put into place the framework to support future government proposals.

Review of the annual accounts

Philly Shipyard prepares and presents its consolidated accounts according to International Financial Reporting Standards (IFRS) as adopted by the European Union.

PHLY was formed on 16 October 2007 to be the holding company of PSI which operates the shipyard located in Philadelphia, Pennsylvania, USA.

In accordance with IFRS, Philly Shipyard is recognizing the two-containership order by Matson (Hull 029 and 030) as a single combined project. As such, revenue and expense for these vessels have been recognized on a combined project basis, whereby the construction progress is measured together. As of 31 December 2018, the Matson project was approximately 95% complete.

Order backlog

As of 31 December 2018, PSI's order backlog was USD 17.4 million and represents a contractual obligation to deliver vessels that have not yet been produced for PSI's customer. Order backlog consists of future contract revenues and is subject to adjustment based on change orders as defined in the construction contracts. At the end of the year, the order backlog was comprised of one container vessel under contract with Matson. The net order backlog decrease of USD 170.3 million from 2017 is due to the continued progress made on the Matson project without any offset by new orders secured during 2018.

Shipping investments

Philly Tankers, a Jones Act shipping company that was majority-owned by Philly Shipyard at year-end 2018, completed an orderly liquidation process for the purpose of distributing its available cash balances to its shareholders. These liquidating distributions totaled approximately USD 83.1 million (including Philly Shipyard's share of USD 44.6 million) and were made on 18 February 2019. Including these distributions, the dividends paid by Philly Tankers to its shareholders total USD 161.2 million (including Philly Shipyard's share of USD 86.6 million).

Profit and loss accounts

Operating revenues and other income in 2018 ended at USD 129.2 million compared to operating revenues and other income of USD 614.6 million in 2017. Operating revenues and other income in 2018 were primarily driven by the continued progress on the Matson vessels (Hulls 029-030), whereas operating revenues and other income in 2017 were primarily driven by the delivery by Philly Shipyard of Hull 026, Hull 027 and Hull 028 to Kinder Morgan and the related sale by Philly Tankers of its Hull 026, Hull 027 and Hull 028 shipping assets to Kinder Morgan (profit and deferred gain from equity-accounted investments), as well as continued progress on the Matson vessels (Hulls 029-030).

As previously disclosed, under International Financial Reporting Standards (IFRS), 100% of the revenue, cost and profit on each of the Philly Tankers vessels (i.e., Hulls 025-028) was deferred, and the deferred amounts for each of these vessels were recognized at delivery, as if Philly Shipyard was originally building these vessels for its own account. This accounting treatment was required for the Philly Tankers vessels because there were no external customers at the time these contracts were signed and shipbuilding activities commenced.

The operating revenues in 2018 were impacted by the implementation of the new IFRS 15 standard (IFRS 15). This had an impact on the timing of revenue recognition by increasing accumulated revenues recognized at 31 December 2017 from Hulls 029 and 030 by USD 38.4 million, with a corresponding decrease in future revenue to be recorded from 1 January 2018. As such, there is a USD 38.4 million difference between accumulated revenue from the 1 January 2018 effective date of IFRS 15 and 31 December 2017 as presented in the annual report for 2017. See note 3 of the Consolidated accounts for further details.

2018 other income of negative USD 0.5 million was comprised of a loss in equity-accounted investments pertaining to Hulls 025-028. 2017 other income of USD 22.8 million was comprised of a profit in equity-accounted investments pertaining to Hulls 026-028 and recognition of a deferred net gain on equity-accounted investments pertaining to Hulls 026-028.

Philly Shipyard's earnings before interest, taxes, depreciation and amortization (EBITDA) was negative USD 15.8 million in 2018, compared to EBITDA of USD 105.1 million in 2017. These figures correspond to EBITDA margins of -12.2% and 17.1%, respectively.

In comparison, Philly Shipyard's Q4 2018 report showed a preliminary EBITDA for 2018 of negative USD 33.4 million. The increase in EBITDA for 2018 from the quarterly report is due to the reclassification of the impairment charge of USD 17.6 million resulting from the write-off of the full amount of the work-in-process assets pertaining to two containerships (Hulls 031-032) in connection with cancellation of the CV3700 project. The impairment charge was reclassified from 'Cost of vessels sold' to 'Impairment of assets' below the EBITDA line. There is no impact to the net result.

Depreciation and impairment expense was USD 25.4 million in 2018 and USD 5.8 million in 2017. Philly Shipyard's earnings before interest and taxes (EBIT) was negative USD 41.2 million in 2018, compared to EBIT of USD 99.3 million in 2017.

In addition to the IFRS financial measures reported above, EBITDA and EBIT are considered relevant earnings indicators for the Company as they measure the operational performance of the shipyard. These non-IFRS measures are included as items in the consolidated income statement. Net financial items in 2018 and 2017 were expense of USD 0.6 million and income of USD 0.7 million, respectively.

Net financial items in 2018 were primarily driven by net interest expense on debt offset slightly by interest income from bank balances, whereas net financial items in 2017 were driven by unrealized currency gains on foreign exchange forward contracts offset slightly by net interest expense on debt.

Income tax expense for 2018 was USD 2.3 million, compared to income tax expense of USD 32.7 million in 2017. The 2018 income tax expense of USD 2.3 million includes a net impairment of USD 2.4 million of tax assets since Philly Shipyard did not have an order backlog after delivery of Hull 030 at year-end 2018. The 2017 income tax expense of USD 32.7 million includes an R&D tax credit of USD 8.7 million.

In comparison, Philly Shipyard's Q4 2018 report showed a preliminary income tax expense for 2018 of USD 3.6 million. The decrease in income tax expense for 2018 from the quarterly report is due to the reversal of a deferred tax asset valuation allowance of USD 1.3 million to offset a deferred tax liability.

In 2018, Philly Shipyard's net loss was negative USD 44.1 million and its basic and diluted loss per share was negative USD 3.64. The corresponding figures for 2017 were net income of USD 67.2 million and basic and diluted earnings per share of USD 5.55. The net loss in 2018 was driven by a loss of USD 11.1 million recognized in 2018 on the Matson project (compared to USD 0 recognized in 2017 on the Matson project), under-recovered overhead costs (i.e., overhead costs incurred and not allocated to projects) of USD 9.4 million (compared to USD 0 in 2017), an impairment charge of USD 17.6 million due to the write-off of the full amount of the work-in-process assets pertaining to two containerships (Hulls 031-032) in connection with cancellation of the CV3700 project, as well as a net impairment of USD 2.4 million of deferred tax asset since Philly Shipyard did not have an order backlog after delivery of Hull 030 at year-end 2018.

Cash flows

The Company's cash flow from operations depends on payment terms for construction and delivery settlement for the vessels sold to external customers. Total net cash flow used in operating activities in 2018 was USD 34.0 million compared to total net cash flow from operating activities of USD 109.6 million in 2017. There are significant changes year-to-year caused by the timing of ship deliveries, the level of completion of vessels and customer and vendor contract payment schedules.

Net cash flow from investment activities was USD 0.3 million in 2018 and USD 32.7 million in 2017. 2018 investment activities were primarily proceeds from the dividend received from Philly Tankers offset mostly by capital improvements. 2017 investment activities were primarily proceeds from the dividend received from Philly Tankers offset slightly by capital improvements.

Net cash flow used in financing activities was USD 26.8 million in 2018 and USD 101.3 million in 2017. Net outflows in 2018 were primarily for restricted cash payments related to the Welcome Fund loan. Net outflows in 2017 were primarily for repayment of the Cat Financial construction loans and the dividend paid.

Statement of financial position and liquidity

As of 31 December 2018, Philly Shipyard has cash and cash equivalents (excluding restricted cash) of USD 49.6 million. The corresponding figure for 2017 is USD 110.1 million. The decrease of USD 60.5 million was primarily due to operating activities and additional restricted cash of USD 26.2 million deposited into an escrow account to secure the Welcome Fund loan. This deposit was funded out of the dividends previously paid by Philly Tankers to Philly Shipyard described above in the Shipping investments section and was required by the Welcome Fund lender in connection with the liquidation of Philly Tankers. Philly Shipyard's net working capital (current assets less current liabilities) is USD 39.0 million at 31 December 2018, compared to USD 103.9 million at 31 December 2017. As of 31 December 2018, Philly Shipyard has restricted cash of USD 44.6 million, of which USD 39.7 million is related to the Welcome Fund loan, which is expected to be used for repayment of the Welcome Fund loan at its maturity in 2020, and USD 4.9 million is related to holdbacks for guarantees, deficiencies and disputed items for Hull 029.

Total assets were USD 190.0 million at 31 December 2018 compared to USD 253.0 million at 31 December 2017.

Current assets as of 31 December 2018 of USD 56.4 million consists of prepayments and other receivables, income tax receivable and cash and cash equivalents. Current assets as of 31 December 2017 of USD 141.3 million consists of prepayments and other receivables, income tax receivable, vessels-under-construction receivable, work-in-process, restricted cash and cash and cash equivalents. The decrease in current assets is primarily due to a decrease in cash and cash equivalents as well as an aggregate decrease in vessels-under-construction receivable and work-in-process. Work-in-process was USD 0 at 31 December 2018 compared to USD 13.4 million at 31 December 2017. As previously disclosed, the project to build up to four containerships (CV3700 vessels) for delivery to TOTE Maritime was canceled and, in connection therewith, the full amount of the work-in-process assets pertaining to the first two CV3700 vessels (Hulls 031-032), totaling USD 17.6 million, was written off in 2018.

Non-current assets as of 31 December 2018 of USD 133.6 million consists of property, plant and equipment, restricted cash, equity-accounted investments and other non-current assets. Non-current assets as of 31 December 2017 of USD 111.7 million consists of property, plant and equipment, restricted cash, equity-accounted investments, deferred tax asset and other non-current assets.

Current liabilities as of 31 December 2018 of USD 17.4 million consists of trade payables and accrued liabilities, warranties, customer advances, net and income tax payable. The corresponding figure for 31 December 2017 is USD 37.3 million and consists of trade payables and accrued liabilities, warranties, current portion of the capital lease and income tax payable. The decrease in current liabilities is primarily due to a reduction in trade payables and accrued liabilities.

Non-current liabilities as of 31 December 2018 of USD 61.1 million consists of interest-bearing long-term debt and deferred tax liability. The corresponding figure for 31 December 2017 is USD 60.1 million and consists of interest-bearing long-term debt and deferred tax liability.

Interest-bearing debt as of 31 December 2018 amounts to USD 59.6 million compared to USD 59.6 million as of 31 December 2017. This is primarily attributable to a USD 0.3 million payoff of the capital lease offset by annual amortization of USD 0.3 million for Welcome Fund loan fees.

Total equity at 31 December 2018 amounts to USD 111.5 million and the equity ratio (total equity divided by total assets) was 59%. Corresponding figures for 31 December 2017 are USD 155.6 million and 61%, respectively. The USD 44.1 million decrease in equity is the result of the current year's loss.

The Board deems that the Company as of 31 December 2018 is financially sound and has an appropriate financing structure.

Risks

Market risks

The overall market risk for construction of commercial vessels is related to the Jones Act. Interest groups have lobbied the U.S. Congress in the past to repeal or modify the Jones Act, and legislation to remove the U.S-build requirement of the Jones Act has been proposed, but market experts believe that repeal of or significant changes to the Jones Act are unlikely. Repeal of or significant changes to the Jones Act could, among other things, increase competition from foreign (non-U.S.) shipbuilders with lower costs or require increased use of higher priced domestic content, and as a result reduce the demand for U.S.-built vessels. In order to address this risk, the Company has continuous engagement with local, state and federal government officials.

Philly Shipyard is also exposed to market risk related to imbalance between supply and demand for vessels in the Jones Act market, which may result in a reduction of vessel prices and/or delay in new projects. PSI faces risks related to the contracts for its vessels, including the risk that those contracts are canceled and the underlying vessels are ultimately sold to third parties for less favorable terms.

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

Philly Shipyard faces significant risks if it is unable to secure new orders and/or financing for vessels after the last vessel in the current order backlog (Hull 030), which is scheduled for delivery in Q1 2019. There can be no assurance that Philly Shipyard will obtain new orders or financing for vessels after Hull 030.

Furthermore, even if Philly Shipyard obtains new orders or financing for vessels after Hull 030, none of the possible projects it is presently pursuing alone will 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 for work after Hull 030 has interrupted its building program, resulting in the idling of all production activities in its facility except in one of two graving docks and a decrease of more than 65% 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; increases in under-recovered overhead costs (i.e., overhead costs incurred and not allocated to projects); and operational inefficiencies for completion of the remaining vessel in the current order backlog.

The longer the delay in securing new orders beyond Hull 030 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 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 will need to do an impairment charge against its fixed assets.

Operational risks

Philly Shipyard faces risks related to construction of vessels. In many cases, these vessels involve complex design and engineering, significant procurement of equipment and supplies and extensive construction management. Management uses its best efforts to properly estimate the costs to complete PSI's project awards; however, PSI's actual costs incurred to complete these projects could exceed its estimates. The Shipyard's ability to meet budgets and schedules may be adversely affected by many factors, including changes in productivity, shortages of materials, equipment and labor and changes in the cost of goods and services, both Philly Shipyard's own and those charged by its suppliers. The Shipyard's operations also depend on stable supplier networks and the availability of key vendors for design and procurement services.

The Company furthermore faces challenges related to the construction of new classes of vessels, as well as managing multiple projects at the same time. These challenges sometimes tend to impact quality, timely delivery and cost efficiencies. In order to reduce these risks, the Shipyard enters into contracts with design and procurement partners.

Given Hulls 029-030 are prototype container vessels and the last container vessel built by Philly Shipyard was delivered in 2006, there is a higher technical design risk and a higher project execution risk compared to the recent construction of multiple product tankers, which were based on a proven design. This prototype risk increases the current construction cost estimation uncertainty and the likelihood of occurrence of contract contingencies. In particular, failure to meet Philly Shipyard's performance obligations to deliver vessels on time and within the contract specifications (e.g., speed, container capacity and fuel consumption) can potentially lead to penalties and ultimately contract termination. The loss incurred on the Matson project is attributable in part to this prototype risk. With the delivery of Hull 029 in Q4 2018, the degree of this prototype risk is reduced going forward, as the technical design risk is largely mitigated and the main risk remaining is project execution risk.

The 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, the 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.

PSI reduced its skilled workforce during 2018 in response to decreases in utilization of its facilities. PSI's productivity and profitability depends substantially on its ability to attract and retain skilled construction workers, primarily welders, fitters and equipment operators, at current forecasted rates. Reductions made in PSI's labor force may make it more difficult for PSI to increase its labor force to desirable levels during periods of rapid expanding customer demand. PSI's ability to expand its operations in tandem with customer demand depends on its ability to increase its labor force when necessary with the appropriate skilled construction workers.

PSI'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 PSI's industry. The loss of the services of one or more of these individuals could adversely affect PSI.

PSI's ability to perform under its contracts depends to some degree on the performance of third parties under subcontracts. PSI depends upon subcontractors for a variety of reasons, including: to perform work as a result of scheduling demands or capacity constraints that PSI would otherwise perform with its employees; to supervise and/or perform certain aspects of the contract more efficiently considering the conditions of the contract; and to perform certain types of skilled work. PSI works closely with these subcontractors to monitor progress and address its customer requirements. PSI generally has the ability to pursue back charges for costs it incurs or liabilities it assumes as a result of a subcontractor's lack of performance. However, the inability of PSI's subcontractors to perform under the terms of their contracts could cause PSI to incur additional costs that reduce profitability or create losses on projects.

The 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 PSI 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 "The Master Agreement, Shipyard Lease and Authorization Agreement with PSDC" on page 13.

The Shipyard's operations are subject to the usual hazards inherent in shipbuilding, such as the risk of equipment failure and work accidents. Despite the Shipyard's best efforts to eliminate these hazards, they can sometimes cause personal injury, business interruption, construction delays, property and equipment damage, pollution and environmental damage. PSI continues to implement its Health, Safety and Environment (HSE) management system and provide training to its workforce to mitigate these risks. The Shipyard's policy of covering these risks through contractual limitations of liability and indemnities and through insurance may not always be effective, and customers and subcontractors may not have adequate financial resources to meet their indemnity obligations to PSI.

PSI relies heavily on computer information and communications technology and related systems in order to properly operate its business. From time to time, PSI experiences occasional system interruptions and delays. In the event PSI is unable to regularly deploy software and hardware, effectively upgrade its systems and network infrastructure, and take other steps to maintain or improve the efficiency and efficacy of its systems, the operation of such systems could be interrupted or result in the loss, corruption or release of data, and the cost associated with responding to such events and restoring compliance could be significant.

The Company faces risk of significant financial, business and intelligence loss if there are cyber security breaches. Philly Shipyard has invested significant resources to provide a more secure computing environment over the last several years, resulting in improved security and business resiliency. PSI maintains a continued high awareness of the Company's risk profile regarding cyber security because new threats can emerge quickly.

The Shipyard's operations are subject to numerous international, national, state and local environmental, health and safety laws, regulations, treaties and conventions, including, inter alia, those controlling the permitted and unpermitted discharge of materials into the environment, requiring removal and cleanup of environmental contamination, establishing certification, licensing, health and safety, labor and training standards or otherwise relating to the protection of human health and the environment. Sanctions for failure to comply with these requirements, which may be applied retroactively, may include: administrative, civil and criminal liabilities, revocation of permits to conduct business and corrective action orders, including orders to investigate and clean up contamination.

PSI's operations historically focused primarily on construction of new vessels for the U.S. Jones Act market. PSI is continuing to develop and implement the policies and procedures required to be a fully compliant U.S. Government contractor. PSI 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 PSI to business and operational risks that are different from those it has experienced historically. PSI's management may not be able to effectively manage these additional risks or implement successful business strategies in new lines of business.

Financial risks

Philly Shipyard's activities expose it to a variety of financial risks: market risk (including commodity pricing risk, currency risk and price risk), credit risk and cash flow interest-rate risk. Philly Shipyard's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on Philly Shipyard's financial performance. Philly Shipyard uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out under policies and protocols approved by the Board of Directors. The Board of Directors provides principles for overall financial risk management as well as policies covering specific areas such as foreign exchange risk, interest-rate risk, credit risk and use of derivative financial instruments and non-derivative financial instruments.

The Company is exposed to changes in prices of steel and other materials and duties, tariffs and other taxes imposed on goods imported from foreign (non-U.S.) countries. The Company attempts to mitigate its exposure with respect to steel and other material price escalation and increased taxes on imported goods by attempting to pass these risks on to its end customers. Matson carries the risk of steel price escalation on Hull 030.

The Company is subject to exchange rate risk for purchases made in currencies other than the U.S. dollar. In order to mitigate exposure to this risk, PSI secured foreign exchange forward contracts for its known requirements for foreign currency for Hull 030.

PSI operates in business areas that are capital intensive. 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 construction financing facilities. Additionally, the Shipyard may be required to obtain bonding capacity in case there is need for payment or performance bonds to support projects. PSI may not be able to obtain sufficient debt financing or bonding capacity if and when needed with favorable terms. Additionally, PSI may be required to provide collateral, pay higher interest rates and otherwise agree to more restrictive terms in order to secure future amendments to the

Welcome Fund loan agreement in the event any such amendment is needed.

Philly Shipyard regularly monitors the financial health of its construction financing lenders as well as the financial health of the financial institutions which it uses for cash management services and in which it makes deposits and other investments.

Through construction financing, the Company is exposed to fluctuations in interest rates. There is no construction financing for Hull 030, as this contract will be fully funded by customer milestone payments.

The credit risk of ship owners is evaluated upon contract signing. Typically, ship owners have financing approvals in place before they enter into contracts with PSI. During the construction period, Philly Shipyard continually evaluates the credit risk associated with ship owners and, except in cases where PSI arranges construction financing, manages this risk by requiring payment for substantially the entire contractual amount prior to delivering a vessel, including milestone payments upon completion of specified milestones. At the completion of a vessel, transfer of ownership takes place upon settlement. Should a ship owner fail to pay, PSI may attempt to dispose of the vessel in the open-market to recover its construction costs.

PSI accrues an estimate for future warranty claims on its delivered vessels. Thus far the claims have been within the reserve amounts. In order to mitigate the risk of warranty claims exceeding warranty provisions, PSI has secured back-to-back warranties for most major components on the vessels.

Events after 31 December 2018

On 6 February 2019, a temporary conditional waiver of the minimum employment condition under the Shipyard Lease was obtained from PSDC. The waiver period extends 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.

On 14 February 2019, a new four-year collective bargaining agreement was ratified by the Philadelphia Metal Trades Council, which represents the ten unions at the shipyard. This new labor contract will extend until 31 January 2023.

On 18 February 2019, Philly Shipyard received a liquidating distribution totaling USD 44.6 million from Philly Tankers AS. Of this, USD 13.1 million will be deposited in Q1 2019 into a collateral account as additional security for the Welcome Fund loan. The receipt of the liquidation distribution will not have any tax consequences.

The going concern assumption

The 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 beyond the delivery of Hull 030 scheduled in Q1 2019. 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 beyond Q1 2019.

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 beyond the delivery of Hull 030 scheduled in Q1 2019. The delay Philly Shipyard has experienced in securing new orders and financing for work after Hull 030 has interrupted its building program, resulting in the idling of all production activities in its facility except in one of two graving docks and a decrease of more than 65% 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; increases in under-recovered overhead costs (i.e., overhead costs incurred and not allocated to projects); and operational inefficiencies for completion of the remaining vessel in the current order backlog.
- The longer the delay in securing new orders beyond Hull 030 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 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), which is scheduled 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, 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 beyond Q1 2019 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 expected to be announced within Q2 2019 with a delivery of the first vessel targeted for the end of Q4 2021. 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 to support this project. PSI may not be able to obtain sufficient construction financing facilities and other loans and debt facilities, or bonding capacity if and when needed with favorable terms.

- In addition, Philly Shipyard is aggressively pursuing several possibilities for short-term work to have some activity in the shipyard in 2019 before a production start of a potential new shipbuilding project. In particular, Philly Shipyard is pursuing possibilities for steel work and repair, 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 beyond Q1 2019, 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 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.

Parent company accounts and allocation of income for the year

The income/(loss) account of Philly Shipyard ASA for the year 2018 shows income of USD 0.8 million. The Board of Directors proposes that the income for the year be allocated as shown below:

Dividend payment	USD 0
Other equity	USD 0.8 million
Total allocated	USD 0.8 million

As of 31 December 2018, before receiving any dividends from PSI, the parent company has approximately USD 5.2 million of equity which could be distributed to shareholders by the Board in accordance with PHLY's dividend policy.

Due to the current main focus on securing new orders beyond Hull 030, the PHLY Board has decided not to pay any ordinary or extraordinary dividends at this time. 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.

The parent company's only assets are cash and the investment in subsidiary (PSI).

Corporate social responsibility

Maintaining a healthy and safe workplace and being friendly to the environment is an essential part of Philly Shipyard's strategy. Philly Shipyard develops policies to comply with or exceed all federal, state and local requirements.

All of PSI's employees work at the shipyard facility located in Philadelphia, Pennsylvania in the United States of America. The Company believes that being a good corporate citizen is good business. As a platform for these beliefs, PSI developed a WeCare program, which provides support for employees and the community through teambuilding, volunteering and educational initiatives.

In 2018, Philly Shipyard continued to work, for a third year, with a local non-profit to organize a book drive for a school in need, and then assisted in setting up a pop-up book store in the school for children to take home free books to start their own library. Philly Shipyard also worked with the Seamen's Church Institute to donate goodie bags which were filled with personal items then delivered to the local Seafarers in the area. Philly Shipyard continues to donate all left over non-perishable food items from sea trials to the local food bank. PSI employees continued to live the Company's CORE values by banding together to raise funds that supported fellow employees in need. Raffles, bake sales and donations were made to help support colleagues throughout the year. Entrenching these measures into the organization strengthens Philly Shipyard's CORE values and brings employees together in a new and powerful arrangement.

PSI seeks to be an attractive employer and maintains a human relations policy that is open and fair. PSI is committed to providing equal employment opportunity to all employees and applicants for employment, regardless of race, color, ethnic background, gender, religion, age, marital status, sexual orientation, national origin, citizenship status, disability, veteran status or any other legally protected status. Diversity strengthens the Shipyard's overall capacity and skills. In support of this diversity, at year-end 2018, approximately 42% of PSI's employees were minorities.

The maritime industry has traditionally been male-dominated. The entire industry faces the challenge of increasing the proportion of female employees. PSI has taken some affirmative steps to address this challenge. For example, the Shipyard encourages female applicants and has seen increased interest among potential female employees to pursue a career with PSI. To further this goal, PSI participates in available government programs that encourage women in manufacturing and has recruited at schools and training programs with more women. PSI has also continued to train supervisors, managers and employees in our Equal Employment Opportunity (EEO) policy.

At year-end 2018, approximately 7% of PSI's employees were women. While there were no women on PSI's senior management team, women held key positions such as Project Cost Controller, Payroll/Benefits Supervisor and HR/ Communications Manager, and a female production employee was awarded the President's Award for the first time in 2018. In addition, two of the four members of PHLY's Board of Directors are women.

The Shipyard is committed to maintaining a work environment that is free of discrimination, harassment and hostilities. In keeping with this commitment, PSI maintains a strict Harassment Free Environment Policy and does not tolerate unlawful harassment of employees by anyone.

Philly Shipyard believes all people share the same fundamental human rights. The Company follows legal and responsible sourcing practices and expects its suppliers to uphold the same standards. In 2018, the Company did not have a formal policy regarding human rights as its sole operating company is located in the United States, which has extensive human rights laws in place.

At the operating subsidiary in Philadelphia, worker's rights are protected by federal, state and local laws. In addition, approximately one-half of PSI's employees are members of the Philadelphia Metal Trades Council (PMTC) union and are covered under the collective bargaining agreement between the PMTC and the Shipyard. This agreement is effective until 31 January 2023.

Under this collective bargaining agreement, union employees are granted vacation and personal time, and most union employees receive shutdown pay during the week of the Fourth of July holiday and in between the Christmas and New Year's holidays. In addition, union employees may take up to 6 unpaid days within a 12-month period. Traditional sick days are not part of the collective bargaining agreement. Non-union employees accrue sick time on a monthly basis and may maintain a balance of up to 200 hours. During 2018, 211 non-union employees used 9,368 hours of sick time, representing 3.0% of total non-union work hours. Comparably, in 2017, 217 non-union employees used 8,651 hours of sick time, representing 2.2% of total non-union work hours.

At the Shipyard, HSE is not just a priority, but is a mindset embedded in all decisions and actions. The Union-Management Safety and Environmental Board reviews the various HSE programs, and makes recommendations on policies and procedures. The HSE system includes safety training of employees and subcontractors, safety inspections, industrial health and wellness programs, drug testing, emergency response and environmental programs. PSI expects to implement new initiatives to continuously improve its HSE mindset during 2019.

In 2018, the other recordable incident frequency rate (OSHA-recordable incidents excluding lost time incidents per 200,000 hours worked) was 3.63, compared to 4.43 in 2017. The incidents came from a total of 1,760,694 hours worked by PSI employees and subcontractors in 2018, compared with 2,845,014 hours worked by PSI employees and subcontractors in 2017. PSI had 3 lost time incidents in 2018. The most serious incident to occur resulted in a fracture to a worker's left hand while other recordable injuries resulted mainly in sprains and strains. PSI continues to work proactively to further improve safety and reduce the number of incidents at the Shipyard. In 2018, the implementation of a mandatory glove usage policy helped reduce the number of hand injuries. Workers are now required to wear approved cut-resistant gloves for all work activities.

In 2019, the Shipyard will continue developing strategies to improve the overall safety culture in anticipation of the workload increasing later in the year. Part of this will be the inclusion of the OSHA ten-hour course for all returning production workers and supervisors. A training plan is being developed to ensure that both the initial and refresher safety training courses are an ongoing part of the workers' employment.

Philly Shipyard takes its environmental responsibilities seriously beginning with the vessel design. The Shipyard uses the latest International Maritime Organization (IMO) requirements as guidance for environmental protection and efficiency during the design and production process. The industrial nature of the Shipyard's activities requires the use of significant amounts of energy, both electrical and gas, as well as the release of particulate and VOC emissions. During 2018, PSI used approximately 24.5 GWh of electricity and approximately 619,706 ccf of natural gas.

Its VOC emissions were 60 tons for the reporting period ending in 2018. PSI had no reported discharges into the surrounding waterways. Environmental status reporting is an integral part of the Shipyard's reporting system, on par with reporting on financial matters and operations. This commitment extends to evaluating and adopting environmentally beneficial improvements in production processes, alternative materials and services. PSI promotes open communication on environmental issues with employees, neighbors, public authorities and other interested parties and has implemented a system through which employees can make observations and suggestions about the Shipyard's environmental performance. In 2018, PSI's HSE department continued its emphasis on advanced environmental training for the HSE coordinators to keep them updated on state and federal EPA standards and guidelines.

In 2018, PSI generated approximately 36 tons of hazardous waste and recycled approximately 774 tons of wood and 1,704 tons of steel. PSI has continued its program to gather and sort waste to promote environmentally responsible handling, disposal and recovery of any residual value.

A basic principle of ethical business conduct requires that each employee of the Shipyard support positively, both on and off the job, the Shipyard's business activities. One important way we satisfy this responsibility is to ensure that our business dealings are never influenced by – or even appear to be influenced by – our own personal interests. The Company has zero tolerance for corruption and has adopted an Anti-Corruption Policy that is in line with the anti-corruption policies at other Aker ASA-related companies. The Company also maintains a strict Conflict of Interests policy, which is reflected in PSI's employee handbook, as well as its Terms and Conditions to outside suppliers.

In support of the above initiatives and policies, the Shipyard maintains a formal policy for the disclosure of wrongful conduct and protection from retaliation (the "Whistleblower Policy"). This policy is available to all employees and is administered by the Vice President of Human Resources. During 2014, a simplified process to make anonymous reports of violations through a third party administrator was implemented. In 2018, there were two cases reported using this process, neither of which was considered material.

Organization

On 31 December 2018, PSI had 253 direct employees and 200 subcontracted personnel. The Shipyard experiences higher turnover amongst its union and production subcontractor employees compared to other employees. The delay PSI has experienced thus far in securing new orders beyond the Matson project has caused it, and will continue to cause it, to experience a slow-down of various departments. Due to this interruption of PSI's building program, the Shipyard has reduced and will continue to adjust its workforce in line with its order backlog.

Corporate governance

Philly Shipyard's corporate governance policy exists to ensure an appropriate division of roles among the Company's owners, Board of Directors and Executive Management. Such a separation of roles ensures that goals and strategies are prepared, that adopted corporate strategies are implemented, and that the results achieved are subject to verification and follow-up. Applying these principles also contributes to satisfactory group-wide monitoring and verification of activities. An appropriate division of responsibilities and satisfactory controls will contribute to the greatest possible value creation over time, to the benefit of shareholders and other interest groups. Philly Shipyard's corporate governance guidelines are presented in greater detail on pages 64-67 of this annual report.

Outlook

Shipbuilding

As of 31 December 2018, Philly Shipyard had an order backlog of USD 17.4 million. This backlog represents a contractual obligation to deliver the second of two container vessels for Matson (Hull 030). Philly Shipyard is scheduled to deliver Hull 030 to Matson during the first quarter of 2019. The key focus area for Philly Shipyard's operations continues to be the completion and delivery of Hull 030. Hull 030 returned to the shipyard from a successful sea trial on 5 March 2019.

As of today, Hull 030 is the last vessel in PSI's order book. Securing contracts for 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 suffer significant losses in 2019, even if the shipyard receives orders for new vessels.

In the near term, 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 U.S. Maritime Administration (MARAD) released a request for proposal (RFP) for a vessel construction manager (VCM) for the NSMV program. The VCM contract is expected to be awarded early this year. The VCM will then enter into a contract with a U.S. shipyard to build the vessels. The shipyard contract is expected to be awarded in Q2 2019. MARAD has received USD 300 million in federal funding for each of the first two vessels (i.e., NSMV 1 and NSMV 2), for a total of USD 600 million. Delivery of the first vessel is targeted for the end of Q4 2021.

In addition, Philly Shipyard is in discussions related to several other potential new construction projects for U.S.-built vessels. Philly Shipyard is expanding its search for new opportunities throughout the marine industry. Philly Shipyard is also exploring potential partnerships that can create a stronger entity 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 in 2019 before a production start of a new shipbuilding project. In particular, Philly Shipyard is pursuing opportunities for steel work and repair, modernization and conversion jobs to utilize idle capacity in its fabrication shops and dry-docks.

Since it began operations, Philly Shipyard has focused exclusively on construction of merchant vessels for the domestic Jones Act market. In the past 15 years, PSI has delivered 5 containerships, 2 aframax crude tankers and 22 product tankers. Until now, these projects have consumed PSI's capacity. The Jones Act fleet of dry cargo and petroleum tankers has been recapitalized over the last decade and there are few, if any, immediate opportunities for PSI to build these same types of vessels. In the next 5-10 years, Philly Shipyard believes there are many prospects within specialty and high-end segments of the Jones Act market and replacement needs remain for segments of the aging Jones Act fleet. However, it is anticipated the market opportunities for large Jones Act ocean-going vessels in this time frame will be cyclical and will not produce a steady and predictable stream of work.

In contrast, the opportunities for the next 5-10 years in the government sector are robust. Given these market conditions, following PSI's last commercial product tanker order in 2015, the Company began to plan combining government and commercial work in order to best achieve continuous shipbuilding activities and a balanced order book. In order to successfully execute this plan, Philly Shipyard has already taken substantial steps to build-up its government contracting resources and systems and ensure it is prepared to handle government work. Among other endeavors, Philly Shipyard has gained valuable experience with the significant investment made over the past several years in connection with the government-funded industry study and bid preparation for the U.S. Coast Guard's next generation Heavy Polar Icebreaker (now known as Polar Security Cutter) program.

The U.S. Navy and Military Sealift Command have recognized that establishing a Common Hull Auxiliary Multi-Mission Platform (CHAMP) could result in significant decreases in cost both in ship construction and life-cycle maintenance cost. This strategic effort has a high priority for the Navy and Naval Sea Systems Command Program Management Office. The demand for the CHAMP program could approach 40+ vessels, with significant acquisition occurring over the next ten years. The CHAMP vessels are not combatants; hence, more commercially oriented and fit the structure of Philly Shipyard with limited changes. Philly Shipyard believes it can participate in the CHAMP program, either with Engineering & Construction or Construction only. Philly Shipyard recently submitted a proposal as a prime contractor to participate in the design studies for the CHAMP program.

The Company faces many challenges and risks but Philly Shipyard continues to believe it can capitalize on future newbuild opportunities in the commercial and government segments that create value for its shareholders. Philly Shipyard remains committed to building the most cost-efficient and environmentally friendly vessels in the Jones Act market and believes that it will build its fair share of these vessels when they are ordered. Additionally, Philly Shipyard intends to offer the government a new, high quality, cost-effective solution to help meet their ship program needs.

Shipping

As part of the process of liquidating Philly Tankers described above, Philly Shipyard has received its liquidating distribution from Philly Tankers, bringing Philly Shipyard's share of total distributions to USD 86.6 million. This caps off an innovative plan for Philly Shipyard to invest in eight Jones Act product tankers with an approximate contract value of USD 1.0 billion through the Philly Shipyard-Crowley joint venture (Hulls 021-024) and Philly Tankers (Hulls 025-028). 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.

Oslo, Norway
5 March 2019
Board of Directors
Philly Shipyard ASA

James H. Miller
Board Chairman

Kristian Røkke
Deputy Board Chairman

Amy Humphreys
Board Member

Elin Karfjell
Board Member

Steinar Nerbøvik
President and CEO

Directors' responsibility statement

Today, the Board of Directors and the Chief Executive Officer reviewed and approved the Board of Directors' report and the consolidated and separate annual financial statements for Philly Shipyard ASA, as of and for the year ending 31 December 2018 (annual report 2018).

The Philly Shipyard ASA consolidated financial statements have been prepared in accordance with IFRS, as adopted by the European Union, and additional disclosure requirements in the Norwegian Accounting Act, and that should be used as of 31 December 2018. The separate financial statements for Philly Shipyard ASA have been prepared in accordance with the Norwegian Accounting Act and Norwegian Accounting Standards as of 31 December 2018. The Board of Directors' report for Philly Shipyard and the parent company is in accordance with the requirements in the Norwegian Accounting Act and Norwegian accounting standard no. 16, as of 31 December 2018.

To the best of our knowledge:

- The consolidated and separate annual financial statements for 2018 have been prepared in accordance with applicable accounting standards
- The consolidated and separate annual financial statements give a true and fair view of the assets, liabilities, financial position and profit as a whole as of 31 December 2018 for Philly Shipyard and the parent company
- The Board of Directors' report for Philly Shipyard and the parent company includes a true and fair review of:
  - The development and performance of the business and the position of Philly Shipyard and the parent company
  - The principal risks and uncertainties Philly Shipyard and the parent company face

Oslo, Norway
5 March 2019
Board of Directors
Philly Shipyard ASA

James H. Miller
Board Chairman

Kristian Røkke
Deputy Board Chairman

Amy Humphreys
Board Member

Elin Karfjell
Board Member

Steinar Nerbøvik
President and CEO

Philly Shipyard ASA

Consolidated Income Statement

Amounts in USD thousands (except share amounts and earnings per share)	*Note*	**2018**	2017
Operating revenues	*2*	**129 737**	591 784
Other (loss)/income	*2*	**(523)**	22 851
Operating revenues and other (loss)/income		**129 214**	614 635
Cost of vessels sold		**(126 560)**	(499 400)
Wages and other personnel expenses, net	*4*	**(1 927)**	(3 308)
Other operating expenses	*5*	**(16 544)**	(6 868)
Operating (loss)/income before depreciation and impairment (EBITDA)		**(15 817)**	105 059
Depreciation	*8*	**(7 830)**	(5 797)
Impairment of assets	*8*	**(17 601)**	-
Operating (loss)/income before interest and taxes (EBIT)		**(41 248)**	99 262
Financial income	*6*	**1 524**	2 703
Financial expense	*6*	**(2 084)**	(2 032)
(Loss)/income before tax		**(41 808)**	99 933
Income tax expense	*7*	**(2 291)**	(32 710)
(Loss)/income after tax		**(44 099)**	67 223
Weighted average number of ordinary shares	*13*	**12 107 901**	12 107 901
Basic (loss)/earnings per share (USD)	*13*	**(3.64)**	5.55
Diluted (loss)/earnings per share (USD)	*13*	**(3.64)**	5.55

Consolidated Statement of Comprehensive Income

Amounts in USD thousands	**2018**	2017
Net (loss)/income for the year	**(44 099)**	67 223
Other comprehensive income, net of income tax	**-**	-
Total comprehensive (loss)/income for the year *	**(44 099)**	67 223

* All attributable to equity holders of the parent company.

Philly Shipyard ASA

Consolidated Statement of Financial Position as of 31 December

Amounts in USD thousands	*Note*	**2018**	2017
ASSETS			
Property, plant and equipment	*8*	**44 084**	50 103
Restricted cash	*12*	**44 616**	13 154
Equity-accounted investments	*23*	**44 641**	47 310
Deferred tax asset	*7*	**-**	897
Other non-current assets	*9*	**231**	239
Total non-current assets		**133 572**	111 703
Prepayments and other receivables	*10*	**3 534**	4 603
Income tax receivable	*7*	**3 262**	5 912
Vessels-under-construction receivable	*3*	**-**	7 275
Work-in-process	*3,8*	**-**	13 420
Restricted cash	*12*	**-**	14
Cash and cash equivalents	*11*	**49 624**	110 066
Total current assets		**56 420**	141 290
Total assets		**189 992**	252 993
EQUITY AND LIABILITIES			
Paid in capital	*14*	**35 206**	35 206
Other equity		**76 272**	120 371
Total equity attributable to equity holders of the parent company		**111 478**	155 577
Total equity		**111 478**	155 577
Interest-bearing long-term debt	*15*	**59 639**	59 370
Deferred tax liability	*7*	**1 500**	704
Total non-current liabilities		**61 139**	60 074
Trade payables and accrued liabilities	*19*	**15 042**	34 814
Other provisions - warranties	*18*	**945**	1 315
Customer advances, net	*3*	**1 218**	-
Interest-bearing short-term debt	*15*	**-**	248
Income tax payable	*7*	**170**	965
Total current liabilities		**17 375**	37 342
Total liabilities		**78 514**	97 416
Total equity and liabilities		**189 992**	252 993

Oslo, Norway
5 March 2019
Board of Directors
Philly Shipyard ASA

James H. Miller
Board Chairman

Kristian Røkke
Deputy Board Chairman

Amy Humphreys
Board Member

Elin Karfjell
Board Member

Steinar Nerbøvik
President and CEO

Philly Shipyard ASA

Consolidated Statement of Changes in Equity

Amounts in USD thousands	Share capital	Share premium	Treasury shares	Other equity	Total equity
Balance at 31 December 2016	22 664	22 511	(9 969)	56 175	91 381
Dividend paid	-	-	-	(3 027)	(3 027)
Total comprehensive income for the year 2017	-	-	-	67 223	67 223
Balance at 31 December 2017	22 664	22 511	(9 969)	120 371	155 577
Total comprehensive loss for the year 2018	-	-	-	(44 099)	(44 099)
Balance at 31 December 2018	**22 664**	**22 511**	**(9 969)**	**76 272**	**111 478**

Philly Shipyard ASA

Consolidated Cash Flow Statement

Amounts in USD thousands	*Note*	**2018**	2017
(Loss)/income before tax		**(41 808)**	99 933
Unrealized foreign exchange loss/(gain)	*6,10*	**146**	(1 829)
Depreciation	*8*	**7 830**	7 649
Impairment of work-in-process assets [1]	*3,8*	**13 420**	-
Amortization of fees of interest-bearing long-term debt	*15*	**289**	289
Loss/(profit) in equity-accounted investments	*2,23*	**523**	(19 618)
Recognized deferred net gain in equity-accounted investments	*2,23*	**-**	(3 233)
Net financial expense	*6*	**460**	1 399
(Increase)/decrease in:			
Vessels-under-construction receivable	*3*	**7 275**	(7 275)
Work-in-process [1]	*3*	**-**	166 901
Restricted cash	*12*	**(4 916)**	6 987
Prepayments and other receivables	*10*	**923**	1 326
Other non-current assets	*9*	**8**	(1)
Increase/(decrease) in:			
Trade payables and accrued liabilities	*18,19*	**(20 142)**	(21 065)
Customer advances, net	*3*	**1 218**	(97 887)
Other non-current liabilities		**-**	(3)
Income taxes refunded/(paid)	*7*	**1 258**	(22 586)
Interest paid, net of capitalized interest	*6*	**(1 938)**	(5 076)
Interest received	*6*	**1 478**	3 677
Net cash flow (used in)/from operating activities		**(33 976)**	109 588
Investments in property, plant and equipment	*8*	**(1 811)**	(7 192)
Distribution received from equity-accounted investments		**2 145**	39 876
Net cash flow from investing activities		**334**	32 684
Portion of interest-bearing long-term debt held in escrow	*12*	**(26 532)**	(53)
Repayment of interest-bearing debt	*15*	**(268)**	(235)
Proceeds from construction loans	*15*	**-**	127 000
Repayment of construction loans	*15*	**-**	(225 000)
Dividend paid		**-**	(3 027)
Net cash flow used in financing activities		**(26 800)**	(101 315)
Net change in cash and cash equivalents		**(60 442)**	40 957
Cash and cash equivalents as of 1 January		**110 066**	69 109
Cash and cash equivalents as of 31 December	*11*	**49 624**	110 066

[1] Total impairment charge for work-in-process assets thru 31 December 2018 amounts to USD 17.601 million which includes spending of USD 13.420 million thru 31 December 2017 plus spending of USD 4.181 million in 2018.

Philly Shipyard ASA

Notes to the accounts

Note 1: Accounting principles

STATEMENT OF COMPLIANCE

The consolidated financial statements of Philly Shipyard ASA and its subsidiaries (referred to herein as a group as Philly Shipyard, the Group or the Company) have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union in effect at each financial reporting period.

These accounts have been approved for issue by the Board of Directors on 5 March 2019. The annual accounts will be submitted to Philly Shipyard's annual general meeting on 5 April 2019 for final approval.

BACKGROUND AND BASIS FOR PREPARATION

Philly Shipyard ASA (referred to herein as PHLY) was formed on 16 October 2007 to be the holding company of Philly Shipyard, Inc. (referred to herein as PSI or the Shipyard) which operates a shipyard located in Philadelphia, Pennsylvania, USA. PSI owns certain subsidiaries in connection with its investments in its shipping assets.

PHLY is domiciled in Oslo, Norway. PSI is domiciled in the Commonwealth of Pennsylvania, USA. The subsidiaries of PSI are domiciled in the State of Delaware, USA. These consolidated financial statements have been prepared on a historical cost basis, except for derivative financial instruments that have been measured at fair value. The consolidated financial statements are presented in USD (thousands), except when indicated otherwise.

USE OF ESTIMATES

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts in the financial statements. Although these estimates are based on management's best knowledge of current events and actions, actual results may ultimately differ from those estimates.

Critical accounting estimates and assumptions are as follows:

Revenue and Cost Recognition

Philly Shipyard recognizes revenue over time in accordance with IFRS 15 *Revenue from Contracts with Customers*. This approach requires Philly Shipyard to measure the progress of contract activity at each statement of financial position date and estimate the ultimate outcome of costs and profit on contracts. Progress towards satisfying performance obligations is measured based on project costs incurred compared to the total forecasted project costs. In case of a loss-making project, a loss provision will be made when it is estimated that total contract costs will exceed total contract revenues. Revenue and cost estimates from shipbuilding activities depend, amongst others, on variables such as steel prices, supplier and subcontractor costs, labor costs and availability, and other production inputs. Philly Shipyard must also evaluate and estimate the outcome of variation orders, liquidated damages, contract claims and requests from customers to modify contractual terms which can involve complex negotiations with customers. Generally, estimates are subject to a greater level of uncertainty when a vessel design is new to the Shipyard than if a vessel is being constructed later in a series.

Estimates of the Fair Value of its Cash Generating Unit

Philly Shipyard has concluded that it has only one primary cash generating unit and must determine the recoverable amount of its cash generating unit in order to perform impairment tests of its long-lived assets when impairment indicators are present. Philly Shipyard evaluates its investment in Philly Tankers LLC (see note 23) separately from its primary cash generating unit. Determining the recoverable amount of the cash generating unit that includes Philly Shipyard's activities is subject to uncertainty and requires estimates of the recoverable amount which is the higher of the fair value less costs to sell and value in use. The estimated recoverable amount is determined based upon the present value of the future cash flows of the cash generating unit. Generally, there will be uncertainties regarding the timing and amount of cash flows for various reasons, including the costs of production and demand in the U.S. Jones Act shipping market and the current lack of order backlog at the Company. In addition, Philly Shipyard must determine an appropriate interest rate to discount expected future cash flows.

Deferred Income Taxes

Deferred income tax assets are recognized when it is probable that they will be realized. Determining probability requires Philly Shipyard to estimate the sources of future taxable income from operations, including profit sharing agreements and reversing taxable temporary differences. Determining these amounts is subject to uncertainty and is based primarily upon historical earnings, reversals of taxable temporary differences and expected earnings due to contracts in progress and contract order backlog. The recognition of deferred tax assets is primarily applicable to U.S. taxes where Philly Shipyard has a net deferred tax asset position.

R&D Tax Credit

Since 2015, PSI has qualified for the research and development (R&D) tax credit for both federal and Pennsylvania tax purposes. The Shipyard qualified for the credit because of the research it undertook to discover information that is technological in nature and intended to be useful in the development of a new or improved business component. The Company recognizes the R&D tax credit estimate as part of the income tax expense based on a calculation of qualifying research expenses using available guidance and the applicable rules and regulations. An R&D tax credit of USD 157 thousand has been included in the income tax expense in 2018. This amount was fully offset by a valuation allowance, so it had no impact on tax expense in the current year.

Accruals/Provisions

Philly Shipyard has various accruals/provisions which require management to make estimates. Accruals/provisions are typically made for costs that arise after vessel deliveries, including warranty costs, and regular accruals/provisions made at the end of a financial period where costs have been incurred but an invoice has not yet been received. In addition, accruals/provisions are made if the Company has identified a commitment or event that will trigger a future payment. Management uses all available facts and circumstances when determining these estimates including historical experiences as well as input from outside advisors.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised if the revision affects that period or in the period of revision and future periods if the revision affects both current and future periods.

SIGNIFICANT JUDGMENTS

The preparation of consolidated financial statements in conformity with IFRS requires management to make judgments that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense.

Going Concern

The 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 beyond the delivery of Hull 030 scheduled in Q1 2019. Whilst 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 beyond Q1 2019.

At 31 December 2018, the Group had net assets (equity) of USD 110.5 million (2017: USD 155.6 million), and a working capital surplus of USD 39.0 million (2017: USD 103.9 million). During the year ended 31 December 2018, the Group recorded cash outflows from operating activities of USD 34.0 million (2017 cash inflows: USD 109.6 million), cash inflows from investing activities of USD 0.3 million (2017: USD 32.7 million) and cash outflows from financing activities of USD 26.8 million (2017: USD 101.3 million). For the year ended 31 December 2018, the Group recorded a net cash outflow of USD 60.5 million (2017 net cash inflow: USD 41.0 million).

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 beyond the delivery of Hull 030 scheduled in Q1 2019. The delay Philly Shipyard has experienced in securing new orders and financing for work after Hull 030 has interrupted its building program, resulting in the idling of all production activities in its facility except in one of two graving docks and a decrease of more than 65% 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; increases in under-recovered overhead costs (i.e., overhead costs incurred and not allocated to projects); and operational inefficiencies for completion of the remaining vessel in the current order backlog.

- The longer the delay in securing new orders beyond Hull 030 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 Philly Shipyard Inc. (PSI) and 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 the last vessel in its order backlog (Hull 030), which is scheduled 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, 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 beyond Q1 2019 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 up to five of the U.S. state maritime academy training ships. The award of this shipyard contract is expected to be announced in Q2 2019 with a delivery of the first vessel targeted for the end of Q4 2021. 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 to support this project. PSI may not be able to obtain sufficient construction financing facilities, debt facilities or bonding capacity if and when needed or with favorable terms.

- In addition, Philly Shipyard is aggressively pursuing several possibilities for short-term work to have some activity in the shipyard in 2019 before a production start of a potential new shipbuilding project. In particular, Philly Shipyard is pursuing possibilities for steel work and repair, 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 beyond Q1 2019, 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 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.

Equity-Accounted Investments

As of 31 December 2018, the Company owns 53.7% of the outstanding shares of Philly Tankers. The Company has performed an analysis of its ownership interests and voting rights in the articles of association in Philly Tankers and concluded that it does not control the relevant activities of Philly Tankers. Therefore, the Company accounts for the investment using the equity method and does not consolidate Philly Tankers.

Revenue and Cost Recognition of Philly Tankers Vessels (completed in 2017)

Philly Shipyard did not use the percentage-of-completion method for accounting for PSI's shipbuilding contracts with Philly Tankers for Hulls 025-028. In management's judgment, these contracts did not meet the definition of construction contracts under IAS 11. Accordingly, Philly Shipyard recognized the revenues, costs and profit on each of these vessels at its delivery date, as if PSI was originally building these vessels for its own account. This accounting treatment for Hulls 025-028 is required because there were no external customers at the time these contracts were signed and shipbuilding activities commenced.

PHILLY SHIPYARD ACCOUNTING AND CONSOLIDATION PRINCIPLES

Subsidiaries

The consolidated financial statements include the financial statements of the parent company, Philly Shipyard ASA, and its subsidiaries. Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability affect those returns through its power over the entity.

Equity-Accounted Investments

Philly Shipyard's equity-accounted investment comprise its interests in an associate (Philly Tankers).

Associates are those entities in which Philly Shipyard has significant influence, but not control or joint control, over the financial and operating policies.

Interest in associates are accounted for using the equity method. They are initially recognized at cost, which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include Philly Shipyard's share of the profit or loss and other comprehensive income of equity–accounted investments, until the date on which significant influence or joint control ceases.

Transactions Eliminated on Consolidation

Intra-group balances and transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated.

Revenues and costs related to vessel construction transactions with equity-accounted investees are not eliminated. However, profits from revenue transactions accounted for as construction contracts are deferred to the extent of Philly Shipyard's ownership of the investee until the investee either sells or operates the related vessel at which time the deferred profit is recognized in full when the investee sells the vessel or ratably over the useful life for vessels held for use by the investee. Deferred profit is treated as an adjustment to revenue with a corresponding adjustment to the investment balance for the equity-accounted investments.

For revenue transactions with equity-accounted investments that are not accounted for as construction contracts, any unrealized gains are eliminated prior to delivery of the vessel and treated as an adjustment to the investment to the extent of Philly Shipyard's interest in the investments. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

Foreign Currency Translation and Transactions

Functional Currency

Items included in the financial statements of each entity in Philly Shipyard are initially recorded in the entity's functional currency, i.e. the currency that best reflects the economic substance of the underlying events and circumstances relevant to that entity.

The consolidated financial statements are presented in United States dollars (USD), rounded to the nearest thousand, which is the reporting currency for the consolidated accounts and the functional currencies for all the entities within Philly Shipyard.

Transactions and Balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities in foreign currencies are translated into the functional currency at the exchange rates in effect on the statement of financial position date. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated income statement. Foreign exchange differences arising in respect of operating items are included in operating profit in the consolidated income statement, and those arising in respect of financial assets and liabilities are recorded net as a financial item.

PROPERTY, PLANT AND EQUIPMENT

General

Property, plant and equipment acquired by the Shipyard is stated at cost at the date of acquisition. Depreciation is calculated on a straight-line basis and adjusted for impairment charges, if any. The carrying value of the property, plant and equipment on the statement of financial position represents the cost net of government grants and subsidies received (if applicable) less accumulated depreciation and any impairment charges. Cost includes expenditures that are directly attributable to the asset. The cost of self-constructed assets includes the costs of material and direct labor, and any other costs directly attributable to bringing the asset to working condition for its intended use. Interest costs on borrowings to finance the construction of property, plant and equipment are capitalized during the period of time that is required to complete and prepare the asset for its intended use.

Land is not depreciated, but other property, plant, and equipment in use are depreciated on a straight-line basis. Expected useful lives of long-lived assets are reviewed annually and, where they differ significantly from previous estimates, depreciation periods are changed accordingly.

Ordinary repairs and maintenance costs are charged to the consolidated income statement during the financial period in which they are incurred. The cost of improvements is included in the asset's carrying amount when it is probable that the Shipyard will derive future economic benefits in excess of the originally assessed standard of performance of the existing asset. Improvements are depreciated over the useful lives of the related assets.

Gains and losses on disposals are determined by comparing the disposal proceeds with the carrying amount and are included in operating profit. Assets to be disposed of are reported at the lower of the carrying amount and the fair value less selling costs.

Component Cost Accounting

The Company allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant components and depreciates separately each such component part over its useful life.

IMPAIRMENT OF LONG-LIVED ASSETS

Property, plant and equipment and other non-current assets are reviewed for potential impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable, mainly independent, cash inflows. An impairment loss is the amount by which the carrying amount of the assets exceeds the recoverable amount. The recoverable amount is the higher of the asset's net selling price and its value in use. The value in use is determined by discounted cash flows and fair market value is based on recent third party appraisals.

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount, however not to an extent higher than the carrying amount that would have been determined had no impairment loss been recognized in prior years.

LEASES

Leases of property, plant and equipment, where the Shipyard has substantially all the risks and rewards of ownership, are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability. Finance charges are charged to interest expense. Property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases net of any incentives received from the lessor is charged to the consolidated income statement on a straight-line basis over the period of the lease when annual installments vary.

When a sale and leaseback results in a finance lease, any gain on the sale is deferred and recognized as income over the lease term. If the leaseback is classified as an operating lease, then any gain is recognized immediately if the sale and leaseback are at fair value.

IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS (effective from 1 January 2018)

IFRS 15 was adopted by the Group from 1 January 2018, which superseded the previous revenue recognition guidance including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and the related interpretations. The standard introduced a new five-step model that applies to revenue arising from contracts with customers.

Philly Shipyard principally generates revenues from activities relating to long-term shipbuilding construction contracts, and no material revenues are recorded from the sale of goods or rendering of services. A detailed review of existing customer contracts was carried out on the contracts for Hulls 029 and 030 with Matson, which were the only open shipbuilding construction contracts between 1 January to 31 December 2018.

- Construction contracts:
  The construction contracts previously in the scope of IAS 11 were reassessed according to IFRS 15 to evaluate whether the revenue from such contracts shall be recognized over time or at a point in time. As a result of the assessment, the Company concluded that the principle-over-time revenue recognition method was appropriate for these contracts based on the fact that the vessels under construction do not create an asset with an alternative use to the entity, and the entity

has an enforceable right to payment from the customer for the work completed to date.

- Performance obligations:
  The Matson vessels are being treated as a single performance obligation due to their similar nature and the integration of the design and production of the hulls. Progress towards completing the Matson performance obligation is measured over time based on project costs incurred compared to the total forecasted project costs. This is considered to be a faithful depiction of the transfer of goods as it accurately reflects the underlying transactions and progress. This differs from prior year treatment under IAS 11 where progress was measured by production hours earned over total budgeted production hours.

- Constraint of variable consideration:
  To include variable consideration in the estimated contract revenue under IFRS 15, the entity has to conclude that it is highly probable that a significant revenue reversal will not occur when the uncertainties related to the variability are resolved. The threshold of including variable considerations in revenue recognition is higher than the requirements under current standards.

On transition to IFRS 15, the Company applied the cumulative effect method which requires the cumulative effect of initial application recognized as an adjustment to the opening balance of retained earnings as of 1 January 2018. Under this transition method, the new standard was applied to the contracts for Hulls 029 and 030 with Matson, which were the only open shipbuilding construction contracts in progress at the time of transition. As allowed under the standard, the comparable information presented was not restated. Based on its assessment, the following adjustment was made at initial application:

Total incurred contract expenses as of 31 December 2017 can be specified as follows:

Contract expenses charged to profit and loss according to IAS 11	221 744
Incurred contract expenses included in the balance	38 397
Total incurred contract expenses thru 31 December 2017	**260 141**

The adoption had an impact on the timing of revenue recognition by increasing accumulated revenues recognized at 31 December 2017 from Hulls 029 and 030 by USD 38.4 million, with a corresponding decrease in future revenue to be recorded from 1 January 2018. As such, there is a USD 38.4 million difference between accumulated revenue from the 1 January 2018 effective date of IFRS 15 and 31 December 2017 as presented in the annual report for 2017. There was no effect on the 2018 opening balance of equity related to IFRS 15, given that the Matson contract was forecast at a breakeven project as of 31 December 2017. In addition there was no material impact on the Group's statement of financial position or cash flow statement for the year ended 31 December 2018.

Project revenue is classified as operating revenues in the consolidated income statement. Vessels-under-construction receivable is classified as a current asset in the statement of financial position. Advances from customers are deducted from the value of vessels-under-construction receivable of the contract involved or, to the extent they exceed this value, recorded as customer advances, net. Customer advances, net that exceed contract offsets would be classified as current liabilities.

VESSEL CONSTRUCTION WHEN IFRS 15 REVENUE FROM CONTRACTS WITH CUSTOMERS DOES NOT APPLY

Vessels-under-construction with no customer contract

Vessels-under-construction which are not under contract with a customer is capitalized into work-in-process. If conditions indicate that the ultimate sales price will be below the estimated cost of the vessel, Philly Shipyard determines the estimated sales price and records an impairment charge as appropriate. The accumulated costs for vessels-under-construction receivable for unspecified customers is included in work-in-process. This treatment is not applicable for the current year as the Company is currently not building any vessels on its own account.

GOVERNMENT GRANTS AND SUPPORT

Government grants and support are recognized at their fair value where there is reasonable assurance that amounts will be received and conditions have been met. In some cases, recognition occurs over a period of time as restrictions lapse or as conditions are met. Grants and support related to capital expenditures or construction of assets for the Shipyard's account are recognized as a reduction of the related asset cost. For assets held for use, this results in a lower depreciation charge over the useful life of the asset. Grants related to specific programs or projects are recognized as reductions in expense over the period in which work that relates to the grant or support is performed.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash on hand, demand deposits with banks and other short-term highly liquid investments with original maturities of three months or less.

INTEREST-BEARING LIABILITIES

All loans and borrowings are initially recognized at cost, being the fair value of the consideration received net of issue costs associated with the borrowing.

After initial recognition, interest-bearing borrowings are subsequently measured at amortized cost using the effective interest method; any difference between proceeds (net of transaction costs) and the redemption value is recognized in the consolidated income statement over the period the interest bearing liabilities are outstanding. Amortized cost is calculated by taking into account any issuance costs, and any discount or premium.

Gains and losses are recognized in net profit or loss when the liabilities are derecognized or impaired, as well as through the amortization process.

INCOME TAXES

Current Income Taxes

Income taxes receivable and payable for the current period are measured at the amount expected to be recovered or paid to the taxation authorities. The tax rates and tax laws as used to compute the amount are those that are enacted or substantively enacted by the statement of financial position date.

Deferred Income Taxes

Deferred income tax is provided, using the asset/liability method, on all temporary differences at the statement of financial position date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes, except upon initial recognition of an asset or a liability that does not impact income.

Deferred income tax assets are recognized for all deductible temporary differences, and carry-forward of unused tax losses and credits, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax losses and credits can be utilized. The carrying amount of deferred income tax assets is reviewed at each statement of financial position date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. The expected utilization of tax losses are not discounted when calculating the deferred tax asset.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the statement of financial position date.

PENSION OBLIGATIONS

The Shipyard has a pension plan that covers its non-union employees whereby contributions are paid to a qualifying pension plan. The Shipyard's union employees are participants in a union selected pension plan. Although the Union Plan is a defined benefit pension plan, because the union does not provide information on the Shipyard's employees and their share of the pension assets and obligations, the plan is accounted for in accordance with the requirements of a defined contribution plan. Under defined contribution pension plans, contributions are charged to the consolidated income statement in the period to which the contributions relate.

PROVISIONS

A provision is recognized when Philly Shipyard has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

Provisions are reviewed at each statement of financial position date and adjusted to reflect the current estimate.

The amount of the provision is the present value of the risk adjusted expenditures expected to be required to settle the obligation, determined using the estimated risk free interest rate as the discount rate. Where discounting is used, the carrying amount of provision increases in each period and is recognized as interest expense.

FINANCIAL RISK MANAGEMENT

Philly Shipyard's activities expose it to a variety of financial risks: market risk (including commodity pricing risk, currency risk and price risk), credit risk and cash-flow interest-rate risk. Philly Shipyard's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on Philly Shipyard's financial performance. Philly Shipyard uses derivative financial instruments to hedge certain risk exposures.

Risk-management is carried out under policies approved by the Board of Directors. The Board of Directors provides principles for overall financial risk management as well as policies covering specific areas such as foreign exchange risk, interest-rate risk, credit risk, and use of derivative financial instruments and non-derivative financial instruments.

Credit Risk

Due to the nature of the Shipyard's operations, revenues and related receivables are typically concentrated amongst a few customers. As of 31 December 2018, the Shipyard has one customer: Matson Navigation Company, Inc. (referred to herein as Matson). Philly Shipyard continually evaluates the credit risk associated with customers and their assignees and manages this risk by requiring payment for substantially the entire contractual amount prior to delivering a vessel, including milestone payments upon completion of specified milestones.

Interest Rate Risk

Philly Shipyard is exposed to fluctuations in interest rates for its variable interest rate debt related to construction financing and working capital facilities.

Foreign Exchange Risk

Philly Shipyard is exposed to foreign currency risk for purchases made in currencies other than the U.S. dollar which primarily relates to materials, supplies and costs related to the services of expatriate workers purchased from Korea, Norway and other countries in Europe. Philly Shipyard attempts to mitigate this risk through its foreign exchange hedging program or passing this risk onto its end customers by having them purchase certain materials directly in foreign currency.

Commodity Price Risk

The Shipyard is exposed to commodity price risk on the steel that it procures in the shipbuilding process. The Shipyard seeks to mitigate this risk by attempting to pass this risk on to its end customers by having them purchase materials directly or by including steel escalation clauses in the shipbuilding contracts. The Shipyard also seeks to mitigate this risk by attempting to pass the risk on to its suppliers by capping the increase in pricing to be paid by the Shipyard.

Capital Management Risk

Philly Shipyard's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders, while maintaining an optimal capital structure to minimize the cost of capital. To meet these capital structure objectives, Philly Shipyard reviews on a quarterly basis with its Board any proposed dividends as well as any needs to raise additional equity for future business opportunities or to reduce debt. Any payment of dividends, including ordinary dividends, is dependent on, among other things, performance on existing contracts and possible new orders and will be considered in conjunction with the Company's financial position, debt covenants, capital requirements, market prospects and potential strengthening of the Company's financial structure.

Funding/Investment Risk

Philly Shipyard regularly monitors the financial condition of its construction financing lenders. Additionally, Philly Shipyard monitors the financial condition of the financial institutions which it uses for cash management services and in which it makes deposits and other investments. Philly Shipyard responds to changes in conditions affecting its financing sources and deposit relationships as situations warrant.

Liquidity Risk

Liquidity risk is the risk that Philly Shipyard will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or other financial assets. Philly Shipyard's approach to managing liquidity is to ensure, to the extent possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to Philly Shipyard's reputation. Philly Shipyard attempts to mitigate this risk through project financing and working capital facilities, progress payments from its customers, and material supplied and paid directly by its customers.

Accounting for Derivative Financial Instruments and Hedging Activities

Derivative financial instruments are recognized initially and in subsequent periods on the statement of financial position at fair value with the resulting gains and losses included in the consolidated income statement.

In accordance with its treasury policy, Philly Shipyard does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Estimates of the fair value for foreign currency contracts are obtained from a third party. The fair value of derivative long-term financial liabilities is disclosed in note 21 regarding financial instruments.

IFRS 9 Financial Instruments (effective from 1 January 2018)

The standard replaced IAS 39 *Financial Instruments Recognition and Measurement*. The standard includes revised guidance on classification and measurement of financial instruments, including a new expected credit loss model for calculating impairment on financial assets. The standard also introduces new general hedge accounting requirements, however Philly Shipyard does not apply hedge accounting to forward foreign exchange contracts held.

- Classification – Financial assets

IFRS 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics. The standard contains three principal classification categories: measured at amortized costs, Fair Value to Other Comprehensive Income (FVOCI) and Fair Value to Profit and Loss (FVTPL).

Based on its assessment and the nature of financial assets held by Philly Shipyard, the current classifications of the financial instruments held as at 31 December 2018 were not materially impacted.

- Impairment – Financial assets and contract assets

IFRS 9 replaces the "incurred loss" model in IAS 39 with a forward-looking "expected credit loss" (ECL) model. The new impairment model applies to financial assets measured at amortized cost or FVOCI and contract assets, except for equity instruments. Under IFRS 9, loss allowance is measured based on either "12-month ECLs" or "lifetime ECLs". The Company applied the simplified approach using "lifetime ECLs" for all trade receivables and contract assets.

Based on the Company's assessment, no significant changes in loss allowance were deemed necessary in order to satisfy the impairment requirement under IFRS 9. The transition to IFRS 9 was applied retrospectively as an adjustment to the opening balance of equity as of 1 January 2018. Further, the Company adopted the exemption allowing it not to restate comparative information for prior years with respect to classification and measurement changes, including impairment measurement.

RELATED PARTY TRANSACTIONS

The Company's policy is that all transactions, agreements and business activities with related parties are conducted on an arm's length basis according to ordinary business terms and conditions.

SEGMENT INFORMATION

Philly Shipyard currently has one business segment which is building vessels for the U.S. Jones Act market.

BASIC AND DILUTED EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to ordinary shareholders using the weighted average number of shares outstanding during the year (not including the treasury shares). The calculation of diluted earnings per share is consistent with the calculation of basic earnings per share while giving effect to all potential dilutive ordinary shares that were outstanding during the period. Philly Shipyard currently has no potentially dilutive shares outstanding.

EVENTS AFTER 31 DECEMBER 2018
A distinction is made between events both favorable and unfavorable that provide evidence of conditions that existed at the statement of financial position date (adjusting events) and those that are indicative of conditions that arose after the statement of financial position date (non-adjusting events). Financial statements will only be adjusted to reflect adjusting events and not non-adjusting events (although there are disclosure requirements for such events).

NEW STANDARDS AND INTERPRETATIONS ADOPTED
Standards Issued But Not Yet Effective
At the date of authorization of the consolidated financial statements, a number of new standards and interpretations were issued but not yet effective. The standards anticipated to affect the Company were assessed for expected impact. The Company has not early adopted any new or amended standards for the financial statements as of 31 December 2018.

IFRS 16 Leases (effective from 1 January 2019)
The standard replaces IAS 17 *Leases* and the related interpretations (see notes 8 and 16 for further details). 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. With regards to lessor accounting, the requirements remain similar to the current standard.

The Company has made the below assessment of the impact on its consolidated financial statements:

- The Company anticipates that new assets and liabilities will be recognized for its operating lease agreements where the Company is a lessee. In addition, the nature and timing of expenses related to these leases will change when the straight-line operating lease expenses will be replaced by depreciation charge for lease assets and interest expenses for lease liabilities under IFRS 16.

- The Company does not anticipate significant impact for the Company's finance leases.

The Company plans to apply IFRS 16 initially on 1 January 2019, using the modified retrospective approach. Therefore, the 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.

Note 2: Operating revenues and other income

Operating revenues and other income consist of the following items:

Amounts in USD thousands	**2018**	2017
Operating revenues	**129 737**	591 784
(Loss)/profit in equity-accounted investments	**(523)**	19 618
Recognized deferred net gain in equity-accounted investments	-	3 233
Other (loss)/income	**(523)**	22 851
Total operating revenues and other (loss)/income	**129 214**	614 635

(Loss)/profit in equity-accounted investments (Hulls 025-028) represents the Company's 53.7% share of the total comprehensive (loss)/profit of Philly Tankers which at 31 December 2018 and 31 December 2017 amounted to negative USD 0.5 million and USD 19.6 million, respectively (see note 23).

Recognized deferred net gain in equity-accounted investments (Hulls 025-028) represents the Company's USD 5.848 million gain that was deferred on the issuance of Philly Tankers shares in July 2014 to external parties at a price exceeding the Company's cost basis, which at 31 December 2018 and 31 December 2017 amounted to USD 0 and USD 3.233 million, respectively. The entire USD 5.848 million was recognized pro rata at delivery of each of Hulls 025-028 (USD 1.462 million per ship), reduced with recognition of a deferred transaction cost of USD 1.153 million in 2017 (see note 23).

Note 3: Construction contracts/vessels built for own account

The order backlog is USD 17.4 million at 31 December 2018 and represents a contractual obligation to deliver vessels that have not yet been produced for the Company's customer (Matson). Order backlog consists of future contract revenues and is subject to adjustment based on change orders as defined in the construction contracts.

The order backlog on long-term contracts is as follows:

Amounts in USD thousands	**Order backlog 31 Dec. 2018**	**Order intake 2018**	Order backlog 31 Dec. 2017	Order intake 2017	Order backlog 31 Dec. 2016
Total	**17 371**	**(950)**	187 668	(4 033)	784 427

As of 31 December 2018, the Company has one contract in progress where revenue is recognized over time in line with construction progress. During 2018, the Company was building two containerships for Matson: Hull 029 delivered in Q4 2018 and Hull 030 scheduled to be delivered in Q1 2019. These vessels are based on a prototype design and the Company last delivered a containership in 2006. Accordingly, there is a higher technical design risk and a higher project execution risk compared to the recent construction of multiple product tankers, which were based on a proven design. This prototype risk increases the current construction cost estimation uncertainty and the likelihood of occurrence of contract contingencies. For the purposes of revenue recognition under IFRS 15, Hulls 029 and 030 are treated as a combined contract, with the related performance obligation satisfied over time. As of 31 December 2018, the Matson project is approximately 95% complete. The recognized contract loss to date (shown below) is provided for as of 31 December 2018.

Impact of IFRS 15 adoption
As discussed in note 1, IFRS 15 *Revenue from Contracts with Customers* establishes a comprehensive framework for determining whether, how much and when revenue is recognized. It replaced IAS 18 *Revenue*, IAS 11 *Construction Contracts* and related interpretations. Philly Shipyard has applied the cumulative transition approach whereby the cumulative effect of initial application is to be recognized as an adjustment to the opening balance of retained earnings as of 1 January 2018, with no restatement of 2017 comparative figures.

The adoption had an impact on the timing of revenue recognition by increasing accumulated revenues recognized at 31 December 2017 from Hulls 029 and 030 by USD 38.4 million, with a corresponding decrease in future revenue to be recorded from 1 January 2018. As such, there is a USD 38.4 million difference between accumulated revenue from the 1 January 2018 effective date of IFRS 15 and 31 December 2017 as presented in the annual report for 2017. There was no effect on the 2018 opening balance of equity related to IFRS 15, given that the Matson contract was forecast at a breakeven project as of 31 December 2017. In addition there was no material impact on the Group's statement of financial position or cash flow statement for the year ended 31 December 2018.

Under IFRS 15, a performance obligation is defined as a promise to deliver a good or service that meets both of the following criteria:
- The customer will benefit from the good or service either on its own or together with the other resources that are readily available to the customer;
- The promise to transfer the good or service is separately identifiable from other promises in the contract.

Progress towards completing the Matson performance obligation is measured based on project costs incurred compared to the total forecasted project costs. This differs from prior year treatment where progress was measured by production hours earned over total budgeted production hours.

The loss recognized on long-term contracts in process (Hulls 029-030) at year-end is as follows:

Amounts in USD thousands	**Actual 31 Dec. 2018**	**Restated IFRS 15 31 Dec. 2017**	**Adjustment Q1 2018**
Contract revenue recognized to date	389 878	260 141	(38 397)
Contract expenses recognized to date	(400 376)	(260 141)	38 397
Provision for loss	(559)	-	-
Recognized contract loss to date	**(11 057)**	**-**	**-**

Total incurred contract expenses as of 31 December 2017 can be specified as follows:

Contract expenses charged to profit and loss according to IAS 11	221 744
Incurred contract expenses included in the balance	38 397
Total incurred contract expenses thru 31 December 2017	**260 141**

The progress and the revenue recognition thru 31 December 2018 is the difference between the accumulated revenue per 31 December 2018 and the restated accumulated revenue per 31 December 2017.

100% of the revenue, cost and profit for each of Hulls 025-028 was recognized at its last delivery in Q4 2016, Q1 2017, Q3 2017 and Q4 2017, respectively. This accounting treatment was required for Hulls 025-028 because there were no external customers at the time these contracts were signed and shipbuilding activities commenced, and these vessels were considered as built by PSI for its own account.

Customer milestone payments as of 31 December 2018 and 31 December 2017 totalled USD 391.8 million and USD 253.8 million, respectively. Customer milestone payments from Matson 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 31 December 2018 and 31 December 2017 totaled USD 1.2 million and USD 0, respectively.

Vessels-under-construction receivable as of 31 December 2018 and 31 December 2017 totaled USD 0 and USD 7.3 million, respectively. As of 31 December 2018, vessels-under-construction receivable represents the difference between costs incurred for the Matson vessels (Hulls 029-030) and customer advances received from Matson for those vessels.

Work-in-process as of 31 December 2018 and 31 December 2017 totaled USD 0 and USD 13.4 million, respectively. Work-in-process related to non-POC accounted projects is presented gross (where costs incurred are presented as a work-in-process asset, and payments from customers received are presented as customer advances, net liability). POC accounted projects are presented net.

Typical variable consideration elements identified in the Company's contracts with customers include liquidated damages, performance guarantees and warranties. Under the current contract, liquidated damages are considered as variable consideration, whereas performance guarantees and warranties are not categorized as variable consideration.

In 2018, the project to build up to four containerships (CV3700 vessels) for delivery to TOTE Maritime was canceled and, in connection therewith, the full amount of the work-in-process assets pertaining to the first two CV3700 vessels (Hulls 031-032), totalling USD 17.6 million, was written off. USD 17.3 million of this impairment charge was taken in Q3 2018 and the remaining USD 0.3 million of this impairment charge was taken in Q4 2018. See note 8 for further details.

As of 31 December 2018, PSI has non-cancellable purchase commitments for materials and equipment of approximately USD 4.6 million for the construction of Hulls 029-030.

Note 4: Wages and other personnel expenses, net

Wages and other personnel expenses, net consist of:

Amounts in USD thousands (except number of employees)	**2018**	2017
Wages	**34 542**	47 462
Social security contributions	**2 945**	4 005
Pension costs (note 17)	**1 416**	1 663
Other expenses	**7 001**	8 542
Total gross expense	**45 904**	61 672
Expenses related to vessel construction	**(43 977)**	(58 364)
Wages and other personnel expenses, net	**1 927**	3 308
Average number of employees	**419**	624
Number of employees at year-end	**253**	588

Other expenses relate primarily to workers' compensation and employee benefits.

Note 5: Other operating expenses

Other operating expenses consist of:

Amounts in USD thousands	**2018**	2017
Under-recovered overhead costs	**9 387**	-
Other operating expenses	**7 157**	6 868
Total	**16 544**	6 868

In 2018, PSI operated at below normal operating levels and under-recovered overhead costs (i.e., overhead costs incurred and not allocated to projects) were expensed in 2018. Other operating expenses primarily relate to selling, general and administrative expenses.

Fees to auditors for Philly Shipyard are as follows:

Amounts in USD thousands	**2018**	2017
Audit fees	**124**	134
Other audit and attestation fees	**22**	2
Tax non-attest fees	**-**	5
Total	**146**	141

Note 6: Financial income and financial expense

Amounts in USD thousands	**2018**	2017
Interest income	**1 478**	874
Foreign exchange gain	**46**	-
Gain on foreign currency forward contracts	**-**	1 829
Financial income	**1 524**	2 703
Interest expense	**(1 938)**	(5 329)
Loss on foreign currency forward contracts	**(146)**	-
Interest expense capitalized on construction contracts	**-**	3 359
Foreign exchange loss	**-**	(62)
Financial expense	**(2 084)**	(2 032)
Net financial items	**(560)**	671

Details regarding the Company's debt facilities and interest rates are provided in note 15 and foreign exchange gain/(loss) details are provided in note 21. In 2018, the foreign exchange gain is attributable to certain cash balances which are held in Norwegian Kroner and the loss on foreign currency forward contracts is attributable to mark-to-market of foreign currency forward contracts in Korean Won, Norwegian Kroner and Euro. In 2017, the gain on foreign currency forward contracts was attributable to mark-to-market of foreign currency forward contracts in Korean Won, Norwegian Kroner and Euro and the foreign exchange loss was attributable to certain cash balances which were held in Norwegian Kroner.

Note 7: Taxes

Income tax expense/(benefit)
Recognized in the income statement

Amounts in USD thousands	**2018**	2017
Current income tax expense:		
Current year - U.S.	**475**	16 345
Current year - Norway	**122**	965
Total current income tax expense	**597**	17 310
Deferred tax expense/(benefit):		
Origination and reversal of temporary differences - U.S.	**1 983**	15 725
Origination and reversal of temporary differences - Norway	**(289)**	(325)
Total deferred tax expense	**1 694**	15 400
Total income tax expense in the income statement	**2 291**	32 710

Reconciliation of effective tax rate:

Amounts in USD thousands	**2018**	2017
(Loss)/income before tax	**(41 808)**	99 933
Nominal Norwegian tax rate	**23.0%**	24.0%
Expected tax (benefit)/expense using nominal Norwegian tax rate	**(9 616)**	23 984
Effect of differences between nominal Norwegian tax rate and U.S. federal, state and city tax rate	**(4 766)**	19 848
Expenses not deductible for tax purposes	**84**	246
Expenses deductible for tax purposes	**-**	(2 091)
R&D tax credits	**36**	(8 659)
Other differences	**1 839**	(618)
Valuation allowance	**14 714**	-
Total income tax expense in the income statement	**2 291**	32 710

The effective tax rate differs from the expected tax rate primarily due to the difference between the nominal Norwegian tax rate and U.S. federal, state and city tax rates, and income that was not taxable in Norway.

Income tax receivable/income tax payable

Amounts in USD thousands	**2018**	2017
Beginning of the period	**4 947**	(329)
Taxes payable	**(597)**	(17 310)
Taxes (refunded)/paid	**(1 258)**	22 586
End of the period	**3 092**	4 947

Income tax receivable and income tax payable are offset when there is a legally enforceable right to offset the taxes; however, when the taxes relate to different tax authorities, they cannot be offset. The Company's income tax receivable and income tax payable at 31 December 2018 relate to different tax authorities and, therefore, cannot be offset. Accordingly, the Company has an income tax receivable of USD 3.262 million and an income tax payable of USD 170 thousand on its statement of financial position at 31 December 2018.

Deferred tax asset/deferred tax liability
Deferred tax asset and deferred tax liability are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities, and when the deferred income taxes relate to the same fiscal authority, which through 31 December 2018 for the Company was primarily Norway, the United States, the State of Delaware, the Commonwealth of Pennsylvania and the City of Philadelphia.

The offset amounts for U.S. items are as follows:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Deferred tax assets - U.S. tax jurisdictions	**2 612**	6 825
Deferred tax liabilities - U.S. tax jurisdictions	**(3 698)**	(5 928)
Net deferred tax (liability)/asset	**(1 086)**	897

The gross movement in the deferred income tax account for U.S. tax jurisdictions is as follows:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Beginning of the period	**897**	16 624
Deferred tax benefit	**(1 983)**	(15 727)
Net deferred tax (liability)/asset	**(1 086)**	897

The movement in deferred tax asset and deferred tax liability during the year for the U.S. tax jurisdictions is as follows:

Deferred tax asset

Amounts in USD thousands	Other assets	Work-in-process	Total
31 December 2017	6 780	45	6 825
(Charged)/credited to the income statement	(4 212)	(1)	(4 213)
31 December 2018	**2 568**	**44**	**2 612**

Deferred tax liability

Amounts in USD thousands	Property, plant and equipment	Other	Total
31 December 2017	(5 928)	-	(5 928)
(Charged)/credited to the income statement	2 230	-	2 230
31 December 2018	**(3 698)**	**-**	**(3 698)**

The movement in deferred tax asset and deferred tax liability during the year for the Norwegian tax jurisdiction is as follows:

Deferred tax liability

Amounts in USD thousands	Other liabilities	Total
31 December 2017	(704)	(704)
Charged to the income statement	290	290
31 December 2018	**(414)**	**(414)**

PSI has federal tax losses in carryforward as of 31 December 2018 of USD 23.7 million in the U.S. which do not expire.

PSI has State and City tax losses in carryforward as of 31 December 2018 of USD 24.8 million in the U.S., which expire in 20 years with respect to the State tax losses and expire in 3 years with respect to the City tax losses.

As a result of the U.S. federal tax reform legislation passed in 2017, which reduced the corporate income tax rate from 35.0% to 21.0%, and changes to the Company’s effective state tax rate, PSI booked a one-time non-cash tax benefit of USD 1.472 million in 2017.

PSI is currently under audit by the State of Pennsylvania for the four-year period ended 31 March 2018. The Company does not anticipate any material adjustments resulting from the audit.

Note 8: Property, plant and equipment

Movements in property, plant and equipment for 2018 are shown below:

Amounts in USD thousands	Machinery and vehicles	Buildings	Land improvements	Assets-under-construction	Total
Cost at 1 January 2018	54 893	61 175	18 928	2 119	137 115
Purchases	-	-	-	1 811	1 811
Transfers	3 538	350	-	(3 888)	-
Assets written-off	(164)	-	-	-	(164)
Cost at 31 December 2018	**58 267**	**61 525**	**18 928**	**42**	**138 762**
Depreciation and impairment losses at 1 January 2018	46 894	31 146	8 972	-	87 012
Depreciation	4 418	2 531	799	-	7 748
Assets written-off	(82)	-	-	-	(82)
Depreciation and impairment losses at 31 December 2018	**51 230**	**33 677**	**9 771**	**-**	**94 678**
Net book value at 31 December 2018 (1)	**7 037**	**27 848**	**9 157**	**42**	**44 084**
(1) Net book value of assets under financial leasing agreements recorded in the statement of financial position (see note 16):	465	7 065	7 060	-	14 590
Depreciation period	3-12 years	7-30 years	20 years		
Depreciation method	Straight-line	Straight-line	Straight-line		

Movements in property, plant and equipment for 2017 are shown below:

Amounts in USD thousands	Machinery and vehicles	Buildings	Land improvements	Assets-under-construction	Total
Cost at 1 January 2017	48 060	60 689	18 524	2 805	130 078
Purchases	-	-	-	7 192	7 192
Transfers	6 988	486	404	(7 878)	-
Assets written-off	(155)	-	-	-	(155)
Cost at 31 December 2017	54 893	61 175	18 928	2 119	137 115
Depreciation and impairment losses at 1 January 2017	42 660	28 679	8 179	-	79 518
Depreciation	4 389	2 467	793	-	7 649
Assets written-off	(155)	-	-	-	(155)
Depreciation and impairment losses at 31 December 2017	46 894	31 146	8 972	-	87 012
Net book value at 31 December 2017 (1)	7 999	30 029	9 956	2 119	50 103
(1) Net book value of assets under financial leasing agreements recorded in the statement of financial position (see note 16):	892	7 930	7 635	-	16 457
Depreciation period	3-12 years	7-30 years	20 years		
Depreciation method	Straight-line	Straight-line	Straight-line		

Leased plant and machinery
The Shipyard leases production equipment and land improvements under a number of finance lease agreements. At the end of each of the leases, the Shipyard has the option to purchase the equipment at a beneficial price. The leased equipment secures lease obligations (see note 16).

Property, plant and equipment under construction
Assets-under-construction primarily relate to upgrades in facilities and equipment.

Depreciation
Philly Shipyard's practice is to present its annual depreciation expense on a separate line item in its consolidated income statement when it is building vessels-under-construction contracts.

During 2017, Philly Shipyard, in accordance with IFRS, recognized 100% of the revenue and cost for Hulls 026-028 at its delivery. The allocated depreciation expense relating to the construction of Hulls 026-028 during 2017 was reclassified to the cost-of-vessels expense line and recognized in 2017. USD 2.0 million of depreciation expense was reclassified to the cost-of-vessels expense line in 2017.

A reconciliation of depreciation on property, plant and equipment to depreciation recognized in the consolidated income statement is as follows:

Amounts in USD thousands	**2018**	2017
Depreciation of property, plant and equipment	**7 830**	7 804
Amount charged as cost of Philly Tankers vessels	**-**	(2 007)
Net depreciation expense	**7 830**	5 797

Impairment of work-in-process assets
Philly Shipyard had been working on a project to build up to four containerships (CV3700 vessels) for delivery to TOTE Maritime in 2020 and 2021. However, in January 2018, this project was placed on hold. Based on new order prospects, market conditions and other circumstances, Philly Shipyard canceled the CV3700 project and an impairment charge of USD 17.6 million was incurred due to the write-off of the full amount of the work-in-process assets pertaining to the first two CV3700 vessels (Hulls 031-032).

Determination of recoverable amounts/fair value
At 2018 year-end, the Company has assessed the risk of impairment due to the uncertainty related to PSI's new order situation and the cessation of certain operations and increasing layoffs at the Shipyard during 2018. This situation is a triggering event and the Group has carried out an impairment test. The cash generating unit used for the analysis is Philly Shipyard, Inc.

No impairment has been recorded in 2018 based on the key uncertain assumption that the Shipyard will be able to secure new contracts and continue operations following the delivery of the last vessel in its backlog (Hull 030), which is scheduled for Q1 2019. The recoverable amount derived from the calculations represents value in use and that the facility is continuing its operations as a shipyard. No impairment was recorded in 2017 for property, plant and equipment based on the expectation of new orders after Hull 030.

The projections have been prepared for the period 2019-2023, with a terminal value based on 2023 cash flows applying a 2.0% annual growth rate. The projections and the annual growth rate are based on an overall assessment of the market. In particular, the outlook for the next 5-10 years in the government sector is very promising (see introduction to the U.S. Government market on pages 12-13 in the Board of Director's report and the Outlook section on pages 21-22). In the near term, Philly Shipyard's main focus is the pursuit of the opportunity to build up to five National Security Multi-Mission Vessels (NSMV), where MARAD has received USD 300 million in federal funding for each of the first two vessels (i.e., NSMV 1 and NSMV 2), for a total of USD 600 million. Philly Shipyard is in discussions related to several other potential new construction projects for U.S.-built vessels for the commercial market. Additionally, Philly Shipyard is aggressively pursuing several possibilities for short-term steel fabrication and repair, modernization and conversion work in order to have some activity in the shipyard in 2019 before a production start of a new shipbuilding project. The shipyard has operated at a level with higher activity than assumed in the projections for the impairment testing and believes the projections and annual growth rate applied are achievable and within the shipyard's capabilities.

The Company has calculated the net present value (NPV) of future expected cash flows, and used weighted probabilities for two scenarios. The most likely scenario is based on securing an order for at least one shipbuilding contract during 2019 which will allow the Company to start production around Q1 2020. In addition, the scenario includes revenues from ship repairs and dry docking services in 2019 and 2020. The less likely scenario is based on no new orders and full cessation of all activities in 2019. The weighted discounted cash flows exceed the carrying value of property, plant and equipment adjusted for the value of net working capital amounts, hence no impairment is required.

The Company has used available market information and management's best assessment of this information when preparing the forecasted future cash flows. Although this represents the best estimate for future cash flows, there is risk when forecasting future cash flows and the actual cash flows may be different from the forecast.

The Company used a post-tax discount rate of 12.0% and an annual growth rate of 2.0% for the calculations. If the post-tax discount rate was set higher than 12.7% or the annual growth rate was set lower than 1.0%, the discounted cash flows would have fallen below the carrying value of property, plant and equipment adjusted for the value of net working capital.

Although the Company has used available market information and management's best assessment when preparing the forecast, there can be no assurance that Philly Shipyard will obtain new orders or financing for vessels after Hull 030. Philly Shipyard has obtained a temporary waiver from the minimum employment condition for the shipyard lease until 31 December 2019. In a situation where the shipyard is not able to secure a new order and/or the minimum employment condition is triggered after the temporary waiver expires, the consequence is that the shipyard will have to write down the value of its property, plant and equipment to the liquidation value. The consequence would be the same if the going concern assumption was not valid anymore and which would result in triggering a full impairment.

Sale leaseback
As part of the 2011 Authorization Agreement, 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 proceeds were used for the construction of Hulls 017 and 018, and proportionately recognized as a reduction of vessel cost over the construction of Hulls 017 and 018.

The net book value of assets under financial leasing agreements recorded in the statement of financial position at 31 December 2018 amounts to USD 14.6 million (USD 16.5 million at 31 December 2017). See page 38 for further details.

From 1 January 2019, when the new IFRS 16 lease standard is in effect, the net book value of the assets PSDC purchased from PSI in 2011 will be reclassified from property, plant and equipment to a right-of-use asset.

Note 9: Other non-current assets

Other non-current assets consist of the following items:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Prepaid lease payments and deposits	**231**	239
Total	**231**	239

Prepaid lease payments and deposits are unsecured and have no collateral.

Note 10: Prepayments and other receivables

Prepayments and other receivables consist of the following items:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Prepayments to suppliers and other	**3 401**	2 444
Claims receivable	**39**	1 787
Trade receivables	**94**	240
Loan to employee	**-**	132
Total	**3 534**	4 603

Claims receivable represents amounts the Company anticipates recovering from vendors and insurers.

Loan to employee represents advances made to PSI's former SVP Operations. For more details, please see note 26.

Note 11: Cash and cash equivalents

Cash and cash equivalents consist of the following items:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Cash and bank deposits	**49 624**	110 066
Cash and cash equivalents in the statement of cash flows	**49 624**	110 066

Cash and bank deposits are invested in overnight deposits.

Note 12: Restricted cash

Restricted cash consists of the following items:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Restricted cash (non-current) - Welcome Fund	**39 686**	13 154
Restricted cash (non-current) - Matson	**4 930**	-
Restricted cash (current)	**-**	14
Total	**44 616**	13 168

Restricted cash (non-current) amounts represent a custody account established in 2015 in connection with the Welcome Fund loan and escrow accounts established in 2018 with Matson related to holdbacks for guarantees, deficiencies and disputed items for Hull 029.

At year-end 2018, PSI had deposited USD 39.3 million into the Welcome Fund custody account (including USD 13.1 million in 2015 and an additional USD 26.2 million in 2018) as collateral for the Welcome Fund loan. This amount will be increased in Q1 2019 with USD 13.1 million of funds received from the liquidation of Philly Tankers AS. As of 31 December 2018, the total amount deposited has earned USD 386 thousand of interest income. The entire balance including interest will be used for purposes of loan repayment in March 2020.

PSI deposited USD 4.3 million in 2018 into a restricted cash account upon delivery of Hull 029 as a guarantee holdback for Matson; the remaining USD 0.6 million is for deficiencies and disputed items. The funds allocated to the guarantee holdback are due to be released within a one-year period of the vessel's delivery, based on the assumption that guarantee issues are completed and covered within the regular warranty provision (see note 18).

For restricted cash (current), PSI deposited USD 20.0 million in the SeaRiver escrow account in 2011. USD 13.0 million of the SeaRiver escrow account was released upon delivery of Hull 020 in 2015 and USD 7.0 million was released in 2017. The remaining USD 14 thousand of interest income was released in 2018.

Note 13: (Loss)/earnings per share

Basic and diluted
Basic and diluted (loss)/earnings per share are calculated by dividing the total comprehensive (loss)/income attributable to equity holders of PHLY by the weighted average number of ordinary shares.

Amounts in USD thousands (except share amounts and earnings per share)	**2018**	2017
Total comprehensive (loss)/income attributable to equity holders of PHLY	**(44 099)**	67 223
Weighted average number of ordinary shares in issue	**12 107 901**	12 107 901
Basic and diluted (loss)/earnings per share (USD)	**(3.64)**	5.55

At 31 December 2018 and 31 December 2017, PHLY had 12,107,901 ordinary shares (excluding 466,865 treasury shares) at a par value of NOK 10 per share. There were no share issuances or repurchases in 2018 or 2017.

There were no potentially dilutive securities outstanding as of 31 December 2018 and 31 December 2017.

Note 14: Paid in capital

The current share capital (excluding 466,865 treasury shares) is 12,107,901 shares issued and outstanding as of 31 December 2018, each with a par value of NOK 10, fully paid. As of 31 December 2018, there are no additional authorized shares.

Amounts in USD thousands	Share capital	Share premium	Paid in capital
31 December 2016	22 664	22 511	45 175
Dividend paid	-	-	-
31 December 2017	22 664	22 511	45 175
Dividend paid	-	-	-
31 December 2018	**22 664**	**22 511**	**45 175**

Summary of purchases of treasury shares:

Amounts in USD thousands (except number of shares)	Number of shares	Consideration
Treasury shares at 31 December 2016	466 865	(9 969)
Purchases	-	-
Treasury shares at 31 December 2017	466 865	(9 969)
Purchases	-	-
Treasury shares at 31 December 2018	**466 865**	**(9 969)**

As of 31 December 2018, before receiving any dividends from PSI, the parent company had approximately USD 5.2 million of equity which could be distributed to shareholders by the Board in accordance with PHLY's dividend policy.

Note 15: Interest-bearing debt

This note provides information about Philly Shipyard's contractual terms of interest-bearing loans and borrowings. For more information about Philly Shipyard's exposure to interest rate risk and foreign currency risk, see note 21.

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Interest-bearing long-term debt:		
Welcome Fund loan, net of fees	**59 639**	59 350
Finance lease liability (non-current portion)	**-**	20
Total interest-bearing long-term debt	**59 639**	59 370
Interest-bearing short-term debt:		
Finance lease liability (current portion)	**-**	248
Total interest-bearing short-term debt	**-**	248

PSI has a secured term loan of up to USD 60.0 million (USD 59.6 million on the statement of financial position which is the 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 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 has a five-year term and is secured by a first lien on: (1) USD 39.7 million of cash collateral; (2) PSI's shares in its wholly-owned subsidiary, APSI Tanker Holdings II LLC (ATH II), representing 100% of the total outstanding shares of ATH II as of 31 December 2018; and (3) ATH II's shares in Philly Tankers AS (PTAS), representing 53.7% of the total outstanding shares of PTAS as of 31 December 2018. The loan also contains a covenant restricting dividends and other distributions by ATH II until an additional USD 13.1 million of cash collateral has been deposited to secure the loan. It is expected that the additional USD 13.1 million of cash collateral will be deposited to secure the loan in Q1 2019 in connection with the liquidation of PTAS. USD 60.0 million is drawn under this term loan at 31 December 2018.

PSI had a loan agreement with Caterpillar Financial Services Corporation (Cat Financial) for a USD 150.0 million loan facility, subject to a maximum borrowing amount of USD 75.0 million per vessel, for construction financing on Hulls 025-028. The loan was secured by a first lien on Hulls 025-028. The loan accrued interest at three-month LIBOR plus 3.0% per annum as defined in the loan agreement. This facility was repaid in full and terminated upon the delivery of Hull 028 on 20 November 2017.

PSI has an unsecured three-year revolving credit facility for up to USD 10.0 million from TD Bank, N.A. (TD Bank). The facility terminates in April 2019. The loan accrues interest at 30-day LIBOR plus 2.50% per annum as defined in the credit agreement. USD 0.7 million of this facility was utilized as of 31 December 2018 for the issuance of letters of credit.

Loan covenants

The Welcome Fund loan facility contains certain financial covenants related to a minimum consolidated equity amount, as defined, of USD 80.0 million and a maximum ratio of consolidated total debt to tangible net worth (defined as consolidated equity minus intangible assets) of no greater than 4.0 to 1.0. The TD Bank loan facility contains a financial covenant requiring a minimum liquidity amount at 31 December 2018, as defined, of USD 37.5 million. As of 31 December 2018, the Company was in compliance with these existing covenants.

The Welcome Fund loan facility also contains a restriction on payment of dividend requiring a minimum liquidity amount at 31 December 2018, as defined, of USD 37.5 million. As of 31 December 2018, the Company satisfied this condition.

Undrawn credit facilities

As of 31 December 2018, PSI has USD 9.3 million of undrawn credit facilities with TD Bank.

Note 16: Operating lease and finance lease liabilities

Non-cancellable operating lease rentals are payable as follows as of 31 December:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Less than one year	**87**	91
Between one and five years	**101**	145
Total	**188**	236

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 and lease liability will be recorded when the new IFRS 16 lease standard is 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 will be recorded 1 January 2019. This treatment will be revisited if the shipyard signs a contract or contracts that secures long-term activity.

Finance lease liabilities are payable as follows as of 31 December:

Amounts in USD thousands	**Payments 2018**	**Interest 2018**	**Principal 2018**	Payments 2017	Interest 2017	Principal 2017
Less than one year	**276**	**8**	**268**	256	8	248
Between one and five years	**-**	**-**	**-**	20	-	20
Total	**276**	**8**	**268**	276	8	268

PSI had a finance lease for priming equipment, which was fully paid off in 2018.

PSI operates on land leased from PSDC through April 2038. 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). 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. 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. Upon transition to IFRS 16, the shipyard will continue to use this policy to record the government grant under IAS 20 against the investment. This will give a zero balance for the right-of-use asset and the lease liability at 1 January 2019, as the grant is deducted to arrive at the carrying amount of the right-of-use asset. For more details regarding the shipyard lease, see note 25.

Note 17: Pension costs

Pension costs recognized in the income statement:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Contribution plans (employer's contribution)	**954**	1 663
Total	**954**	1 663

PSI has a defined contribution plan for its non-union employees which provides for a PSI contribution based on a fixed percentage of certain employee contributions plus a discretionary percentage of salaries. In addition, PSI's union employees are participants in a multi-employer union selected pension plan (Union Plan). PSI contributes a fixed amount per hour worked to the Union Plan. If PSI were to terminate its relationship with the Union Plan, PSI could be statutorily liable for a termination liability calculated at the termination date. The termination liability at 31 December 2018 was USD 5.6 million. Currently, PSI has no plans to terminate this relationship. Thus, no termination liability has been recognized in the financial statements. However, the termination liability will be incurred in the event the company permanently ceases its operation. PSI estimates that it will contribute approximately USD 0.1 million to the Union Plan in 2019.

Note 18: Other provisions — warranties

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Current balance as of 1 January	**1 315**	2 246
Provisions made during the period	**500**	1 079
Provisions released during the period	**(241)**	(1 417)
Provisions used during the period	**(629)**	(593)
Current balance as of 31 December	**945**	1 315

The warranty provision relates to the warranty work for vessels (Hulls 021-029) which were delivered through 31 December 2018. The warranty provision decreased as specific issues previously accrued for were resolved in 2018. The normal warranty period for a new vessel is typically twelve months after delivery, but can be extended in cases where there are specific issues that have not been fully resolved within the normal warranty period.

Note 19: Trade payables and accrued liabilities

Trade payables and accrued liabilities comprise the following items:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Ship material and subcontracting accruals	**5 710**	14 396
Employee-related cost accruals	**4 985**	8 121
Trade payables	**2 188**	6 496
Overhead and capital projects accruals	**2 159**	5 801
Total	**15 042**	34 814

In connection with the PSDC agreement, the City of Philadelphia agreed to temporarily defer USD 8.0 million in real estate tax payments due from PSI over three years (2011-2013). The Company discounted the deferred payments and imputed interest expense over the deferral period. The full deferred real estate tax amount of USD 8.0 million was paid in 2017.

Note 20: Net interest-bearing debt

Net interest-bearing debt comprise the following items at 31 December:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Interest-bearing long-term debt (see note 15)	**59 639**	59 370
+ Interest-bearing short-term debt (see note 15)	**-**	248
Total interest-bearing debt	**59 639**	59 618
- Cash and cash equivalents (see note 11)	**(49 624)**	(110 066)
- Restricted cash (see note 12)	**(44 616)**	(13 168)
Total interest-bearing assets	**(94 240)**	(123 234)
Net interest-bearing debt	**(34 601)**	(63 616)

Net interest-bearing debt is defined by the Company to be total interest-bearing debt less total interest-bearing assets.

Note 21: Financial instruments

Exposure to credit, liquidity, currency and interest rate risks arise in the normal course of the Company's business. Derivative financial instruments are used to hedge exposure to fluctuations in foreign exchange rates for business purposes.

Credit risk
The carrying amount of financial assets represents the maximum credit exposure. At 31 December 2018 and 2017, respectively, the maximum exposure to credit risk is as follows:

Amounts in USD thousands	**31 Dec. 2018**	31 Dec. 2017
Cash and cash equivalents	**49 624**	110 066
Restricted cash	**44 616**	13 168
Trade receivables	**94**	240
Vessels-under-construction receivable	**-**	7 275
Total	**94 334**	130 749

Work-in-process of USD 13.4 million at 31 December 2017 was not accounted for as a credit risk given that it represented the costs incurred by PSI on the CV3700 project (Hulls 031-032) built for its own account. The cost was fully written-off in 2018.

Liquidity risk
The following are the contractual maturities of financial liabilities including interest payments:

				31 December 2018			
Amounts in USD thousands	**Book value**	**Contractual cash flow**	**Less than 6 months**	**6-12 months**	**1-2 years**	**2-5 years**	**More than 5 years**
Non-derivative financial liabilities:							
Welcome Fund loan	**60 000**	**(61 925)**	**(792)**	**(805)**	**(60 328)**	**-**	**-**
Trade payables	**2 188**	**(2 188)**	**(2 188)**	**-**	**-**	**-**	**-**
Finance lease	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**62 188**	**(64 113)**	**(2 980)**	**(805)**	**(60 328)**	**-**	**-**

				31 December 2017			
Amounts in USD thousands	Book value	Contractual cash flow	Less than 6 months	6-12 months	1-2 years	2-5 years	More than 5 years
Non-derivative financial liabilities:							
Welcome Fund loan	60 000	(63 522)	(792)	(805)	(1 597)	(60 328)	-
Trade payables	6 496	(6 496)	(6 496)	-	-	-	-
Finance lease	268	(276)	(128)	(128)	(20)	-	-
Total	66 764	(70 294)	(7 416)	(933)	(1 617)	(60 328)	-

Book values included in the above tables are gross loan amounts.

Currency risk
The Company incurs foreign currency risk on purchases that are denominated in a currency other than USD. The currencies giving rise to this risk are primarily EUR (Euro), KRW (Korean Won) and NOK (Norwegian Kroner).

Changes in the fair value of forward exchange contracts that economically hedge highly probable forecasted transactions (consisting of the unpaid portion of purchase commitments made by PSI) in foreign currencies and for which hedge accounting is not applied are recognized in the income statement. Both the changes in fair value of the forward contracts and the foreign exchange gains and losses relating to the monetary items are recognized as part of net financial items (see note 6). The fair value of exchange contracts used as economic hedges of highly probable forecasted transactions in foreign currencies at 31 December 2018 was USD 58 thousand recognized in current assets (USD 162 thousand at 31 December 2017).

Exposure to currency risk
The Company's exposure to currency risk at 31 December 2018 and 2017 was as follows based on the following notional amounts:

		2018			2017	
Amounts in USD thousands	**EUR**	**KRW**	**NOK**	EUR	KRW	NOK
Gross balance sheet exposure						
Trade payables (-)	**(18)**	**(1)**	**-**	(75)	(42)	(2)
Cash	**-**	**-**	**209**	-	-	253
Gross balance sheet exposure	**(18)**	**(1)**	**209**	(75)	(42)	251
Estimated forecast expenses (-)	**(2)**	**(514)**	**(8)**	(615)	(3 049)	(95)
Gross exposure	**(20)**	**(515)**	**201**	(690)	(3 091)	156
Forward exchange contracts	**-**	**-**	**-**	598	3 648	72
Net exposure	**(20)**	**(515)**	**201**	(92)	557	228

Sensitivity analysis
In managing interest rate and currency risks, the Company aims to reduce the impact of short-term fluctuations on its earnings. Over the longer term, however, permanent changes in interest and foreign exchange rates would have an impact on consolidated earnings.

At 31 December 2018 it is estimated that a 10% strengthening of the USD against other foreign currencies would have increased the Company's loss before tax by approximately USD 0.2 million. At 31 December 2017 it is estimated that a 10% strengthening of the USD against other foreign currencies would have increased the Company's income before tax by approximately USD 1.3 million.

Exposure to interest rate risk
It is estimated that a general increase of one percentage point in interest rates would not have impacted the Company's loss before tax for 2018 and would not have impacted the Company's income before tax for 2017.

Fair values
The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair value hierarchy. It does not include fair value information for financial assets and financial liabilities not measured at fair value if the carrying amount is a reasonable approximation of fair value.

Amounts in USD thousands	**Carrying amount 2018**	**Fair value 2018**	**FV hierarchy level 2018**	Carrying amount 2017	Fair value 2017	FV hierarchy level 2017
Welcome Fund loan	**(60 000)**	**(58 383)**	**2**	(60 000)	(57 592)	2
Forward exchange contracts	**58**	**58**	**2**	162	162	2
Finance lease	**-**	**-**	**-**	(268)	(257)	2

The fair value of the Welcome Fund loan is calculated by using the difference between a 4.0% market rate and the actual 2.625% loan rate.

The fair value of fixed-interest long-term debt (i.e. finance lease liabilities) is calculated based on the present value of future principal and interest cash flows discounted at a market rate of 4.0% for 2018 and 4.0% for 2017.

Except for forward exchange contracts, none of the Company's financial assets and liabilities are measured at fair value.

Financial instruments measured at fair value
The following table shows the valuation techniques used in measuring Level 2 and Level 3 fair values, as well as the significant unobservable inputs used:

Type	**Valuation technique**	**Significant unobservable inputs**	**Inter-relationship between significant unobservable inputs and fair value measurement**
Forward exchange contracts	Market comparison technique: The fair values are based on banker quotes. Similar contracts are traded in an active market and the quotes reflect the actual transactions in similar instruments.	Not applicable.	Not applicable.

In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

The Company has categorized its assets and liabilities that are recorded at fair value, based on the priority of the input to the valuation technique, into a three-level fair value hierarchy. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used to measure the assets and liabilities fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument. The categories are described below:

Level 1. Assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market that we have the ability to access.

Level 2. Assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. Examples of Level 2 inputs include quoted prices for identical or similar assets or liabilities in non-active markets and pricing models whose inputs are observable for substantially the full term of the asset or liability.

Level 3. Assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management's own assumptions about the assumptions a market participant would use in pricing the asset or liability.

Note 22: Shares owned or controlled by and remuneration to the President and Chief Executive Officer, Board of Directors and Senior Management of Philly Shipyard

Shares owned in Philly Shipyard ASA as of 31 December 2018 and 31 December 2017

Name	Position	2018 Number of shares held	2017 Number of shares held
Elin Karfjell	Board Member	1 200	1 200
Steinar Nerbøvik	President and CEO	1 000	1 000

There is no share option agreement between Philly Shipyard ASA and Senior Management or Directors.

Remuneration to the Board of Directors for the years ended 31 December 2018 and 31 December 2017

		2018 Remuneration		2017 Remuneration	
Name	Position	(NOK)	(USD)	(NOK)	(USD)
James H. Miller	Board Chairman	345 000	40 095	327 500	39 545
Elin Karfjell	Board Member	235 000	27 311	218 750	26 447
Amy Humphreys	Board Member	235 000	27 311	218 750	26 447
Kristian Røkke (July-Dec. 2018)	Deputy Board Chairman	120 000	13 946	-	-
Audun Stensvold (Jan.-June 2018)	Deputy Board Chairman	115 000	13 365	218 750	26 447
Sum Directors' fees		**1 050 000**	**122 028**	**983 750**	**118 886**

No Board members received any remuneration other than Directors' fees, except James H. Miller who received USD 90,000 for 2018, related to consulting services through the company SeaJay Consulting LLC. The Board remuneration for Audun Stensvold and Kristian Røkke is paid to Aker ASA.

Remuneration to the audit committee
The audit committee of PHLY is comprised of Elin Karfjell (Chairperson) and Audun Stensvold (January-June 2018), replaced by Amy Humphreys (July-December 2018). Remuneration for the Chairperson is NOK 50,000 (USD 5,811) and for each member is NOK 40,000 (USD 4,649). The audit committee remuneration for Audun Stensvold is paid to Aker ASA. This is in addition to the amounts shown in the Board of Directors table above.

Remuneration to the nomination committee
The nomination committee of Philly Shipyard ASA has the following members: Leif Arne Langoy (Chairman), Arild Støren Frick and Gerhard Heiberg. Remuneration earned by each member of the committee in 2018 was NOK 34,000 (USD 3,951). The nomination committee remuneration for Arild Støren Frick is paid to Aker ASA. This is in addition to the amounts shown in the Board of Directors table above.

Guidelines for remuneration to the President and CEO and members of the Executive Team
The basis of the remuneration of the President and CEO and members of the Executive Team has been developed in order to create a performance-based system. This system of reward is designed to contribute to the achievement of good financial results and increase shareholder value.

The President and CEO and members of the Executive Team receive a base salary. In addition, a variable pay may be awarded in accordance with a variable pay program which was implemented in 2007. This variable pay program is based on the achievement of financial and personal performance targets and leadership performance in accordance with the Company's values.

The variable pay program for the President and CEO represents a potential for an additional variable pay up to 70% of base salary depending on the achievement of defined short-term and long-term results such as financial targets (profit and working capital) and personal targets (project targets, development of commercial solutions, alignment with values and improvement of HSE).

The variable pay program for other members of the Executive Team represents a potential for an additional variable pay in the range of 20% to 60% of base salary depending on the achievement of the same factors described for the President and CEO.

Commencing in 2016, the variable pay program for some members of the Executive Team includes two payments, i.e., a base award (calculated as provided above) and a deferred payment. The deferred payments are designed to incentivize and retain key personnel. The deferred payments are equal to 50% of the base awards and are payable twelve months after the base awards.

In addition, commencing in 2017, the variable pay program for some members of the Executive Team includes additional payments for the achievement of specific project targets. The additional payments are designed to retain key personnel and ensure delivery of the last two vessels in the order book (Hulls 029 and 030). In 2018, there were two such additional payments, each equal to 25% of the maximum base award. The first was paid upon launch of Hull 029 in Q1 2018 and the second was paid upon delivery of Hull 029 in Q4 2018. There is a third additional payment equal to 50% of the maximum base award payable upon the delivery of Hull 030, which is scheduled for Q1 2019.

The President and CEO and Executive Team participate in the standard pension and insurance schemes, applicable to all employees.

The Company practices standard employment contracts and standard terms and conditions regarding notice period and severance pay for the President and CEO and members of the Executive Team.

The Company does not offer share option programs to the Executive Team.

Remuneration paid to Senior Management for 2018 (1)

Amounts in USD		Base salary	Variable pay (2)	Pension contribution	Other benefits	Total remuneration	Severance Pay
Steinar Nerbøvik	President and CEO	435 999	389 129	32 000	73 342	930 470	12 months
Jan Ivar Nielsen	CFO	265 200	210 834	15 000	19 643	510 677	12 months

(1) PHLY has no employees. The Senior Management is employed in the operating company.
(2) A substantial portion of variable pay in 2018 was earned under the 2017 variable pay program based on the achievement of defined short-term and long-term results for 2017. The remainder was paid for achievement of specific project targets related to launch and delivery of Hull 029.

Remuneration paid to Senior Management for 2017 (1)

Amounts in USD		Base salary	Variable pay (2)	Pension contribution	Other benefits	Total remuneration	Severance Pay
Steinar Nerbøvik	President and CEO	435 999	200 974	32 000	73 342	742 315	12 months
Jan Ivar Nielsen	CFO	267 040	105 020	15 000	19 574	406 634	12 months

(1) PHLY has no employees. The Senior Management is employed in the operating company.
(2) The entire variable pay in 2017 was earned under the 2016 variable pay program based on the achievement of defined short-term and long-term results for 2016.

Note 23: Equity-accounted investments

Equity-accounted investments with Philly Tankers
In July 2014, Philly Tankers completed a USD 65.025 million private placement with a registration in the Norwegian OTC.

Prior to the Philly Tankers private placement, in return for 62,475 shares in Philly Tankers, the Company contributed a promissory note with a face value of USD 58.0 million to the equity capital of Philly Tankers. This note was reduced dollar-for-dollar as PSI invested its own funds into the construction of Hulls 025 and 026. As this note was issued as an interest-free instrument, the Company discounted its value and imputed interest expense on the discounted amount at a rate of 3.49% per annum. The dollar-for-dollar reductions commenced in the third quarter of 2015 with a total reduction of the full USD 58.0 million through the second quarter of 2016.

In addition, as part of the Philly Tankers private placement, the Company invested USD 6.025 million in cash in exchange for an additional 6,025 shares in Philly Tankers. As the initial shareholder of Philly Tankers, the Company was paid a cash distribution of USD 5.525 million out of the proceeds of the Philly Tankers private placement.

On 10 August 2015, Philly Tankers executed definitive agreements with a third party for the assignment of its existing contracts and related assets for four product tankers (Hulls 025-028). Per the agreements, each of the contracts and related assets were assigned by Philly Tankers to the third party immediately prior to the delivery of the relevant vessel.

In accordance with IFRS, upon each delivery, Philly Tankers recognized a gain-on-sale and Philly Shipyard, in turn, recognized a portion of the gain as profit in equity-accounted investments recorded as other income on the income statement. Upon deliveries of Hull 026 in Q1 2017, Hull 027 in Q3 2017 and Hull 028 in Q4 2017, Philly Tankers recognized a combined gain-on-sale of approximately USD 37.2 million and Philly Shipyard recognized USD 19.6 million as profit in equity-accounted investments recorded as other income on the 2017 income statement. Upon delivery of Hull 025 in Q4 2016, Philly Tankers recognized a gain-on-sale of approximately USD 12.0 million and Philly Shipyard recognized USD 6.2 million as profit in equity-accounted investments recorded as other income on the 2016 income statement.

As of 31 December 2018, the dividends paid by Philly Tankers to its shareholders total USD 78.1 million, and Philly Shipyard's share of those dividends totals USD 42.0 million, of which USD 39.9 million was received in 2017 and USD 2.1 million was received in 2018.

As of 31 December 2018, the Company owns 53.7% of the outstanding shares of Philly Tankers. The Company has performed an analysis of its ownership interests and voting rights in the articles of association in Philly Tankers and concluded that it does not control the relevant activities of Philly Tankers. While the Company may vote up to 50.1% of the shares of Philly Tankers, the Company cannot elect a majority of the board of directors of Philly Tankers and cannot control the vote on actions that require the approval of a "super-majority" of the shares of Philly Tankers. The Company does not have the current ability to direct the activities that significantly affect Philly Tankers' returns. Therefore, the Company accounts for the investment using the equity method and does not consolidate Philly Tankers.

The liquidation of Philly Tankers was approved by its shareholders at an extraordinary general meeting on 13 February 2019, and the liquidation distribution of USD 83.1 million was paid to the shareholders of Philly Tankers the week of 18 February 2019. Philly Shipyard received approximately USD 44.6 million from this distribution, of which USD 13.1 million will be deposited in Q1 2019 into a collateral account to secure the Company's five-year term loan from PIDC Regional Center, LP XXXI through the Welcome Fund loan program.

Amounts in USD thousands	**2018**	2017
Percentage ownership interest	**53.7%**	53.7%
Current assets	**85 305**	85 771
Current liabilities	**(2 214)**	(272)
Net assets (100%)	**83 091**	85 499
Company's share of net assets (53.7%)	**44 641**	45 934
Adjustments for carrying value of investment:		
Dividend owed but not received	**-**	1 376
Carrying amount of equity-accounted investments	**44 641**	47 310
(Loss)/income from operations (100%)	**(974)**	36 532
Other comprehensive income (100%)	**-**	-
Total comprehensive (loss)/income (100%)	**(974)**	36 532
Company's share of total comprehensive (loss)/income (53.7%)	**(523)**	19 618

The recognition of deferred gain on equity-accounted investments represents the Company's USD 5.848 million gain that was deferred on the issuance of Philly Tankers shares in July 2014 to external parties at a price exceeding the Company's cost basis, before deduction of a deferred transaction cost of USD 1.153 million. The net gain at 31 December 2018 and 31 December 2017 amounted to USD 0 and USD 3.233 million, respectively.

Note 24: PHLY companies

Company name	Incorporation State	Incorporation Country	Ownership %
Philly Shipyard, Inc.	Pennsylvania	USA	100.0%
APSI Member 021, Inc. (1)	Delaware	USA	100.0%
APSI Member 022, Inc. (1)	Delaware	USA	100.0%
APSI Member 023, Inc. (1)	Delaware	USA	100.0%
APSI Member 024, Inc. (1)	Delaware	USA	100.0%
APSI Shipholding 017, Inc. (2)	Delaware	USA	100.0%
APSI Shipholding 018, Inc. (2)	Delaware	USA	100.0%
APSI Tanker Holdings, Inc. (2)	Delaware	USA	100.0%
APSI Tanker Holdings II, LLC	Delaware	USA	100.0%
PSI Containership Holdings, Inc.	Delaware	USA	100.0%

(1) On 31 December 2018, each of these companies was merged with and into APSI Tankers Holdings, Inc.
(2) Immediately following the mergers described in footnote #1 above, on 31 December 2018, each of these companies was merged with and into Philly Shipyard, Inc.

Note 25: Government grants, other commitments and contingencies and legal matters

Government grants
For the year ended 31 December 2018, the Shipyard received USD 15 thousand as reimbursement of employee training costs from various governmental agencies (USD 102 thousand in 2017).

For the year ended 31 December 2018, the Shipyard received USD 347 thousand in grant funds for capital and infrastructure improvements under the Small Shipyard Grant Program (USD 0 in 2017).

Other commitments and contingencies
PSI is required to pay a common area maintenance charge each month of approximately USD 54 thousand, subject to escalation, through the term of its shipyard lease.

On 13 September 2002, the Shipyard finalized an agreement with the City of Philadelphia (and others), whereby the parties agreed to the Real Estate and Use and Occupancy Tax for the years 2001 through 2017. The Shipyard paid a fixed assessment of approximately USD 3.3 million to USD 3.6 million per year, commencing in 2003. In connection with the closing of certain other transactions with PSDC in March 2011, the City of Philadelphia agreed to temporarily defer USD 8.0 million in tax payments due from PSI over three years (2011-2013). The full deferred amount was paid in June 2017 (see note 19).

On 29 November 2017, PSI finalized a new long-term agreement with the City of Philadelphia (and others), whereby the parties agreed to the Real Estate and Use and Occupancy Tax for the years 2018 through 2025. PSI is committed to a fixed payment-in-lieu-of-taxes (PILOT) of approximately USD 863 thousand per year, commencing in 2018.

Pursuant to the Shipyard Lease, 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 the 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), which is scheduled 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, the waiver of the minimum employment condition will continue until PSI reaches the 200 full-time employee requirement. 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.

Legal matters
The Company is involved in various legal disputes in the ordinary course of business related primarily to personal injury matters, employment matters and commercial matters. Provisions have been made to cover the expected outcomes when it is probable that a liability has been incurred and the amount is reasonably estimable. Although the final outcome of these matters is subject to uncertainty, in the Company's opinion the ultimate resolution of such legal matters will not have a material adverse effect on the Company's financial position or results of operations.

Note 26: Transactions, guarantees and agreements with related parties and concentration of business

Aker Capital AS, a wholly-owned subsidiary of Aker ASA, is the majority shareholder in PHLY, owning 57.6% of its total outstanding shares as of 31 December 2018. In addition, Kristian Røkke, the Deputy Chairman of the Board of Directors of PHLY, is a Board member of TRG Holding AS, which owns 66.7% of the total outstanding shares of Aker ASA as of 31 December 2018.

Transactions
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 are as follows:

Amounts in USD thousands	**Expenses 2018**	Expenses 2017
Aker U.S. Services LLC	**120**	120
Aker ASA	**7**	8

PSI entered into an administrative services agreement with Philly Tankers LLC (PTLLC) whereby PSI will supply certain administrative services to PTLLC. Related revenues for the year ending 31 December 2018 were USD 120 thousand (USD 120 thousand for the year ending 31 December 2017) and corresponding receivables for the year ending 31 December 2018 were USD 120 thousand (USD 120 thousand for the year ending 31 December 2017). 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.

On 13 July 2017, PSI made an advance of USD 130 thousand to Jari Anttila, PSI's former Senior Vice President Operations. The advance was made on market terms and secured by future bonus that Mr. Anttila was eligible to receive under the variable pay program for the Executive Team. The advance was fully paid back in 2018.

Concentrations
Operating revenues are detailed below:

Amounts in USD thousands	**Revenue 2018**	Revenue 2017
Matson	**129 737**	247 159
Philly Tankers	**-**	383 022

Note 27: Events after 31 December 2018

On 6 February 2019, a temporary conditional waiver of the minimum employment condition under the Shipyard Lease was obtained from PSDC. The waiver period extends 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.

On 14 February 2019, a new four-year collective bargaining agreement was ratified by the Philadelphia Metal Trades Council, which represents the ten unions at the shipyard. This new labor contract will extend until 31 January 2023.

On 18 February 2019, Philly Shipyard received a liquidating distribution totaling USD 44.6 million from Philly Tankers AS. Of this amount, USD 13.1 million will be deposited in Q1 2019 into a collateral account as additional security for the Welcome Fund loan. The receipt of the liquidation distribution will not have any tax consequences.

Philly Shipyard ASA

Income Statement

Amounts in USD thousands	*Note*	**2018**	2017
Operating revenues		**-**	-
Operating expenses	*2*	**(463)**	(296)
Operating loss		**(463)**	(296)
Interest income from subsidiaries		**1 637**	1 313
Interest expense to subsidiaries		**(2 230)**	(2 213)
Other interest income and financial income	*3*	**1 767**	2 995
Other interest expense and financial expense		**(52)**	(63)
Income before tax		**659**	1 736
Income tax benefit/(expense)	*5*	**167**	(640)
Net income for the year		**826**	1 096

Allocation of net income:			
Net income for the year		**826**	1 096
Other equity	*6*	**(826)**	(1 096)
Total		**-**	-

Philly Shipyard ASA

Statement of Financial Position
as of 31 December

Amounts in USD thousands	*Note*	**2018**	2017
ASSETS			
Shares in subsidiary	*4*	**67 000**	67 000
Loan to subsidiary	*9*	**31 000**	31 000
Total non-current assets		**98 000**	98 000
Prepayments and other receivables		**38**	603
Cash and cash equivalents	*7*	**2 721**	1 840
Total current assets		**2 759**	2 443
Total assets		**100 759**	100 443
EQUITY AND LIABILITIES			
Share capital		**22 664**	22 664
Share premium reserve		**12 542**	12 542
Total paid in capital		**35 206**	35 206
Other equity		**9 250**	8 424
Total equity	*6*	**44 456**	43 630
Deferred tax liability	*5*	**415**	704
Loan from subsidiary	*9*	**55 562**	55 000
Total non-current liabilities		**55 977**	55 704
Trade payables and accrued liabilities		**156**	144
Income tax payable	*5*	**170**	965
Total current liabilities		**326**	1 109
Total liabilities		**56 303**	56 813
Total equity and liabilities		**100 759**	100 443

Oslo, Norway
5 March 2019
Board of Directors
Philly Shipyard ASA

James H. Miller
Board Chairman

Kristian Røkke
Deputy Board Chairman

Amy Humphreys
Board Member

Elin Karfjell
Board Member

Steinar Nerbøvik
President and CEO

Philly Shipyard ASA

Cash Flow Statement

Amounts in USD thousands	**2018**	2017
Income before tax	**659**	1 736
Income taxes paid	**(917)**	(211)
Change in prepayments and other receivables	**565**	(574)
Change in trade payables and accrued liabilities	**12**	(57)
Net cash flow from operating activities	**319**	894
Loan proceeds from subsidiary	**562**	3 000
Dividend paid	**-**	(3 027)
Net cash flow from/(used in) financing activities	**562**	(27)
Net change in cash and cash equivalents	**881**	867
Cash and cash equivalents at beginning of period	**1 840**	973
Cash and cash equivalents as of 31 December	**2 721**	1 840

Note 1: Basis for preparation

The accounts of Philly Shipyard ASA (referred to herein as PHLY) are presented in conformity with Norwegian legislation and generally accepted accounting principles in Norway. PHLY's functional and reporting currency is the U.S. dollar (USD), except when indicated otherwise.

Subsidiaries
Subsidiaries are presented on a historical cost basis in the parent company accounts. The investment is valued at historical cost for the shares unless impairment write-downs have been deemed necessary. The shares are written down to fair value if the impairment is not of a temporary nature and is necessitated by generally accepted accounting principles. Write-downs are reversed when the basis for the write-down no longer exists.

Dividends and other payments are taken to income in the year they are accrued in the subsidiary. If dividends exceed retained earnings after the purchase, the excess represents repayment of invested capital and the payments are deducted from the invested value in PHLY's statement of financial position.

Classification and valuation of statement of financial position items
Current assets and current liabilities include items that have less than one year to maturity, and other items that are deemed operational working capital. Other items are classified as non-current assets/non-current liabilities.

Current assets are valued at the lower of historical cost and fair value. Current liabilities are valued at their nominal historical value at the time the liability arises.

Non-current assets are valued at historical cost, but are written down to fair value if impairment is deemed to be of a permanent nature. Non-current liabilities are valued at nominal historical values.

Tax
Tax expense in the income statement comprises both current payable taxes and the change in deferred tax. Payable tax is calculated on the basis of the profit for the period in Norwegian Kroner (NOK). Deferred tax at 31 December 2018 is calculated using a 22% income tax rate utilizing the difference that exists between book values and tax values and the net operating losses that can be carried forward at the statement of financial position date. Tax-increasing and tax-reducing temporary differences that are reversing or can reverse in the same period are offset against each other. Net tax assets are shown in the statement of financial position to the extent it is probable that these assets can be utilized.

To the extent a group contribution is not shown in the income statement, the tax effect is taken directly against the investment item in the statement of financial position.

Cash flow statement
The cash flow statement is shown using the indirect method. Cash and cash equivalents comprises cash, bank deposits and other short-term liquid placements.

Use of estimates
Preparation of financial statements in conformity with generally accepted accounting principles in Norway requires management to make estimates and assumptions that affect the income statement, the reported amounts of assets and liabilities and also the disclosure of contingent assets and liabilities on the statement of financial position date.

Contingent losses that are probable and quantifiable are expensed when they are identified.

Note 2: Other operating expenses

Fees to the auditors for ordinary audit and other audit and attestation fees have been expensed

Amounts in USD thousands	**2018**	2017
Audit fees	**31**	31
Other audit and attestation fees	**8**	-
Total	**39**	31

PHLY has no employees. The Senior Management is employed in the operating company. Fees to the Board of Directors of USD 122 thousand and USD 119 thousand were expensed in 2018 and 2017, respectively.

Note 3: Other interest income and financial income

Amounts in USD thousands	**2018**	2017
Guarantee provisions (1)	**1 686**	2 916
Interest income external	**35**	9
Foreign exchange gain	**46**	-
Gain on foreign currency forward contracts	**-**	70
Total	**1 767**	2 995

(1) See note 9 for further details pertaining to the guaranty fee agreements.

Note 4: Shares in subsidiary

This item comprises the following as of 31 December 2018:

Amounts in USD thousands	Ownership and voting rights (%)	Business address	Historical cost	Book value
Philly Shipyard, Inc. (PSI)	100%	Philadelphia, PA	67 000	67 000
Total shares in subsidiary			**67 000**	**67 000**

PSI's results after-tax in 2018 and equity at the end of 2018 are (in USD thousands):

Results after-tax 2018	**(44 926)**
Equity at 31 December 2018	**134 022**

Based on the net asset position of PSI (the investment in subsidiary) as well as the cash on hand at PSI, PHLY has concluded that no impairment has occurred to the investment in subsidiary at 31 December 2018.

Note 5: Taxes

The table below shows the difference between book and tax values by the end of 2018 and 2017 and the amounts of deferred taxes at these dates and the change in deferred taxes.

Amounts in USD thousands	**2018**	2017
Losses carried forward	**-**	-
Other temporary differences	**(1 884)**	(3 409)
Total differences	**(1 884)**	(3 409)
Net deferred tax asset/(liability), 22%/23%	**(415)**	(784)
Foreign currency impact	**-**	80
Deferred tax asset/(liability) in the statement of financial position	**(415)**	(704)

Estimated result for tax purposes:

Amounts in USD thousands	**2018**	2017
Loss/(income) before tax measured in NOK for taxation purposes	**(643)**	2 810
Change in temporary differences	**1 427**	1 224
Foreign currency impact	**(51)**	-
Permanent differences	**5**	-
Estimated income for tax purposes	**738**	4 034
Income tax payable, 23%/24%	**170**	965

Income tax expense in the income statement:

Amounts in USD thousands	**2018**	2017
Income tax payable	**(170)**	(965)
Change in deferred tax in the statement of financial position	**326**	325
Foreign currency impact	**11**	-
Income tax benefit/(expense)	**167**	(640)

Note 6: Total equity

Changes in equity are:

Amounts in USD thousands	Share capital	Share premium	Treasury shares	Total paid in capital	Other equity	Total equity
Equity as of 1 January 2018	22 664	22 511	(9 969)	35 206	8 424	43 630
Net income for the year 2018	-	-	-	-	826	826
Equity as of 31 December 2018	**22 664**	**22 511**	**(9 969)**	**35 206**	**9 250**	**44 456**

The share capital of NOK 125,747,660 consists of 12,574,766 shares (including 466,865 treasury shares) with a par value of NOK 10 as of 31 December 2018.

PHLY is a part of the consolidated accounts of Aker ASA, Oksenoyveien 10, NO-1366 Lysaker, Norway.

Twenty largest shareholders
(as of 31 December 2018)

Shareholders	Number of shares held	Ownership (in %)
Aker Capital AS	7 237 631	57.6%
Goldman Sachs & Co. LLC	2 392 688	19.0%
J.P. Morgan Securities LLC	499 330	4.0%
Philly Shipyard ASA	466 865	3.7%
Morgan Stanley & Co. LLC	344 608	2.7%
J.P. Morgan Securities LLC	145 167	1.2%
Pershing LLC	130 262	1.0%
Citibank, N.A. S/A National Financial Services	110 611	0.9%
Interactive Brokers LLC	98 603	0.8%
Morgan Stanley & Co. LLC	93 606	0.7%
Patineer Management LLC	59 857	0.5%
Citibank, N.A. S/A Charles Schwab FBO Customers	50 272	0.4%
Citibank, N.A. S/A RBC Capital Markets, LLC II	43 442	0.4%
Lars Ro	40 000	0.3%
Ramadan Kovaci	38 855	0.3%
Citibank, N.A. S/A Morgan Stanley	31 683	0.3%
J.P. Morgan Chase Bank, N.A., London	27 875	0.2%
Heggum Holding AS	26 500	0.2%
Espen Einar Dalby	20 500	0.2%
Nordnet Livsforsikring AS	19 424	0.2%
Total, 20 largest shareholders	**11 877 779**	**94.6%**
Other shareholders	696 987	5.4%
Total	**12 574 766**	**100.0%**

Note 7: Cash and cash equivalents

There is no restricted cash.

Note 8: Shares owned by the Board of Directors and the Senior Management

For information regarding shares owned by the members of the Board of Directors and the Senior Management, see note 22 to the consolidated accounts.

Note 9: Related party transactions and guarantees

PHLY has made the following guarantees:

Description	Beneficiary	Amount (USD thousands)	Borrower
Welcome Fund loan	PIDC Regional Center, LP XXXI	60 000	PSI
Working capital facility	TD Bank, N.A.	10 000	PSI

For additional information regarding the above loan facilities, see note 15 to the consolidated accounts.

PHLY has supplied a parent guarantee for the obligations of PSI under the two construction contracts with Matson Navigation Company, Inc. (Hulls 029-030).

PHLY has service agreements with Aker ASA and certain of its affiliates which provide certain administrative services. All payables under these agreements are paid within the normal course of business. Total expenses incurred under these agreements in 2018 and 2017 were USD 7 thousand and USD 8 thousand, respectively.

On 29 April 2008, PSI, as borrower, entered into a loan agreement with PHLY, as lender. The facility is for up to USD 50.0 million and interest is at a floating rate of three-month LIBOR plus 3.00% per annum. The loan is payable on demand with advance notice of 30 days. As of 31 December 2018, USD 31.0 million is outstanding under the facility and PHLY does not intend to call the loan for repayment in 2019.

On 18 July 2013, PSI, as lender, entered into a loan agreement with PHLY, as borrower. This facility is for up to USD 60.0 million and interest is at a fixed rate of 4.00% per annum. The loan is payable on demand with advance notice of 90 days. As of 31 December 2018, USD 55.6 million is outstanding under the facility.

PSI and PHLY are parties to certain guaranty fee agreements related to the above-referenced loan and performance guarantees by PHLY. Total revenues of PHLY from PSI under these guaranty fee agreements in 2018 and 2017 were USD 1.7 million and USD 2.9 million, respectively, with fees ranging from 0.15% to 0.30 % for performance guarantees, and 0.75% for loan guarantees.

KPMG AS
P.O. Box 7000 Majorstuen
Sørkedalsveien 6
N-0306 Oslo

Telephone +47 04043
Fax +47 22 60 96 01
Internet www.kpmg.no
Enterprise 935 174 627 MVA

To the Annual General Meeting of Philly Shipyard ASA

Independent auditor's report

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Philly Shipyard ASA. The financial statements comprise:

- The financial statements of the parent company Philly Shipyard ASA (the Company), which comprise the statement of financial position as at 31 December 2018, and the income statement and cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies, and
- The consolidated financial statements of Philly Shipyard ASA and its subsidiaries (the Group), which comprise the statement of financial position as at 31 December 2018, and income statement, statement of comprehensive income, statement of changes in equity, cash flow statement for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion:

- The financial statements are prepared in accordance with the law and regulations.
- The accompanying financial statements give a true and fair view of the financial position of the Company as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with the Norwegian Accounting Act and accounting standards and practices generally accepted in Norway.
- The accompanying consolidated financial statements give a true and fair view of the financial position of the Group as at 31 December 2018, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Basis for Opinion

We conducted our audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company and the Group as required by laws and regulations, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

We draw attention to Note 1 in the financial statements and the Board of Directors' report, which describe that the Group does not have order backlog beyond the delivery of Hull 030 scheduled in Q1 2019. In addition, without continuous shipbuilding activity the shipyard lease covenant to maintain at least 200 full-time employees for 90 consecutive days may result in the termination of the shipyard lease following the expiry of a temporary conditional waiver of this covenant until 31 December 2019. These conditions indicate that a material uncertainty exists that may cast significant doubt on the Group's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. In addition to the matter described in the *Material Uncertainty Related to Going Concern* section, we have determined the matters described below to be the key audit matters to be communicated in our report.

KPMG

Philly Shipyard ASA

1. Assessment of the carrying value of property, plant and equipment
Refer to Note 1 (Accounting Principles), and Note 8 (Property, plant and equipment)

The key audit matter	*How the matter was addressed in our audit*
The impairment assessment of property, plant and equipment, with a carrying value of USD 44.1 million, is considered a key audit matter due to the conditions described in the *Material Uncertainty Related to Going Concern* section, and the size of the balance. In the event that the going concern assumption becomes inappropriate this would result in a full impairment of property, plant and equipment balances. No impairment of property, plant and equipment has been recorded in 2018 based on the Group's value in use calculations, which rely on external factors and management's assumptions which are subject to a high degree of uncertainty. The key assumptions are that the Group will be able to secure new shipbuilding contracts and continue operations following the delivery of the last vessel in its backlog (Hull 030), which is scheduled for Q1 2019, at the expected profit margins, the discount rate applied, growth rate assumptions, and estimated timing of cash flows.	Our audit procedures to assess the carrying amount of property, plant and equipment included: • challenging management's cash flow forecast assumptions used in their value in use calculations, including specifically identifying the targeted shipbuilding contracts for tender in the next 12 months, the forecasted margins compared to historical rates achieved, growth rate assumptions and the timing of cash flows; • Assessing the mathematical and methodological integrity of the calculations; • using our internal valuation specialists to assess the reasonableness of the discount rate applied. We have also evaluated the transparency and appropriateness of the disclosures related to the carrying value of property, plant and equipment, including the sensitivity and scenario analyses.

2. Revenue recognition on construction contracts
Refer to Note 1 (Accounting Principles), and Note 3 (Construction Contracts)

The key audit matter	*How the matter was addressed in our audit*
Accounting for construction contracts is considered a key audit matter due to the significant estimates and judgments applied by management, and the degree of complexity relating to project execution risk. As of 31 December 2018 the Group is building the second of two containerships to be delivered in 2019, which is accounted for as one project. Revenue is recognized over time based on total costs incurred relative to total forecast costs in accordance with IFRS 15 *Revenue from contracts with customers*, which became effective from 1 January 2018. As discussed in Note 3 (Construction Contracts) these vessels are an all-new design and the Group last delivered a containership in 2006. Accordingly there is a higher project execution risk compared to the recent construction of multiple product tankers, which increases the current estimation uncertainty. In addition, the project was determined to be a loss-making project during 2018. The key judgments and estimates applied by management to assess the contract revenue and costs include: • forecasting the total loss on the project based on an estimate of contract costs to complete, including contingencies for uncertain costs; • assessing the measure of progress of the project, which determines the revenue to be recognized based on the project forecast; and • appropriately providing for the loss-making project. These management estimates and judgments are often complex and involve assumptions regarding future events for which there may be limited internal or external corroborative data.	For the vessel construction project in process as at 31 December 2018, our response included: • with the use of assistance from our internal Major Construction Project specialists, challenging management's measure of progress estimate, and evaluating the appropriateness of management's assumptions used to develop construction contract estimates, with a focus on risk contingencies, delivery dates and estimates to complete; • corroborating management's contractual revenue amounts included in project forecasts with reference to signed contracts; • evaluating variable costs to complete (including potential liquidated damages and warranty provisions) with reference to contract terms, actual and forecasted costs and construction schedule, and external and internal documentation available; • considering the overall consistency of information presented in the project forecasts, including the interrelationships between performance according to schedule, cost, revenues, penalty forecasts and incorporating any events or information received after the reporting date; • evaluating factors during the year that resulted in significant changes in estimated contract revenues and costs, and reconsidering our assessment of the risk of management bias; and • assessing the accounting impacts and disclosure requirements of IFRS 15 *Revenue from contracts with customers*, which became effective from 1 January 2018.

Philly Shipyard ASA

Other information

Management is responsible for the other information. The other information comprises information in the annual report, except the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon, with the exception of our report on Other Legal and Regulatory Requirements below.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Board of Directors and the Managing Director for the Financial Statements

The Board of Directors and the Managing Director (Management) are responsible for the preparation in accordance with law and regulations, including fair presentation of the financial statements of the Company in accordance with the Norwegian Accounting Act and accounting standards and practices generally accepted in Norway, and for the preparation and fair presentation of the consolidated financial statements of the Group in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's and the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern. The financial statements of the Company use the going concern basis of accounting insofar as it is not likely that the enterprise will cease operations. The consolidated financial statements of the Group use the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error. We design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's or the Group's internal control.

- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company and the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the

Philly Shipyard ASA

date of our auditor's report. However, future events or conditions may cause the Company and the Group to cease to continue as a going concern.

- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Board of Directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Board of Directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Board of Directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on Other Legal and Regulatory Requirements

Opinion on the Board of Directors' report

Based on our audit of the financial statements as described above, it is our opinion that the information presented in the Board of Directors' report and in the statements on Corporate Governance and Corporate Social Responsibility concerning the financial statements, the going concern assumption and the proposed allocation of the result is consistent with the financial statements and complies with the law and regulations.

Opinion on Registration and Documentation

Based on our audit of the financial statements as described above, and control procedures we have considered necessary in accordance with the International Standard on Assurance Engagements *(ISAE) 3000, Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, it is our opinion that management has fulfilled its duty to produce a proper and clearly set out registration and documentation of the Company's accounting information in accordance with the law and bookkeeping standards and practices generally accepted in Norway.

Oslo,12 March 2019
KPMG AS

Gunnar Sotnakk
Gunnar Sotnakk
State Authorised Public Accountant

Good dialogue

Philly Shipyard ASA (referenced to herein as "PHLY") is committed to maintaining an open and direct dialogue with its shareholders, potential investors, analysts, brokers and the financial community in general.

The timely release of information to the market that could affect PHLY's share price helps ensure that Philly Shipyard ASA's share price reflects its underlying value.

Philly Shipyard's goal is that PHLY's shareholders will, over time, receive competitive returns on their investments through a combination of dividends and share price growth. On 26 February 2014, the Company's Board of Directors adopted the following dividend policy:

"The Company's objective is to provide its shareholders with a competitive return on its shares over time based on the Company's earnings. The Company aims to pay a quarterly dividend of USD 0.25 per share, beginning with the second quarter of 2014, with intentions of increasing the amount over time. Any payment of dividends will be considered in conjunction with the Company's financial position, debt covenants, capital requirements, market prospects and potential strengthening of the Company's financial structure."

PHLY's Board of Directors uses this dividend policy as a guideline to determine how much of PHLY's earnings it will pay to shareholders.

In 2018, PHLY did not pay any ordinary or extraordinary dividends.

The Norwegian Public Limited Liability Companies Act allows for the Board of Directors to pay dividends on the basis of an authorization from the general meeting. The Board of Directors will therefore propose to the annual general meeting in 2019 that the Board of Directors is granted an authorization to pay dividends based on PHLY's annual accounts for 2018, valid up to PHLY's annual general meeting in 2020. Such authorization will facilitate potential payments of dividends by the Board of Directors in accordance with PHLY's dividend policy.

Due to the delay in securing new orders beyond Hull 030, at this time, PHLY does not plan to pay any further ordinary or extraordinary dividends in 2019. The Board of Directors will revisit PHLY's dividend policy and dividend plan when it has more clarity about the Company's new order situation and related capital requirements.

Shares and share capital

As of 31 December 2018, Philly Shipyard ASA has 12,574,766 ordinary shares; each share has a par value of NOK 10 (see note 6 to the Parent company's 2018 accounts). As of 31 December 2018, PHLY had 587 shareholders, of whom 33.4% were non-Norwegian shareholders.

PHLY has a single share class. Each share is entitled to one vote. PHLY holds 466,865 of its own (treasury) shares, constituting approximately 3.71% of the shares outstanding, as of 31 December 2018.

Stock exchange listing

Philly Shipyard ASA was listed on Oslo Axess on 17 December 2007 (ticker: PHLY). PHLY's shares are registered in the Norwegian Central Securities Depository; the shares have the securities registration number ISIN NO 0010395577. DNB Bank ASA is PHLY's registrar.

Majority shareholder

Philly Shipyard ASA's majority shareholder is Aker Capital AS, a wholly-owned subsidiary of Aker ASA. Companies that are part of Aker are legally and financially independent units. Aker Capital AS exercises active ownership as part of systematic efforts to create value for all PHLY shareholders.

From time to time, agreements are entered into between the Company and one or more Aker companies. The Boards of Directors and other parties involved in the decision-making processes related to such agreements are all critically aware of the need to handle such matters in the best interests of the involved companies, in accordance with good corporate governance practice. If needed, external, independent opinions are sought.

Current Board authorizations

As of 31 December 2018, the Board of Directors of Philly Shipyard ASA has an authorization to pay dividends, an authorization to increase the share capital and two separate authorizations to acquire own shares. All of these current Board authorizations are valid up until the next annual general meeting in 2019. For more details, please see "Board authorizations" on pages 64-65.

Stock option plans

As of 31 December 2018, Philly Shipyard ASA has no stock option program.

Investor relations

Philly Shipyard ASA seeks to maintain an open and direct dialogue with shareholders, financial analysts and the financial market in general.

All Philly Shipyard press releases and investor relations publications, including archived material, are available at the Company's website: www.phillyshipyard.com. This online resource includes PHLY's quarterly and annual reports, prospectuses, articles of association, financial calendar and its Investor Relations and Corporate Governance policies, along with other information.

Shareholders can contact the Company at contactus@phillyshipyard.com.

Electronic interim and annual reports

Philly Shipyard ASA encourages its shareholders to subscribe to the electronic version of PHLY's annual reports. Annual reports are published on the Company's website at the same time as they are made available via website release by the Oslo Stock Exchange/Oslo Axess: www.newsweb.no (ticker: PHLY). Subscribers to this service receive annual reports in PDF format by email.

Share capital development over the past three years

Date	Change in share capital (in NOK)	Share capital (in NOK)	Number of shares	Par value (in NOK)
Change in 2016	-	-	-	-
31 December 2016	-	125 747 660	12 574 766	10.00
Change in 2017	-	-	-	-
31 December 2017	-	125 747 660	12 574 766	10.00
Change in 2018	-	-	-	-
31 December 2018	-	125 747 660	12 574 766	10.00

Quarterly reports, which are generally only distributed electronically, are available from the Company's website and other sources. Shareholders who are unable to receive the electronic version of interim and annual reports, may subscribe to the printed version by contacting Philly Shipyard's investor relations staff.

Nomination committee

PHLY's nomination committee has the following members: Leif Arne Langoy, Gerhard Heiberg and Arild Støren Frick. Shareholders who wish to contact Philly Shipyard's nomination committee may do so using the following address:

Nomination Committee of
Philly Shipyard ASA
Vika Atrium
Munkedamsveien 45
NO-0250 Oslo, Norway

Annual shareholders' meeting

Philly Shipyard ASA's annual shareholders' meeting is normally held in March or early April. Written notification is sent to all shareholders individually or to shareholders' nominees. To vote at shareholders' meetings, shareholders (or their duly authorized representatives) must either be physically present or vote by proxy.

2018 share data

PHLY's total market capitalization as of 31 December 2018 was NOK 352 million. During 2018, a total of 1,494,933 Philly Shipyard ASA shares traded, corresponding to 0.119 times PHLY's freely tradable stock. The shares traded on 237 trading days in 2018.

Twenty largest shareholders
(as of 31 December 2018)

Shareholders	Number of shares held	Ownership (in %)
Aker Capital AS	7 237 631	57.6%
Goldman Sachs & Co. LLC	2 392 688	19.0%
J.P. Morgan Securities LLC	499 330	4.0%
Philly Shipyard ASA	466 865	3.7%
Morgan Stanley & Co. LLC	344 608	2.7%
J.P. Morgan Securities LLC	145 167	1.2%
Pershing LLC	130 262	1.0%
Citibank, N.A. S/A National Financial Services	110 611	0.9%
Interactive Brokers LLC	98 603	0.8%
Morgan Stanley & Co. LLC	93 606	0.7%
Patineer Management LLC	59 857	0.5%
Citibank, N.A. S/A Charles Schwab FBO Customers	50 272	0.4%
Citibank, N.A. S/A RBC Capital Markets, LLC II	43 442	0.4%
Lars Ro	40 000	0.3%
Ramadan Kovaci	38 855	0.3%
Citibank, N.A. S/A Morgan Stanley	31 683	0.3%
J.P. Morgan Chase Bank, N.A., London	27 875	0.2%
Heggum Holding AS	26 500	0.2%
Espen Einar Dalby	20 500	0.2%
Nordnet Livsforsikring AS	19 424	0.2%
Total, 20 largest shareholders	**11 877 779**	**94.6%**
Other shareholders	696 987	5.4%
Total	**12 574 766**	**100.0%**

Geographic distribution of shareholders
(as of 31 December 2018)

Nationality	Number of shares held	Ownership (in %)
Norwegian shareholders	8 372 883	66.6%
Non-Norwegian shareholders	4 201 883	33.4%
Total	12 574 766	100.0%

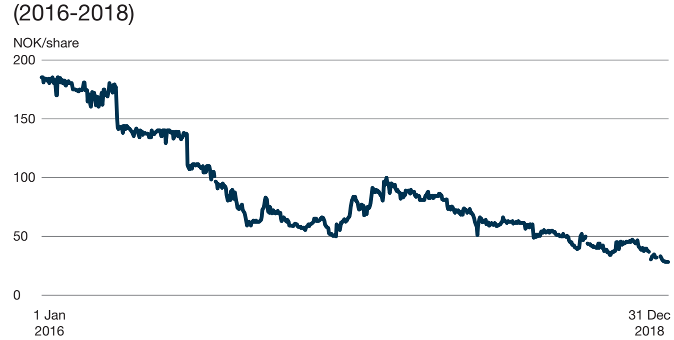
Ownership structure by number of shares held
(as of 31 December 2018)

Shares owned	Number of shareholders	Percent of share capital
1 – 100	180	0.1%
101 – 1 000	254	0.9%
1 001 – 10 000	119	2.9%
10 001 – 100 000	26	6.0%
100 001 – 500 000	6	13.5%
Over 500 000	2	76.6%
Total	587	100.0%

Share price development in 2018
2018 share data

Highest traded	NOK	73.40
Lowest traded	NOK	28.00
Share price as of 31 Dec.	NOK	28.00
Shares issued as of 31 Dec.		12 574 766
Own (treasury) shares as of 31 Dec.		466 865
Shares issued and outstanding as of 31 Dec.		12 574 766
Market capitalization as of 31 Dec.	NOK million	352
Proposed share dividend	NOK per share	-

Share price development *
(2016-2018)



* For 2016-2018, PHLY paid dividends of approximately 63 NOK per share (61 NOK/share in 2016, 2 NOK/share in 2017 and 0 NOK/share in 2018).

Corporate governance

Philly Shipyard ASA (referenced to herein as "PHLY") aims to create maximum value for its shareholders over time. Good corporate governance will help to reduce risk and ensure sustainable value creation.

The Board has reviewed and updated PHLY's principles for corporate governance. The principles are based on the Norwegian Code of Practice for Corporate Governance, dated 17 October 2018 (the "Code of Practice"), the principles set out in the Continuing Obligations of stock exchange listed companies from the Oslo Stock Exchange, and the relevant Norwegian background law such as the Norwegian Accounting Act and the Norwegian Public Limited Liability Companies Act. The Code of Practice is available at www.nues.no and the Continuing Obligations of stock exchange listed companies may be found at www.oslobors.no. The principles also apply to PHLY's subsidiaries when relevant. The Board's statement of corporate governance is included in the annual report. The following presents the current practice of PHLY regarding each of the recommendations contained in the Code of Practice. Any deviations from the recommendations are explained under the item in question.

Purpose

PHLY's Corporate Governance principles ensure an appropriate division of roles and responsibilities among PHLY's owners, its Board of Directors, and its Executive Management, and that business activities are subject to satisfactory control. The appropriate division of roles and satisfactory control contribute to the greatest possible value creation over time, to the benefit of owners and other stakeholders.

Values and ethical guidelines

The Board has adopted corporate values and ethical guidelines. The Company's corporate values are presented on page 6 of this annual report. These values consist of the following four "CORE" principles: Caring, One shipyard, Responsible and Efficient. Philly Shipyard has zero tolerance for corruption and, in 2015, the Board approved an Anti-Corruption Policy that is in-line with the anti-corruption policies in place at other Aker ASA-related companies. Philly Shipyard works to promote a sustainable and responsible company that is driven by good results and the demands for social responsibility.

Business

PHLY's business purpose clause in the articles of association is as follows:

"The Company's business is to own and manage industry and other related business related to building of ships, capital management and other operations for the group, including participating in or acquiring other business."

The function of the business purpose clause is to ensure that shareholders have control of the business and its risk profile, without limiting the Board or management's ability to carry out strategic and financially viable decisions within the defined purpose. PHLY's goals and main strategies and risks for its business activities are presented in the Board of Directors' report. PHLY's vision is for Philly Shipyard "To be – and be recognized as – a leading shipyard in America that delivers on its commitments, every time" and its supporting strategies for 2019 are delivering Hull 030 to Matson according to plan, securing new orders beyond Hull 030, expanding into government work and communicating openly with the workforce.

Equity and dividends

Equity

PHLY's equity as of 31 December 2018 amounted to USD 111.5 million, which corresponds to an equity ratio (total equity divided by total assets) of approximately 59%. PHLY regards its current equity structure as appropriate and adapted to its objectives, strategy, and risk profile.

Dividends

PHLY's dividend policy is included in the section "Shares and shareholder matters" (see page 62). As stated in that policy:

"The Company's objective is to provide its shareholders with a competitive return on its shares over time based on the Company's earnings. The Company aims to pay a quarterly dividend of USD 0.25 per share, beginning with the second quarter of 2014, with intentions of increasing the amount over time. Any payment of dividends will be considered in conjunction with the Company's financial position, debt covenants, capital requirements, market prospects and potential strengthening of the Company's financial structure."

PHLY's Board of Directors uses this dividend policy as a guideline to determine how much of the Company's earnings it will pay to shareholders.

Due to the current main focus on securing new orders beyond Hull 030, the PHLY Board has decided not to pay any ordinary or extraordinary dividends at this time. The PHLY Board will revisit PHLY's dividend policy and dividend plan when it has more clarity about the Company's new order situation and related capital requirements.

Board authorizations

It is the intention that the Board's proposals for future Board authorizations to issue shares and to undertake share buybacks are to be limited to defined purposes and to be valid only until the next annual shareholders' meeting.

To facilitate the potential payment of dividends in accordance with PHLY's dividend policy, the Board of Directors has an authorization to pay dividends based on PHLY's annual accounts for 2017.

The Board of Directors has an authorization to increase the share capital by up to NOK 12,574,766, which can only be used to raise equity capital for new shipbuilding projects or other future investments within the Company's scope of operations.

The Board of Directors has an authorization to acquire own shares with a total nominal value of NOK 12,574,766 which can only be used for the purpose of utilizing PHLY's shares as transaction currency in acquisitions, mergers, de-mergers or other transactions.

The Board of Directors has an authorization to acquire own shares with a total nominal value of NOK 12,574,766 which can only be used for the purpose of investment or subsequent sale or deletion of such shares.

All of these Board authorizations are valid up to the annual shareholders' meeting in 2019.

The Board currently has no other authorizations to issue shares or undertake share buybacks. The Board will propose to the annual shareholders' meeting in 2019 that the Board is granted an authorization for payment of dividends, an authorization to increase the share capital and two authorizations to acquire own shares similar to the authorizations described above.

Equal treatment of shareholders and transactions with close associates

PHLY has a single class of shares, and all shares carry the same rights in PHLY. Equal treatment of all shareholders is crucial. If existing shareholders' pre-emptive rights are proposed waived upon an increase in share capital, the Board will justify the waiver. The Board will also publicly disclose such justification in a stock exchange announcement issued in connection with such increase in share capital. Transactions in own (treasury) shares are executed on the Oslo Stock Exchange or by other means at the listed price.

If there are material transactions between the Company and a shareholder, Board member, member of Executive Management, or a party closely related to any of the aforementioned, the Board shall ensure that independent valuations are available.

See additional information on transactions with related parties in note 26 to the consolidated accounts. As of 31 December 2018, 57.6% of the shares in PHLY are owned by Aker Capital AS, a wholly-owned subsidiary of Aker ASA. For further details on the relationship between Philly Shipyard and Aker ASA, see note 26 to the consolidated accounts.

Shares and negotiability

There are no limitations on any party's ability to own, trade or vote for shares in PHLY. No restrictions on transferability are found in PHLY's articles of association.

General meetings

The Board of Directors encourages shareholders to participate in shareholders' meetings. It is PHLY's priority to hold the annual shareholders' meeting as early as possible after the year-end. Notices of shareholders' meetings are sent physically by post and comprehensive supporting information, including the recommendations of the nomination committee, are made available for the shareholders on the Company's home page, in each case not later than 21 days prior to the annual shareholders' meeting. The Board seeks to ensure that the resolutions and supporting information are sufficiently detailed and comprehensive to enable the shareholders to form a view on all matters to be considered at the meeting. The deadline for shareholders to register to the shareholders' meetings is set as close to the date of the meeting as possible and the deadline for registration may not expire earlier than five days prior to the date of the shareholders' meeting. Shareholders who are unable to attend the meeting in person may vote by proxy, and normally the proxy may be given to the chairman of the meeting or any other person appointed by the chairman. Both on the attendance and proxy form and the notice of meeting, all procedures for registration are thoroughly explained. In addition, information on how to propose a resolution to the items on the agenda at the annual shareholders' meeting will be included in the notice.

Pursuant to PHLY's articles of association, the Chairman of the Board, or any other person appointed by the Chairman, chairs the shareholders' meetings. Although the Code of Practice recommends an independent chair for annual general meetings, it is the view of PHLY that the procedure followed by PHLY provides efficient and well prepared general meetings and is in the interests of the shareholders. The shareholders are invited to make a joint voting on the composition of the Board of Directors as proposed by the nomination committee and not on each board member separately. Hence, PHLY deviates from the Code of Practice in this regard as the nomination committee emphasizes that the Board's composition shall reflect a variety of experience, knowledge and qualifications.

To the extent possible, the CEO/General Manager, nomination committee leader and auditor attend annual shareholders' meetings.

Minutes of shareholders' meetings are published as soon as practically possible on the Oslo Stock Exchange, www.newsweb.no (ticker: PHLY) and on the Company's home page www.phillyshipyard.com, under the heading "Media Center".

Nomination committee

PHLY has a nomination committee, as set forth in Section 7 of PHLY's articles of association. Pursuant to the articles of association, the nomination committee is to comprise no fewer than three members. Each member is normally elected for a two-year period. The composition of the nomination committee reflects the interests of the shareholders, and its members are independent from the Board and Executive Management. The members and Chairman of the nomination committee are elected by PHLY's annual shareholders' meeting, which also approves the remuneration payable to committee members.

Pursuant to PHLY's articles of association, the nomination committee recommends candidates for members of the Board of Directors. The nomination committee also makes recommendations as to remuneration of the members of the Board and the nomination committee. The nomination committee will justify its recommendation and such justification will address the criteria specified in Section 8 of the Code of Practice on the composition of the Board of Directors.

The nomination committee comprises the following members:

- Leif Arne Langoy, Chairman (2017-2019)
- Gerhard Heiberg (2017-2019)
- Arild Støren Frick (2017-2019)

None of the members of the nomination committee is a member of the Board of Directors. Neither the CEO/General Manager nor any other senior executive is a member of the nomination committee.

The shareholders' meeting has stipulated guidelines for the duties of the nomination committee.

PHLY provides the shareholders with information on how to submit proposals to the nomination committee for candidates for election to the Board of Directors on the Company's website.

Board of Directors: composition and independence

Pursuant to Section 4 of PHLY's articles of association, the Board comprises between three and seven members. The Board is currently comprised of a total of four members. PHLY's shareholders elect the Chairman of the Board at the annual shareholders' meeting. The Board may elect its own Deputy Board Chairman. Board members are elected for a period of two years.

The composition of the Board of Directors is designed to ensure that it can operate independently of any special interests and function effectively as a collegiate body. A majority of the shareholder-elected

Board members are independent of PHLY's Executive Management and its significant business associates. The Board of Directors does not include any executive personnel. Further, three of the four shareholder-elected Board members are independent of PHLY's main shareholder, Aker ASA. Kristian Røkke, the Deputy Chairman of the Board of Directors of PHLY, is Chief Investment Officer of Aker ASA. Mr. Røkke replaced Audun Stensvold as the Deputy Chairman in June 2018, following Mr. Stensvold's resignation from the Board of Directors.

The current composition of the Board, as well as the Board members' expertise, capabilities, and experience, are presented on pages 68-69 of this annual report. The shareholder-elected Board members represent a combination of expertise, capabilities, and experience from various businesses and industries.

The Board members' shareholdings are presented in note 22 to the consolidated accounts. PHLY encourages the Board members to invest in PHLY's shares.

One of the four shareholder-elected Board members are up for election. PHLY will provide the relevant information regarding such Board member in accordance with the Code of Practice guidelines in advance of the annual general meeting.

The work of the Board of Directors

The Board of PHLY annually adopts a plan for its work, emphasizing the goals, strategies, and risk profile of the Company's business activities. The plan also recognizes the Company's corporate social responsibility. Also, the Board has adopted instructions that regulate areas of responsibility, tasks, and division of roles of the Board, Board Chairman, and the CEO/General Manager. These instructions feature rules governing Board schedules, rules for notice and chairing of Board meetings, decision-making rules, the CEO's/General Manager's duty and right to disclose information to the Board, professional secrecy, impartiality, and other issues.

In order to ensure a more independent consideration of matters of a material character in which the Board Chairman is, or has been, personally involved, the Board's consideration of such matters are chaired by the Deputy Board Chairman, if there is one serving at the time, or some other member of the Board in the absence of a Deputy Board Chairman.

The Board of PHLY established an audit committee in 2010. The audit committee consists of two members, Elin Karfjell (Chairperson) and Amy Humphreys. Ms. Humphreys replaced Audun Stensvold on the audit committee in June 2018, following Mr. Stensvold's resignation from the Board of Directors. Both members are independent from operations of the Company and neither member is linked to PHLY's main shareholder.

The Board of PHLY established a tendering committee in 2012 to review tenders for new business. The tendering committee consists of two members, James H. Miller (Chairman) and Amy Humphreys. Both members are independent from operations of the Company and neither member is linked to PHLY's main shareholder.

PHLY does not have any other active Board committees at this time. In particular, PHLY does not have a remuneration committee because all members of the Board are independent of PHLY's executive personnel.

PHLY has prepared guidelines designed to ensure that members of the Board of Directors and Executive Management notify the Board of any direct or indirect stake they may have in agreements entered into by the Company. The Board evaluates its own performance and expertise once a year.

Risk management and internal control

The Board is to ensure that the Company maintains solid in-house control practices and protocols and appropriate risk management systems tailored to the Company's business activities. These practices and systems encompass the Company's guidelines for how it integrates considerations related to stakeholders into its creation of value. The Company's policy regarding corporate social responsibility is set forth on pages 19-20 of this annual report. The Board annually reviews the Company's most important risk areas and internal control systems and procedures, and these risk areas are mentioned in the Board of Directors' report. Through the use of a risk matrix and log, the Board also monitors the key risks related to the Company's business goals and assesses those risks, taking into account mitigating actions, on a quarterly basis. The issue is further described in notes 1 and 21 to the consolidated accounts.

Audit committee

The audit committee has reviewed the Company's internal reporting systems, internal control and risk management and had dialogue with the Company's auditor. The audit committee has also considered the auditor's independence.

PHLY's financial policies ensure follow-up of financial risk. Key targets are identified by the Board and management to ensure timely follow-up of currency exposure, interest rate exposure and compliance with covenants.

PHLY has prepared an authorization matrix and approval procedures for costs included in the Company's governing documents.

Financial statement close process

The Company has implemented Aker ASA's accounting and reporting guidelines which contains requirements and procedures for the preparation of both quarterly and annual reporting. The reporting is done quarterly through PHLY's reporting and consolidation system. Consolidation and control over the financial statement close process is the CFO's responsibility. Financial results and cash development are analyzed and compared to the budget by the CEO/General Manager and CFO and reported to the Board monthly.

Remuneration of the Board of Directors

Board remuneration reflects the Board's responsibility, expertise, time spent, and the complexity of the business. Remuneration does not depend on PHLY's financial performance and PHLY does not grant share options to members of its Board. Board members and companies with whom they are associated are not to take on special tasks for the Company beyond their Board appointments unless such assignments are disclosed to the full Board and the remuneration for such additional duties is approved by the Board. In this respect, PHLY's Board Chairman, James H. Miller, provides consulting services to Philly Shipyard, Inc. (PSI) on behalf of Mr. Miller's consulting company against a monthly fee. Approval of this assignment has been handled by the Board of Directors in accordance with the said procedure.

Additional information on remuneration paid to Board members for 2018 is presented in note 22 to the consolidated accounts.

Remuneration of Executive Management

The Board has adopted guidelines for remuneration of Executive Management in accordance with Section 6-16a of the

Norwegian Public Limited Company Act. Salary and other remuneration of the CEO/General Manager of PHLY are determined in a Board of Directors' meeting. The basis of remuneration of Executive Management has been developed in order to create a performance-based system. The system of reward is designed to contribute to the achievement of good financial results and increase in shareholder value.

PHLY does not have stock option plans or other such share award programs for employees. Further information on remuneration for 2018 for members of the Company's Executive Management is presented in note 22 to the consolidated accounts. PHLY's guidelines for remuneration to Executive Management are discussed on pages 46-47 of this annual report and will be presented to the shareholders at the annual shareholders' meeting. The maximum size of any payment under the existing performance-related remuneration program to any executive is linked to the size of the executive's base salary.

The Board's guidelines for remuneration of Executive Management will be made available as a separate appendix to the agenda for the annual shareholders' meeting. The statement will include information on which aspects of the guidelines are advisory, and which, if any, are binding. The Company currently does not grant remuneration to Executive Management being subject to binding guidelines.

Information and communications

PHLY's reporting of financial and other information is based on openness and on equal treatment of shareholders, the financial community, and other interested parties.

The long-term purpose of PHLY's investor relations activities is to ensure the Company's access to capital at competitive terms and to ensure shareholders' correct pricing of shares. These goals are to be accomplished through correct and timely distribution of information that can affect PHLY's share price; PHLY is also to comply with current rules and market practices, including the requirement of equal treatment.

All stock exchange notifications and press releases are made available on the Company's home page www.phillyshipyard.com; stock exchange notices are also available from www.newsweb.no. All information that is distributed to shareholders is simultaneously published on the Company's home page.

PHLY's financial calendar is found on the inside front cover of this annual report.

PHLY's investor relations staff is responsible for maintaining regular contact with PHLY's shareholders, potential investors, analysts and other financial market stakeholders. The Board is regularly informed about PHLY's investor relations activities. For more information regarding PHLY's guidelines for reporting of financial and other information, see pages 62-63.

Takeovers

PHLY has not produced special principles for how it will act in the event of a takeover bid. However, if a takeover bid occurred the Board would follow the overriding principle of equal treatment for all shareholders. Unless the Board has particular reasons for so doing, the Board will not take steps to prevent or obstruct a take-over bid for the Company's business or shares, nor use share issue authorizations or other measures to hinder the progress of the bid, without such actions being approved by a shareholders' meeting after the take-over offer has become public knowledge.

The Company will not enter into any agreement with a bidder that acts to limit the Company's ability to arrange other bids for the Company's business or shares unless it is self-evident that such an agreement is in the common interest of PHLY and its shareholders. This provision shall also apply to any agreement on the payment of financial compensation to the bidder if the bid does not proceed. Any financial compensation will be limited to the costs the bidder has incurred in making the bid.

Agreements entered into between PHLY and a bidder that are material to the market's evaluation of the bid will be announced to the public no later than at the same time as the disclosure that the bid has been made is published.

Upon the issuance of an offer for PHLY's shares, the Board will make a statement to the shareholders that provides an assessment of the bid, the Board's recommendations and reasons for these recommendations. If the Board cannot recommend to the shareholders whether they should or should not accept the bid, the Board will explain the reasons for this. The Board's statement on the offer will make it clear whether the views expressed are unanimous, and if this is not the case, it will explain the basis on which specific members of the Board have excluded themselves from the Board's statement.

For each instance, an assessment will be made as to the necessity of bringing in independent expertise and obtaining a third party valuation. If a third party valuation is obtained, such valuation will include an explanation, and the Board will aim at recording such valuation in its statement. It may be necessary to obtain a valuation from an independent expert where a competing bid is made and the bidder either is the main shareholder or has a connection to the Board members or executive personnel.

Transactions that have the effect of sale of the Company or a major component of it are to be decided on by shareholders at a shareholders' meeting.

Auditor

The auditor makes an annual presentation to the Board of a plan for the auditing work for the year. Further, the auditor has provided the Board with a written confirmation that the requirement of independence is met.

The auditor participates in the Board meeting that deals with the annual accounts, and the auditor has reviewed the companies' internal control with the Board. At these meetings, the auditor reviews any material changes to PHLY's accounting principles, comments on any material estimated accounting figures and reports all matters on which there have been disagreement between the auditor and PHLY's executive personnel. Once a year a meeting is held between the auditor and the Board, at which no representatives of Executive Management are present. In addition to the presentations to the full Board, the auditor is present at all audit committee meetings which occur throughout the year and presents both its preliminary and final audit findings to the committee during such meetings.

Guidelines have been established for Executive Management's use of auditors for services other than auditing. Auditors are to provide the Board with an annual overview of services other than auditing that have been supplied to the Company.

Remuneration for auditors is presented in note 5 to the consolidated accounts and note 2 to the parent company accounts, detailed in auditing and other services. In addition, these details are presented at the annual general meeting.

Presentation of the Board of Directors

James H. Miller
Board Chairman

James H. Miller (b. 1955) is the sole member of SeaJay Consulting LLC and is currently providing consulting services to the construction and maritime industries. During the period of June 2011 through September 2017, Mr. Miller served as Executive Vice President – Americas at Kvaerner and President of Kvaerner Americas Holdings Inc. Prior to that Mr. Miller served as President and CEO of Philly Shipyard from June 2008 to April 2011. Before coming to the shipyard, Mr. Miller was President of Aker Solutions Process and Construction (P&C) Americas, where he was responsible for the operations of seven international business units. During his tenure, Aker Solutions P&C Americas became a leading provider of global engineering and construction solutions with 7,500 employees, including 4,500 construction trades personnel. Prior to joining Aker Solutions P&C Americas, Mr. Miller held the position of President of Aker Construction, Inc., which was one of the largest union construction companies in North America. He is currently the sole Director for all remaining Kvaerner U.S. based legal and operating entities. In addition, Mr. Miller currently serves as Board Director of Matrix Service Company based in Tulsa, Oklahoma, which is a public company listed on the Nasdaq Exchange. Mr. Miller also serves on the BOD's of San Juan Construction, an ESOP company based in Montrose, Colorado. Mr. Miller previously served as Chairman of the Board for Philly Shipyard ASA from June 2011 to April 2014. Mr. Miller graduated from the University of Edinboro in Pennsylvania with a BA. Mr. Miller is a U.S. citizen. Mr. Miller holds zero shares in the company and has no stock options. He has been elected for the period 2018-2020.

Amy Humphreys
Board Member

Amy Humphreys (b. 1966) currently serves as a director for multiple companies spanning several industries. Ms. Humphreys was Chief Financial Officer of Darigold, one of the largest dairy cooperatives in the United States. Prior to that role, Ms. Humphreys was President and CEO of Icicle Seafoods, Inc, a multi-species seafood processor and marketer. Prior to joining Icicle Seafoods, Ms. Humphreys served as CFO of North Star Petroleum Group, the Petroleum Division of Saltchuk Resources. Prior to that role, Ms. Humphreys was President of Delta Western, Inc., a petroleum marketing and distribution company in Alaska and a subsidiary of Saltchuk Resources. From 1995 to 2006, Ms. Humphreys held various leading positions in her 11 year tenure with American Seafoods Group, including VP Corporate Development and Treasurer. For the past 15 years, Ms. Humphreys has worked within companies operating under the Jones Act and has managed companies in the oil industry within an environment subject to OPA 90 regulation. Ms. Humphreys holds a Master of Business Administration (MBA), with honors, from University of Washington, is a Certified Public Accountant (CPA) and holds a Bachelor of Arts (BA) in Accounting and Finance, magna cum laude, from University of Puget Sound. Ms. Humphreys is a U.S. citizen. Ms. Humphreys holds zero shares in the company and has no stock options. She has been elected for the period 2018-2020.

Elin Karfjell
Board Member

Elin Karfjell (b. 1965) is Managing Partner of Atelika AS. Prior to that, she was CEO of Fabi Group and Director of Finance and Administration of Atea AS. She is former partner of Ernst & Young AS. Ms. Karfjell joined Ernst & Young AS in 2002. Prior to this, Ms. Karfjell held various positions including partner at Arthur Andersen. At Ernst & Young/Arthur Andersen, she held various leading positions, both within advisory and audit, and she has experience from a broad specter of industries. Ms. Karfjell is also a Board member of North Energy ASA, DNO ASA, Hent ASA and Contesto AS. Previously, she has been a Board member of Sevan Drilling Ltd., Norse Energy Corporation ASA, Aktiv Kapital ASA and Aker Floating Production ASA. Ms. Karfjell is a state authorized public accountant. She has a bachelor accountant's degree from Okonomisk College (Hoyskolen i Oslo) and a master of accounting and auditing from the Norwegian School of Economics and Business Administration. Ms. Karfjell is a Norwegian citizen. Ms. Karfjell holds 1,200 shares in the company and has no stock options. She has been elected for the period 2017-2019.

Kristian Røkke
Deputy Board Chairman

Kristian Røkke (born 1983) was appointed Chief Investment Officer at Aker ASA in January 2018. He has extensive experience from offshore oil services, shipbuilding and mergers and transactions. Mr. Røkke joined Aker ASA from Akastor, an investment company listed on the Oslo stock exchange, where he was the CEO from 2015-2017. Mr. Røkke is Chair of the board of Akastor ASA, a Director of TRG Holding AS, Aker Capital AS and Aker Solutions ASA and previously a Director of Aker ASA. He has an MBA from The Wharton School, University of Pennsylvania. Mr. Røkke holds both Norwegian and American citizenships. Mr. Røkke owns no shares in the company and has no stock options. He has been elected for the period 2018-2020.

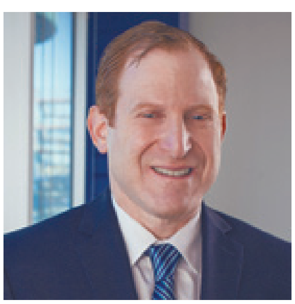
Presentation of the Management Team

Steinar Nerbøvik
President and CEO

Steinar Nerbøvik (b. 1961) was appointed President and Chief Executive Officer of Philly Shipyard ASA and Philly Shipyard, Inc. in November 2014 after serving as Managing Director since April 2014. Previously, Mr. Nerbøvik served as SVP Operations from October 2013. Prior to that, Mr. Nerbøvik served as SVP Yard Director for Norwegian Shipyard VARD Langsten (former Aker Yards and STX OSV Langsten), a leading provider of sophisticated offshore support vessels. Mr. Nerbøvik first joined Philly Shipyard in 2003 as Vice President Projects. Mr. Nerbøvik has held other management positions as combined Design Manager and Project Manager at Aker Langsten from 1991-2003. Mr. Nerbøvik holds a Master of Science in Ship Naval Engineering from the Norwegian Institute of Technology (NTNU) in Trondheim. Mr. Nerbøvik lives in Wilmington, DE, USA. Mr. Nerbøvik is a Norwegian citizen. As of 1 February 2019, Mr. Nerbøvik holds 1,000 shares in the company and has no stock options.

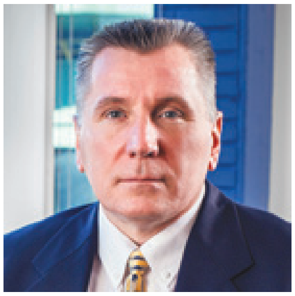
Jan Ivar Nielsen
Chief Financial Officer

Jan Ivar Nielsen (b. 1962) was appointed Chief Financial Officer of Philly Shipyard ASA and Philly Shipyard, Inc. in October 2015. Previously, Mr. Nielsen was EVP and CFO for VARD from 2009-2015 after serving as the VP of Finance for VARD's operations in Brazil from 2007-2009. Prior to working at VARD, Mr. Nielsen was CFO and Head of Investor Relations for Aker American Shipping from its formation in 2005-2007, and its predecessor Aker Philadelphia Shipyard from 2002-2005. From 1998-2002 he was CFO for Kvaerner Shipbuilding in London and had CFO assignments for Kvaerner Masa Yards in Finland and Warnow Werft in Germany. Mr. Nielsen had various finance positions in the process industry from 1990-1997. Mr. Nielsen holds a Master of Science in Business degree from Bodo Graduate School of Business and an Executive MBA degree from Temple University in Philadelphia, PA, USA. Mr. Nielsen lives in Philadelphia, PA, USA. Mr. Nielsen is a Norwegian citizen. As of 1 February 2019, Mr. Nielsen holds zero shares in the company and has no stock options.



Dean Grabelle
Senior Vice President and General Counsel

Dean Grabelle (b. 1970) was appointed Senior Vice President and General Counsel of Philly Shipyard, Inc. (PSI) in November 2016, after serving as PSI's General Counsel since May 2008. Prior to joining the shipyard, Mr. Grabelle was employed with the law firm Drinker Biddle & Reath LLP in Philadelphia, PA, USA where he established a legal career spanning 12 years. Past experience includes mergers and acquisitions, business counseling, lending, private equity and corporate finance. Mr. Grabelle graduated from Duke University with a Bachelor of Arts in Economics and Public Policy Studies. He also holds a Juris Doctor from the University of Pennsylvania Law School. Mr. Grabelle lives in Voorhees, NJ, USA. Mr. Grabelle is a U.S. citizen. As of 1 February 2019, Mr. Grabelle holds zero shares in the company and has no stock options.

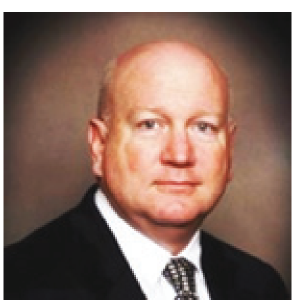


Robert Fitzpatrick
Vice President Production

Robert Fitzpatrick (b. 1964) joined Philly Shipyard, Inc. in 2001 and had held numerous key positions including Prefabrication Manager and Senior Production Manager before being promoted to Vice President Production in January 2007. Prior to coming to the shipyard, Mr. Fitzpatrick amassed 20 years of experience in industrial manufacturing including 12 years as a production manager responsible for the fabrication of naval circuit breakers and switchgear at L-3 Communications. Mr. Fitzpatrick holds a Bachelor of Science in Mechanical Engineering from Spring Garden College in Philadelphia, PA, USA. Mr. Fitzpatrick lives in Burlington, NJ, USA. Mr. Fitzpatrick is a U.S. citizen. As of 1 February 2019, Mr. Fitzpatrick holds zero shares in the company and has no stock options.

Michael Giantomaso
Vice President Human Resources

Michael Giantomaso (b. 1966) joined Philly Shipyard, Inc. as Human Resources Manager in May 1998 and was the shipyard's first locally hired manager. Mr. Giantomaso was promoted to Vice President Human Resources in August 2001. He has 29 years of human resources experience in the manufacturing and health care fields. Mr. Giantomaso holds a Bachelor of Arts in Business Administration and Human Resources from Temple University. Mr. Giantomaso lives in Huntingdon Valley, PA, USA. Mr. Giantomaso is a U.S. citizen. As of 1 February 2019, Mr. Giantomaso holds zero shares in the company and has no stock options.



Brian Leathers
Strategy and Compliance Officer

Brian Leathers (b. 1960) joined Philly Shipyard, Inc. as Strategy and Compliance Officer in January 2019. Mr. Leathers has diverse experience that includes manufacturing, banking and finance, and government contracting and served as the Chief Financial Officer for shipbuilder Austal USA. Mr. Leathers holds an Executive Masters in Business Administration from Troy University, a Bachelor of Arts in Accounting from the University of West Florida and is a graduate of the Graduate School of Banking held at Louisiana State University. Mr. Leathers lives in Philadelphia, PA, USA. Mr. Leathers is a U.S. citizen. As of 1 February 2019, Mr. Leathers holds zero shares in the company and has no stock options.

Disclaimer

This annual report includes and is based, inter alia, on forward-looking information and statements that are subject to risks and uncertainties that could cause actual results to differ. Such forward-looking information and statements are based on current expectations, estimates and projections about global economic conditions, the economic conditions of the regions and industries that are major markets for Philly Shipyard ASA and its subsidiaries and affiliates (the “Philly Shipyard Group”) lines of business. These expectations, estimates, and projections are generally identifiable by statements containing words such as “expects”, “believes”, “estimates” or similar expressions. Important factors that could cause actual results to differ materially from those expectations include, among others, economic and market conditions in the geographic areas and industries that are or will be major markets for the Philly Shipyard Group’s businesses, oil prices, market acceptance of new products and services, changes in governmental regulations, interest rates, fluctuations in currency exchange rates and such other factors as may be discussed from time to time. Although Philly Shipyard ASA believes that its expectations and the information in this annual report were based upon reasonable assumptions at the time when they were made, it can give no assurance that those expectations will be achieved or that the actual results will be as set out in this annual report. Neither Philly Shipyard ASA nor any other company within the Philly Shipyard Group is making any representation or warranty, expressed or implied, as to the accuracy, reliability or completeness of the information in the annual report, and neither Philly Shipyard ASA, any other company within the Philly Shipyard Group nor any of their directors, officers or employees will have any liability to you or any other persons resulting from your use of the information in the annual report.

Philly Shipyard ASA undertakes no obligation to publicly update or revise any forward-looking information or statements in the annual report, other than what is required by law.

The Philly Shipyard Group consists of various legally independent entities, constituting their own separate identities. Philly Shipyard is used as the common brand or trade mark for most of these entities. In this annual report we may sometimes use “Company”, “Philly Shipyard”, “Group”, “we” or “us” when we refer to Philly Shipyard companies in general or where no useful purpose is served by identifying any particular Philly Shipyard company.

Philly Shipyard ASA

Vika Atrium, Munkedamsveien 45,
NO-0250 Oslo, Norway
Tel: + 47 23 11 91 00, Fax: + 47 23 11 91 01

Philly Shipyard, Inc.

2100 Kitty Hawk Avenue
Philadelphia, PA 19112 USA
Tel: +1 (215) 875 2600, Fax: +1 (215) 875 2700

website: www.phillyshipyard.com
email: info@phillyshipyard.com

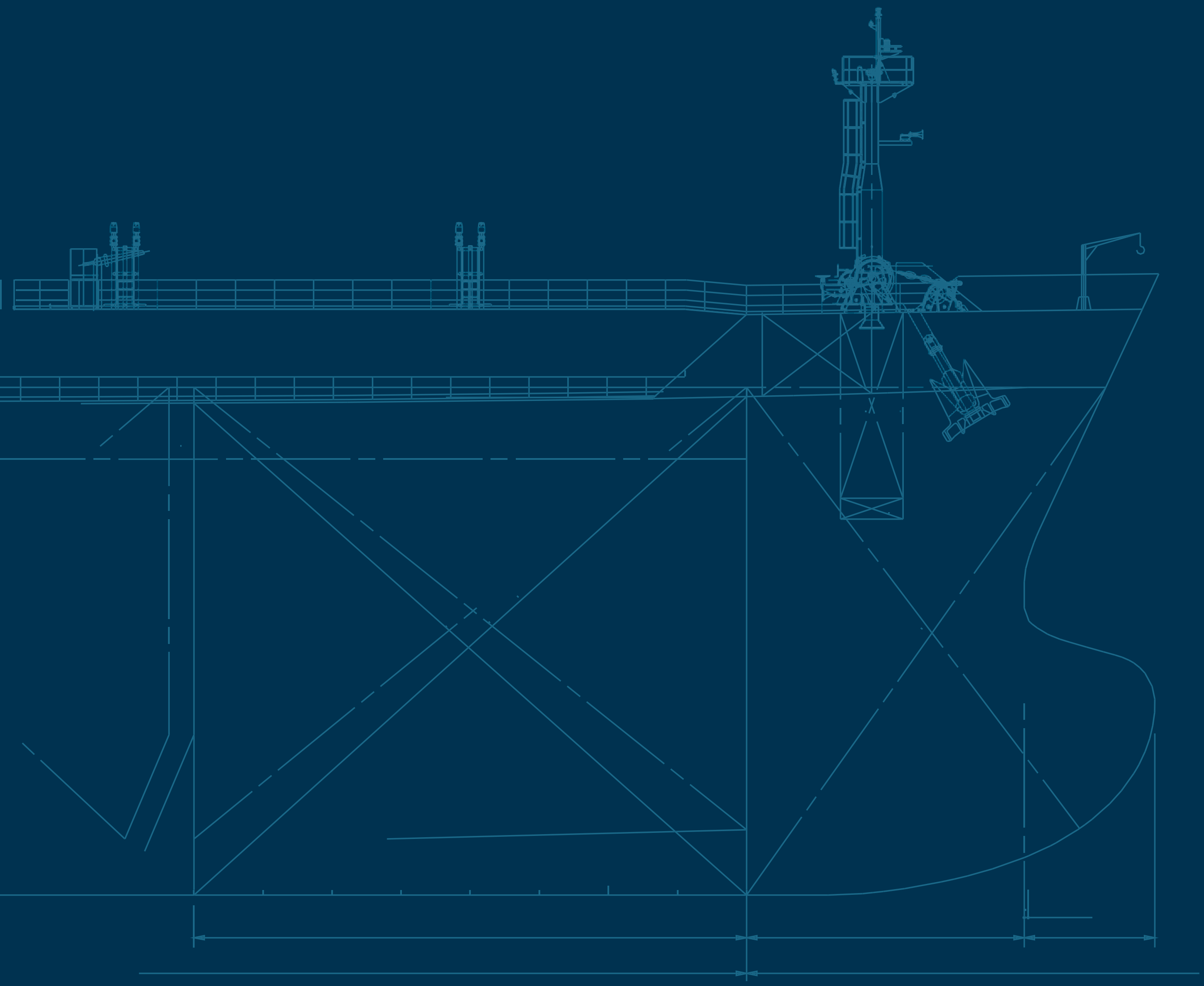
Save the environment — read reports online

The annual reports of Philly Shipyard ASA are available via the Internet: www.phillyshipyard.com. Alternatively, Philly Shipyard ASA encourages its shareholders to subscribe to the company's annual reports via the electronic delivery system of the Norwegian Central Securities Depository (VPS). Please note that VPS services (VPS Investortjenester) are designed primarily for Norwegian shareholders. Subscribers to this service receive annual reports in PDF format by email. VPS distribution takes place at the same time as distribution of the printed version of Philly Shipyard's annual report to shareholders who have requested it.

Electronic distribution is the fastest channel for accessing company information; it is also cost-effective and environmentally friendly.

Photos/illustrations:
All photos courtesy of
Philly Shipyard, Inc. and
Charles Cerrone Photography

Layout/production:
Donnelley Financial Solutions



Philly Shipyard ASA

Annual report 2018

www.phillyshipyard.com