Philly Shipyard ASA (OSE: PHLY)
Q2 2018 and Half-Year 2018 Results

16 July 2018

Key Events

- ✓ As of 30 June 2018, the two-containership order for Matson is approximately 84% complete
- ✓ Philly Shipyard continued to idle certain operations and impose layoffs due to the lack of new work after the Matson project
- ✓ Second quarter and first half 2018 operating revenues and other income of USD 40.4 million and USD 83.4 million, respectively, compared to USD 47.2 million and USD 215.1 million in the same periods in 2017
- ✓ Second quarter and first half 2018 EBITDA of USD 0.2 million and negative USD 1.1 million, respectively, compared to USD 4.2 million and USD 34.2 million in the same periods in 2017
- ✓ Second quarter and first half 2018 net loss of USD 2.0 million and USD 5.6 million, respectively, compared to net income of USD 2.2 million and USD 19.4 million in the same periods in 2017
- ✓ Total cash and cash equivalents of USD 92.8 million at 30 June 2018, excluding USD 13.2 million of restricted cash securing a loan
- ✓ Order backlog of USD 65.2 million on 30 June 2018
- ✓ On 5 April 2018, the PHLY Annual General Meeting was held; all proposals were approved and no changes were made to the Board of Directors
- ✓ On 29 June 2018, the proposal to elect Kristian Røkke as Deputy Chairman of the Board was approved at an Extraordinary General Meeting

Subsequent Events

- ✓ On 16 July 2018, Philly Shipyard and an undisclosed potential customer executed a non-binding Term Sheet for the construction and sale of two newbuild Jones Act Medium Range (MR) product tankers

Operations and Shipping Investments

Vessel Construction

At the end of the second quarter of 2018, Philly Shipyard was building two containerships under contract with Matson (Hulls 029-030). Hull 029 (named *Daniel K. Inouye)* was christened at a ceremony at the Philly Shipyard on 30 June 2018. When delivered, this vessel will be the largest containership ever built in the United States.

Hull 029 production activities continue to progress in the Commissioning Dock and sea trials are expected to occur next month. Hull 030 production activities continue to progress in the Building Dock. The planned delivery dates for Hulls 029 and 030 remain Q3 2018 and Q1 2019, respectively.

While Philly Shipyard continues to actively seek the new orders and capital necessary to build vessels after Hull 030, it continues to adjust its operations and workforce in line with its current order backlog. These adjustments include idling additional parts of its facilities and laying off some more of its employees. Since the beginning of 2018, Philly Shipyard has laid off approximately 25% of its employees in a series of layoffs.

Shipping Investments

During Q2 2018, Philly Tankers, a Jones Act shipping company that is majority-owned by Philly Shipyard, held an Extraordinary General Meeting whereby it was decided to commence an orderly liquidation process. Philly Tankers is proceeding with this process for the purpose of distributing its available cash balances to shareholders in 2018. To date, the dividends paid by Philly Tankers to its shareholders total USD 78.1 million, and Philly Shipyard's share of those dividends totals USD 41.9 million. Philly Tankers will not make any further dividend payments before liquidation other than any dividends necessary to cover U.S. tax withholding payments on behalf of its non-U.S. shareholders due at an earlier time.

Health, Safety, Security and Environment (HSSE)

Philly Shipyard's 12-month trailing average for its Lost Time Incident Frequency Rate (LTIFR), as defined by the Occupational Safety and Health Administration (OSHA), at the end of Q2 2018 was 0.65 compared to 1.15 at the end of Q2 2017. Philly Shipyard's 12-month trailing average for its other Recordable Incident Frequency Rate, based on recordable incidents (other than lost time incidents) per 200,000 hours, at the end of Q2 2018 was 3.82 compared to 4.18 at the end of Q2 2017. Philly Shipyard continues to work proactively to further improve safety and reduce the number of incidents at the shipyard.

Financial Information

Second Quarter and Year-to-Date 2018 Results

Operating revenues and other income for the second quarter of 2018 were USD 40.4 million compared to operating revenues and other income of USD 47.2 million for the second quarter of 2017. Q2 2018 operating revenues and other income were driven by the continued progress on the Matson vessels (Hulls 029-030); Q2 2017 operating revenues and other income were also driven by continued progress on the Matson vessels (Hulls 029-030).

Net loss for Q2 2018 was USD 2.0 million compared to net income of USD 2.2 million for Q2 2017.

As previously disclosed, under International Financial Reporting Standards (IFRS), 100% of the revenue, cost and profit on each of 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 (i.e., Hulls 025-028) because there were no external customers at the time these contracts were signed and shipbuilding activities commenced. Since none of these vessels was delivered during Q2 2017, this project did not contribute to Q2 2017 operating revenues and other income, even though there was continued progress on Hulls 027 and 028 in that period.

In addition to the IFRS financial measures reported above, EBITDA[1] and Adjusted EBITDA[2] are considered other relevant earnings indicators for Philly Shipyard as they measure the operational performance of the shipyard. In particular, Philly Shipyard believes presenting Adjusted EBITDA is useful to investors as it provides another measure of Philly Shipyard's profitability from its operations, as if Philly Shipyard never had any shipping investments, and more closely represents earnings from shipbuilding activities.

EBITDA for the second quarter of 2018 was USD 0.2 million compared to EBITDA of USD 4.2 million in the second quarter of 2017. The net loss and decrease in EBITDA were mainly driven by the fact that in Q2 2018 Philly Shipyard recognized a loss of USD 3.7 million on the Matson project (Hulls 029-030) compared to a breakeven project margin in Q2 2017, as well as overhead expenses incurred in Q2 2018 not allocated to projects. Adjusted EBITDA for the second quarter of 2018 was USD 0.1 million compared to Adjusted EBITDA of USD 11.4 million in the second quarter of 2017. The decrease in Adjusted EBITDA was driven primarily by the recognized loss on the Matson project compared to the significantly higher margin on the Philly Tankers project, as well as overhead expenses incurred in Q2 2018 not allocated to projects.

Net financial items in Q2 2018 was expense of USD 0.1 million compared to expense of USD 0.4 million in Q2 2017. The expense for net financial items in both Q2 2018 and Q2 2017 were mainly due to unrealized currency losses on foreign exchange forward contracts and net interest costs.

Operating revenues and other income in the first six months of 2018 ended at USD 83.4 million compared to operating revenues and other income of USD 215.1 million in the first six months of 2017. June 2018 year-to-date operating revenues and other income were primarily driven by the continued progress on the Matson vessels (Hulls 029-030) whereas June 2017 year-to-date operating revenues and other income were primarily driven by the delivery by Philly Shipyard of Hull 026 to Kinder Morgan, the related sale by Philly Tankers of its Hull 026 shipping assets to Kinder Morgan (profit and deferred gain from equity-accounted investments) and continued progress on the Matson vessels (Hulls 029-030).

[1] EBITDA is defined as earnings before interest, taxes, depreciation and amortization.

[2] Adjusted EBITDA is defined as EBITDA plus capitalized Welcome Fund interest expense plus or minus net deferred shipbuilding profits plus or minus loss or profit, respectively, in equity-accounted investments minus recognized deferred gain in equity-accounted investments.

The operating revenues in first half of 2018 were impacted by the implementation of the new IFRS 15 standard (IFRS 15). The 2017 accumulated revenue has been adjusted according to IFRS 15 with an increase of USD 38.4 million as of 31 December 2017. This had an impact on the revenue in Q1 2018 leading to a reduction in revenue of USD 38.4 million compared to a revenue recognition as the difference between accumulated revenue as of 31 March 2018 and 31 December 2017 as presented in the annual report for 2017. See notes 4 and 11 for further details.

Net loss for the first six months of 2018 was USD 5.6 million compared to net income of USD 19.4 million in the same period of 2017.

EBITDA for the first six months of 2018 was negative USD 1.1 million compared to EBITDA of USD 34.2 million in the same period of 2017. Adjusted EBITDA in the first six months of 2018 totaled negative USD 1.3 million compared to Adjusted EBITDA of USD 25.8 million in the same period of 2017.

Statement of Financial Position

Total assets were USD 236.0 million at 30 June 2018 compared to USD 253.0 million at 31 December 2017.

Total interest-bearing debt was USD 59.6 million at 30 June 2018 compared to USD 59.6 million at 31 December 2017.

Cash and cash equivalents (excluding restricted cash) were USD 92.8 million at 30 June 2018 compared to USD 110.1 million at 31 December 2017. The decrease of USD 17.3 million was primarily due to operating activities. As of 30 June 2018, restricted cash consisted of USD 13.2 million related to the Welcome Fund loan, which is expected to be released in 2020 when the loan matures.

Work-in-process was USD 16.6 million at 30 June 2018 compared to USD 13.4 million at 31 December 2017. Work-in-process represents the costs incurred by Philly Shipyard on the construction-related activities for the CV3700 vessels (Hulls 031-032) which were being undertaken for its own account until this project was placed on hold in January 2018. This project continues to be suspended as these vessels are still not yet secured by firm contracts.

Total equity decreased to USD 150.0 million at 30 June 2018 from USD 155.6 million at 31 December 2017 due to the net loss of USD 5.6 million.

Financing

The Company has a secured five-year term loan for up to USD 60.0 million from PIDC Regional Center, LP XXXI through the Welcome Fund loan program. The loan matures in March 2020. The entire USD 60.0 million amount was drawn under this facility as of 30 June 2018.

The Company also has an unsecured three-year revolving credit facility for up to USD 10.0 million from TD Bank, N.A. The facility terminates in April 2019. USD 1.2 million of this facility was utilized as of 30 June 2018 for the issuance of letters of credit.

Shareholder Distributions

Due to the current main focus on securing new orders beyond Hull 030, the PHLY Board has decided not to pay any further 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.

Outlook

Shipbuilding

The contract with Matson (Hulls 029-030) provides for shipbuilding activity with delivery dates through Q1 2019. As of 30 June 2018, Philly Shipyard had an order backlog of USD 65.2 million. The key focus area for Philly Shipyard’s operations continues to be the completion and delivery of the Matson vessels.

Philly Shipyard expects it will recognize revenues in 2018 only for the continued progress on the Matson project (Hulls 029-030) and potentially some initial progress on contracts for new vessel construction projects, if and when secured. Philly Shipyard currently forecasts the Matson vessels to be a loss-making project. Further, Philly Shipyard expects that the combined margin in 2018 from the Matson project and any other possible project will be insufficient to cover S,G&A and overhead costs not allocated to those same projects.

Securing contracts for new vessels is the key to Philly Shipyard's long-term future and ultimate return to sustained profitability, but will not materially improve its near-term forecast. Due to the under-recovery of the costs mentioned above, Philly Shipyard expects it will suffer significant losses in 2018 and 2019, even if the shipyard receives orders for new vessels. The current forecast is also subject to sensitivity due to the potential for operational inefficiencies arising from the timing of new vessel orders and other unforeseen impacts.

Until earlier this year, Philly Shipyard had been working on a project to build up to four containerships (CV3700 vessels) for delivery to TOTE in 2020 and 2021. However, in January 2018, this project was placed on hold. Philly Shipyard still intends to resume the CV3700 project, if conditions permit. However, there can be no assurance this project will resume. If this project is cancelled, then Philly Shipyard must write-off the work-in-process for this project, totaling USD 16.6 million. The total cost of a potential cancellation is estimated to be less than USD 20.0 million, of which around 90% of the cash impact has already been factored into the Q2 2018 financials. Philly Shipyard continues to explore alternatives in order to secure contracts and financing for these containerships.

In addition, Philly Shipyard is in active discussions related to several potential new construction projects for other types of Jones Act vessels. In particular, on 16 July 2018, Philly Shipyard signed a non-binding Term Sheet with an undisclosed potential buyer for the construction and sale of two new, state-of-the-art, cost-effective and eco-friendly 50,000 DWT class product tankers for operation in the Jones Act trade with targeted deliveries in Q4 2020 and Q1 2021. If built, these vessels will be substantially similar to the recently completed series of eight MT-50 class product tankers delivered by Philly Shipyard, except the main engines will be upgraded from Tier II to Tier III compliant. The transaction is subject to agreement by the parties on definitive documentation and fulfillment of certain closing conditions, including, but not limited to, securing commitments for charters. The Term Sheet provides for a period of exclusivity to negotiate and complete the transaction. In order to support the delivery timetable, Philly Shipyard has initiated preliminary design work for the vessels. However, there can be no assurance that Philly Shipyard will obtain contracts or financing for this project or any other project. Furthermore, none of these possible projects alone will fully cover the estimated under-recovered overhead costs (i.e., overhead costs not allocated to projects) due to the lack of work.

In the near term, Philly Shipyard is expanding its search for new opportunities throughout the marine industry, including various specialized vessels such as fishing trawlers and cable layers, as well as vessels to support the growing offshore wind 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.

In the longer term, 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, Philly Shipyard is pursuing opportunities to expand its base for operations also into new long-term projects for non-commercial end users.

Among other endeavors, Philly Shipyard has teamed with Fincantieri Marine Group and Vard Marine to compete for the detail design and construction (DD&C) of the U.S. Coast Guard's next generation heavy polar icebreaker. In support of this effort, the team is participating in a government funded industry study to develop a baseline icebreaker design, cost estimate, and project schedule and refine key vessel features and performance requirements. The final request for proposal (RFP) was issued in Q1 2018, with bids due in Q4 2018 and award of the contract for DD&C expected in Q3 2019.

Shipping

As part of the process of liquidating Philly Tankers described above, Philly Shipyard expects to receive its liquidating distribution from Philly Tankers later in 2018. Going forward, in line with its business strategy, Philly Shipyard will continue to evaluate opportunities to participate in the post-delivery economics of the ships that it constructs.

Risks

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.

The delay Philly Shipyard has experienced in securing new orders and financing for work after Hull 030 has interrupted its building program, causing Philly Shipyard to idle certain operations and lay-off some employees. If this delay continues, then it will further interrupt Philly Shipyard's building program and increase the risks faced by Philly Shipyard, including challenges related to attracting and retaining skilled workers; increases in under-recovered overhead costs (i.e., overhead costs not allocated to projects); and operational inefficiencies for completion of the remaining vessels in the current order backlog. Moreover, legal and contractual requirements may make employee reductions difficult and costly to implement.

If the shipyard fails to obtain new orders or financing for vessels following Hull 030 before the Matson project is substantially complete, then it is expected that the Company would incur significant expenses (including cancellation costs for long-lead items) and it would be challenging for Philly Shipyard to continue shipbuilding operations after delivery of Hull 030. In particular, if Philly Shipyard is not able to secure a contract for the CV3700 project (Hulls 031-032), then there is a risk that the work-in-process incurred for this project will be written-off. If the CV3700 project is not resumed before year-end, then Philly Shipyard will likely write-off the full amount of this work-in-process. There can be no assurance that this project will resume.

Operational risk is the ability to deliver vessels under existing contracts at the agreed time, quality, functionality and cost. Delivering projects in accordance with the contract terms and the anticipated cost framework represents a substantial risk element. Results also depend on costs of goods and services, both Philly Shipyard's own and those charged by suppliers, and on interest expense, exchange rates and customers' ability to pay.

Philly Shipyard is dependent on commitments for debt financing and has exposure in the financial markets, including currency, interest rate, counterparty and liquidity risks. Philly Shipyard has established guidelines and systems to manage this exposure.

Philly Shipyard faces risks related to the contracts for its vessels, including the risk that those contracts are cancelled and the underlying vessels are ultimately sold to third parties for less favorable terms. If this risk were to materialize, then it could have a negative effect on Philly Shipyard's financial performance.

During 2017, Philly Shipyard completed the transition from building Hulls 021-028 as tankers to building Hulls 029-030 as prototype container vessels. The container vessels are viewed as a higher risk since Philly Shipyard's main activity during the last ten years has been building tankers and the last container vessel built by Philly Shipyard was delivered 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 increases the current construction cost estimation uncertainty and the risk of occurrence of contract contingencies. Furthermore, 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.

For a further analysis of risks, please refer to the Company's 2017 annual report.

Responsibility Statement
The unaudited condensed interim consolidated financial statements and interim financial report as of and for the six months ended 30 June 2018 were approved by the Board of Directors and the President and CEO on 16 July 2018.

The condensed interim consolidated financial statements have been prepared in accordance with IAS 34 Interim Financial Reporting as endorsed by the European Union and the Norwegian additional requirements in the Securities Trading Act.

To the best of our knowledge, the condensed interim consolidated financial statements give a true and fair view of the assets, liabilities, financial position and profit of PHLY, and the interim management report of PHLY includes a fair review of the development and performance of the business and the position of PHLY, together with a description of the principle opportunities and risks associated with the expected development of PHLY for the remaining months of the financial year.

Oslo, Norway
16 July 2018
Board of Directors and President and CEO
Philly Shipyard ASA

James H. Miller
Board Chairman

Kristian Røkke
Deputy Board Chairman

Amy Humphreys
Board Member

Elin Karfjell
Board Member

Steinar Nerbovik
President and CEO

CONDENSED CONSOLIDATED INCOME STATEMENT

Amounts in USD millions (except number of shares and earnings per share)	Q2 Unaudited 2018	Q2 2017	6 Months Ended 30 June Unaudited 2018	6 Months Ended 30 June 2017	Full Year 2017 *
Operating revenues and other income	40.4	47.2	83.4	215.1	614.6
Operating expenses	(40.2)	(43.0)	(84.5)	(180.9)	(509.5)
Operating income/(loss) before depreciation - EBITDA	**0.2**	**4.2**	**(1.1)**	**34.2**	**105.1**
Depreciation	(2.0)	(1.1)	(3.9)	(4.3)	(5.8)
Operating (loss)/income - EBIT	**(1.8)**	**3.1**	**(5.0)**	**29.9**	**99.3**
Net financial items	(0.1)	(0.4)	(0.5)	0.9	0.6
(Loss)/income before tax	**(1.9)**	**2.7**	**(5.5)**	**30.8**	**99.9**
Tax expense	(0.1)	(0.5)	(0.1)	(11.4)	(32.7)
(Loss)/income after tax **	**(2.0)**	**2.2**	**(5.6)**	**19.4**	**67.2**
Weighted average number of shares	**12,107,901**	**12,107,901**	**12,107,901**	**12,107,901**	**12,107,901**
Basic and diluted (loss)/earnings per share (USD)	**(0.17)**	**0.18**	**(0.46)**	**1.60**	**5.55**

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Amounts in USD millions	Q2 Unaudited 2018	Q2 2017	6 Months Ended 30 June Unaudited 2018	6 Months Ended 30 June 2017	Full Year 2017 *
(Loss)/income after tax	(2.0)	2.2	(5.6)	19.4	67.2
Other comprehensive income, net of income tax	-	-	-	-	-
Total comprehensive (loss)/income for the period **	**(2.0)**	**2.2**	**(5.6)**	**19.4**	**67.2**

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Amounts in USD millions	Unaudited 30 June 2018	31 Dec. 2017 *
Assets		
Non-current assets		
Property, plant and equipment	48.0	50.1
Equity-accounted investments	45.3	47.3
Restricted cash	13.2	13.2
Deferred tax asset	0.9	0.9
Other non-current assets	0.3	0.2
Total non-current assets	**107.7**	**111.7**
Current assets		
Cash and cash equivalents	92.8	110.1
Work-in-process	16.6	13.4
Vessels-under-construction receivable	9.1	7.3
Income tax receivable	3.8	5.9
Other current assets	6.0	4.6
Total current assets	**128.3**	**141.3**
Total assets	**236.0**	**253.0**
Equity and liabilities		
Total equity	**150.0**	**155.6**
Non-current liabilities		
Interest-bearing long-term debt	59.5	59.4
Deferred tax liability	0.8	0.7
Total non-current liabilities	**60.3**	**60.1**
Current liabilities		
Trade payables, accrued liabilities and provisions	24.9	36.1
Income tax payable	0.7	1.0
Interest-bearing short-term debt	0.1	0.2
Total current liabilities	**25.7**	**37.3**
Total liabilities	**86.0**	**97.4**
Total equity and liabilities	**236.0**	**253.0**

* Annual 2017 financial information is derived from audited financial statements.
** All attributed to the equity holders of PHLY.

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Amounts in USD millions	6 Months Ended 30 June Unaudited 2018	2017
As of beginning of period	155.6	91.4
Total comprehensive (loss)/income for the period *	(5.6)	19.4
Dividend paid	-	(3.0)
As of end of period	**150.0**	**107.8**

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

Amounts in USD millions	6 Months Ended 30 June Unaudited 2018	2017
Net cash used in operating activities	(17.4)	(32.4)
Investment in property, plant and equipment	(1.8)	(4.5)
Dividend received from equity-accounted investments	2.0	39.9
Net cash from investing activities	0.2	35.4
Proceeds from construction loans	-	100.0
Repayment of construction loans	-	(75.0)
Repayment of capital lease	(0.1)	(0.1)
Dividend paid	-	(3.0)
Net cash (used in)/from financing activities	(0.1)	21.9
Net change in cash and cash equivalents	**(17.3)**	**24.9**
Cash and cash equivalents at beginning of period	110.1	69.1
Cash and cash equivalents at end of period	**92.8**	**94.0**

* All attributed to the equity holders of PHLY.

Notes to the condensed interim consolidated financial statements for the 2nd quarter and year-to-date 2018

1. Introduction – Philly Shipyard ASA

Philly Shipyard ASA (PHLY) is a company domiciled in Norway. The condensed interim consolidated financial statements for the three-month and six-month periods ended 30 June 2018 and 30 June 2017 are comprised of PHLY and its direct and indirect wholly-owned subsidiaries, including Philly Shipyard, Inc. (PSI).

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

The audited consolidated financial statements of PHLY as of and for the year ended 31 December 2017, which include a detailed description of accounting policies and significant estimates, are available at www.phillyshipyard.com.

2. Basis of preparation

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

The interim consolidated financial statements for the second quarter of 2018 have been prepared on the basis of a going concern assumption. Although the current order backlog ends in Q1 2019, PSI is actively working on securing new orders beyond this timeframe. The Company expects that its current financial situation, including its cash position, will make it possible to continue as a going concern after delivery of the last vessel in the current order book (i.e., Hull 030) in Q1 2019.

3. Statement of compliance

These condensed interim consolidated financial statements have been prepared in accordance with IFRS as adopted by the European Union IAS 34 Interim Financial Reporting. They do not include all of the information required for full annual financial statements, and should be read in conjunction with the audited consolidated financial statements of PHLY as of and for the year ended 31 December 2017.

4. Significant accounting principles

The accounting policies applied by PHLY in these condensed interim consolidated financial statements are substantially the same as those applied by PHLY in its audited consolidated financial statements as of and for the year ended 31 December 2017.

When implementing the new IFRS 15 standard (IFRS 15), the Company has concluded that the Company can continue with revenue recognition over time. In addition, the Company has assessed the effect implementing IFRS 15 has on the costs related to the contract. In 2017, the cost incurred has exceeded the cost recognized as expense according to IAS 11, and presented as an asset (work-in-process). According to IFRS 15 these expenses cannot be presented as an asset. For 2017, applying IFRS 15 for this contract, these incurred expenses that are not charged as cost shall be recognized as cost with a similar increase in revenue based on IFRS 15, with no margin. The Matson contract was as of 31 December 2017 estimated to be a zero margin contract and there was no effect on equity in the opening balance related to IFRS 15. In Q2 2018, the contract is estimated to be a loss making contract. The estimated loss is provided for per Q2 2018.

Although IFRS 15 had no impact on the Matson vessels in 2017, it has had an impact on those vessels in the first half of 2018 and will continue to have an impact on those vessels in the second half of 2018. The impact is related to how percentage of completion (POC) is measured under IFRS 15. Until the end of 2017, POC was measured using production hours, whereas from the beginning of 2018, POC is measured based on costs, by calculating the proportion of contract costs incurred for work performed compared to the estimated total costs for each contract. This is considered a better measure of the progress and completion of a project, as it also captures the progress for design, planning and procurement activities before start of production. Measuring POC by using costs incurred is also commonly used in earned value management systems.

Through Q2 2018, measuring progress and revenue recognition is based on the restated revenue and cost numbers as if IFRS 15 was applied in 2017.

Further details of the changes can be seen in note 11.

5. Use of estimates

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

The most significant judgments made by management in preparing these condensed interim consolidated financial statements in applying PHLY's accounting policies, and the key sources of estimation uncertainty, are the same as those that are applied to the audited consolidated financial statements as of and for the year ended 31 December 2017 unless described elsewhere in this report.

6. Tax estimates

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

7. Share capital and equity

At 30 June 2018 and 30 June 2017, PHLY had 12,107,901 ordinary shares (excluding 466,865 own shares) at a par value of NOK 10 per share. There were no share issuances or repurchases for the quarters or for the year-to-date periods ended 30 June 2018 or 30 June 2017. Accordingly, 12,107,901 ordinary shares was used in the calculation of earnings per share for the quarters and for the year-to-date periods ended 30 June 2018 and 30 June 2017.

8. Interest-bearing debt

The following shows material changes in interest-bearing debt during 2018:

Amounts in USD millions	Non-current debt	Current debt	Total interest-bearing debt
Balance 31 December 2017	**59.4**	**0.2**	**59.6**
Repayment of debt	-	(0.1)	(0.1)
Reclass of debt	0.1	-	0.1
Balance 30 June 2018	**59.5**	**0.1**	**59.6**

PSI has a secured term loan of up to USD 60.0 million (USD 59.5 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 13.1 million of cash collateral; (2) PSI's shares in its wholly-owned subsidiary, APSI Tanker Holdings II LLC (ATH II); and (3) ATH II's shares in Philly Tankers AS. The loan also contains a covenant restricting dividends and other distributions by ATH II until an additional USD 39.3 million of cash collateral has been deposited to secure the loan. It is expected that the additional USD 39.3 million of cash collateral will be deposited to secure the loan in 2018 in connection with the liquidation of Philly Tankers. USD 60.0 million is drawn under this term loan at 30 June 2018.

The Company has an unsecured three-year revolving credit facility for up to USD 10.0 million from TD Bank, N.A. 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 1.2 million of this facility was utilized as of 30 June 2018 for the issuance of letters of credit.

9. Related party transactions

Aker Capital AS, a wholly-owned subsidiary of Aker ASA, is the majority shareholder of PHLY, owning 57.6% of its total outstanding shares as of 30 June 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 30 June 2018.

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

Related administrative costs and financial statement amounts for the three-month period ending 30 June 2018 were USD 30 thousand (USD 30 thousand for the same period in 2017) and for the six-month period ending 30 June 2018 were USD 60 thousand (USD 60 thousand for the same period in 2017).

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 three-month period ending 30 June 2018 were USD 30 thousand (USD 30 thousand for the same period in 2017) and for the six-month period ending 30 June 2018 were USD 60 thousand (USD 60 thousand for the same period in 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.

10. Capitalized interest

	Q2		6 Months Ended 30 June	
Amounts in USD millions	**2018**	**2017**	**2018**	**2017**
Interest expense	(0.4)	(1.4)	(0.8)	(3.0)
Interest capitalized on construction contracts	-	1.0	-	2.1
Net interest expense	**(0.4)**	**(0.4)**	**(0.8)**	**(0.9)**

11. Construction contracts

The order backlog is USD 65.2 million at 30 June 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.

Amounts in USD millions	Order backlog 30 June 2018	Order intake 6 months to 30 June 2018	Order backlog 31 Dec. 2017
	65.2	**(0.9)**	**187.7**

The profit recognized on long-term contracts in process (Hulls 029-030) as of 30 June 2018 is as follows:

Amounts in USD millions	Actual 30 June 2018	Restated IFRS 15 31 Dec. 2017	Adjustment Q1 2018
Contract revenue recognized to date	343.4	260.1	(38.4)
Less: contract expenses recognized to date	(347.1)	(260.1)	38.4
Loss recognized to date (Hulls 029-030)	**(3.7)**	**-**	**-**

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

Contract expenses charged to profit and loss according to IAS 11	221.7
Incurred contract expenses included in the balance	38.4
Total incurred contract expenses thru 31 Dec. 2017	**260.1**
Contract costs incurred thru 30 June 2018 (Hulls 029-030)	**347.1**

Contract revenue and loss recognized to date includes revenue and loss for Hulls 029-030 since the contract for these vessels is accounted for as a long-term construction contract on a percentage of completion basis.

The progress and the revenue recognition thru Q2 2018 is the difference between the accumulated revenue per 30 June 2018 and the restated accumulated revenue per 31 December 2017.

The adjustment in Q1 2018 is due to cost incurred in 2017 that was included in the statement of financial position as work-in-process according to IAS 11, but according to IFRS 15 will be expensed with a corresponding increase in revenue.

The adjusted revenue and cost for 2017 include the costs presented in the statement of financial position as work-in-process as of 31 December 2017.

The total revenues to be recognized for this contract starting 1 January 2018 through delivery of Hull 030 will be USD 38.4 million lower due to this change in IFRS 15. There is no change in the contractual amount to be received from the Company's customer (Matson).

100% of the revenue, cost and profit for each of Hulls 025-028 was recognized at its delivery in Q4 2016, Q1 2017, Q3 2017 and Q4 2017, respectively. This accounting treatment is 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 for its own account.

As of 30 June 2018, the Company has one contract in progress that is accounted for using the percentage of completion method. The Company is building two containerships (Hulls 029-030) to be delivered to Matson in 2018 and 2019. These vessels are based on an all-new 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 increases the current estimation uncertainty. Philly Shipyard recognizes revenues and expenses for the two-containership order from Matson as one project. As of 30 June 2018, the Matson project is approximately 84% complete. The estimated contract loss is provided for as of Q2 2018.

Customer milestone payments as of 30 June 2018 and 31 December 2017 totaled USD 333.9 million and USD 253.8 million, respectively.

Vessels-under-construction receivable as of 30 June 2018 and 31 December 2017 totaled USD 9.1 million and USD 7.3 million, respectively. As of 30 June 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 30 June 2018 and 31 December 2017 totaled USD 16.6 million and USD 13.4 million, respectively. Work-in-process related to non-percentage-of-completion accounting 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). Percentage-of-completion accounted projects are presented net.

Work-in-process as of 30 June 2018 represents the costs incurred by Philly Shipyard on the construction-related activities for the CV3700 vessels (Hulls 031-032) which were being undertaken for its own account until this project was placed on hold in January 2018. In case of a cancellation of the CV3700 project, the total cost is estimated to be less than USD 20.0 million, of which around 90% of the cash impact has already been included in the financial statements for Q2 2018.

As of 30 June 2018, PSI has non-cancellable purchase commitments for materials and equipment of approximately USD 12.9 million for the construction of Hulls 029-030.

12. Operating revenues and other income

	Q2		6 Months Ended 30 June	
Amounts in USD millions	**2018**	**2017**	**2018**	**2017**
Operating revenues	40.3	47.3	83.2	207.3
Profit/(loss) in equity-accounted investments (Hulls 025-028)	0.1	(0.1)	0.2	6.3
Recognized deferred net gain in equity-accounted investment (Hull 026)	-	-	-	1.5
Operating revenues and other income	**40.4**	**47.2**	**83.4**	**215.1**

Profit/(loss) in equity-accounted investments (Hulls 025-028) represents the Company's 53.7% share of the total comprehensive income of Philly Tankers, which for the six months ending 30 June 2018 and 30 June 2017 amounted to USD 0.2 million and USD 6.3 million, respectively.

Recognized deferred net gain in equity-accounted investments (Hulls 025-028) represents the Company's USD 4.7 million net 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 for the six months ending 30 June 2018 and 30 June 2017 amounted to USD 0 and USD 1.5 million, respectively. USD 1.5 million was fully recognized at delivery of Hull 026 in Q1 2017.

13. Financial instruments

As of 30 June 2018, the Company had no forward exchange contracts or other financial instruments.

14. Commitments and contingencies

Pursuant to the shipyard lease between PSI and Philadelphia Shipyard Development Corporation (PSDC), PSDC has the right to repossess the shipyard if PSI fails to maintain an average of at least 200 full-time employees at the shipyard for 90 consecutive days, 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. Philly Shipyard expects that PSI will have at least 200 full-time employees on staff as long as there is continuous shipbuilding activity at the shipyard. If PSI fails to obtain new orders or financing for vessels before the Matson project is substantially complete, then it would be challenging for PSI to continue shipbuilding operations after delivery of the last vessel in its order backlog (Hull 030), which is scheduled in Q1 2019.

15. Use and reconciliation of non-GAAP financial measures

	Q2		6 Months Ended 30 June	
	Unaudited		Unaudited	
Amounts in USD millions	**2018**	**2017**	**2018**	**2017**
EBITDA	0.2	4.2	(1.1)	34.2
(less)/plus: (profit)/loss in equity-accounted investments (Hulls 025-028)	(0.1)	0.1	(0.2)	(6.3)
plus: deferred shipbuilding profits (Hulls 025-028)	-	7.0	-	21.9
plus: capitalized Welcome Fund interest expense	-	0.1	-	0.2
less: recognized shipbuilding profit previously deferred (Hull 026)	-	-	-	(22.7)
less: recognized deferred net gain in equity-accounted investment (Hull 026)	-	-	-	(1.5)
Adjusted EBITDA	**0.1**	**11.4**	**(1.3)**	**25.8**

Non-GAAP financial measures are defined as numerical measures that either exclude or include amounts that are not excluded or included in the comparable measures calculated and presented in accordance with GAAP (i.e. IFRS).

The following financial measure may be considered a non-GAAP financial measure:

Adjusted EBITDA, which is defined as EBITDA (i.e., earnings before interest, taxes, depreciation and amortization) plus capitalized Welcome Fund interest expense plus or minus net deferred shipbuilding profits plus or minus loss or profit, respectively, in equity-accounted investments minus recognition of deferred net gain on equity-accounted investments.

The Company has made adjustments to EBITDA to reflect shipbuilding activities (1) as if Philly Shipyard had no shipping investments, (2) as if profit was recognized on Hulls 025-028 using the percentage of completion method of accounting and (3) to adjust for capitalized interest expense on long-term debt. The Company believes presenting Adjusted EBITDA is useful to investors as it provides another measure of Philly Shipyard's profitability from its operations, as if Philly Shipyard never had any shipping investments, and more closely represents earnings from shipbuilding activities.

16. Events after 30 June 2018

On 16 July 2018, PSI and an undisclosed potential customer executed a non-binding Term Sheet for the construction and sale of two newbuild Jones Act Medium Range (MR) product tankers.

Contact information:

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

Steinar Nerbovik
President and CEO
Tel: + 1 215 875 2600
steinar.nerbovik@phillyshipyard.com

Jan Ivar Nielsen
Chief Financial Officer
Tel: + 1 215 875 2600
jan.nielsen@phillyshipyard.com

Stian Myhre
Vice President
Tel: +47 91 63 00 20
stian.myhre@akerasa.com

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