Philly Shipyard ASA (OSE: PHLY)
Q3 2018 and First Nine Months 2018 Results

5 November 2018

Key Events

- ✓ As of 30 September 2018, the two-containership order for Matson is approximately 90% complete
- ✓ Philly Shipyard continued to idle certain operations and impose layoffs due to the lack of new work after the Matson project
- ✓ Third quarter and first nine-months 2018 operating revenues and other income of USD 26.5 million and USD 109.8 million, respectively, compared to USD 200.8 million and USD 415.9 million in the same periods in 2017
- ✓ Third quarter and first nine-months 2018 EBITDA of negative USD 28.9 million and negative USD 30.1 million, respectively, compared to USD 31.6 million and USD 65.8 million in the same periods in 2017
- ✓ Third quarter and first nine-months 2018 net losses of USD 30.8 million and USD 36.4 million, respectively, compared to net incomes of USD 17.1 million and USD 36.5 million in the same periods in 2017
- ✓ Total cash and cash equivalents of USD 56.2 million at 30 September 2018, excluding USD 39.5 million of restricted cash securing a loan
- ✓ Order backlog of USD 39.0 million on 30 September 2018

Subsequent Events

- ✓ On 31 October 2018, Philly Shipyard delivered the first vessel (Hull 029) in the two-containership order for Matson

Operations and Shipping Investments

Vessel Construction

At the end of the third quarter of 2018, Philly Shipyard was building two containerships under contract with Matson (Hulls 029-030). Hull 029 (named *Daniel K. Inouye)* was delivered to Matson on 31 October 2018. This vessel is the largest containership ever built in the United States. Hull 030 production activities continue to progress in the Building Dock. The planned delivery date for Hull 030 remains Q1 2019.

While Philly Shipyard continues to actively seek new orders and the 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 parts of its facilities and laying off more of its employees. Since the beginning of 2018, Philly Shipyard has idled all production activities in its fabrication shops and laid off approximately 42% of its employees in a series of layoffs.

Until earlier this year, 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. Since then, Philly Shipyard has explored alternatives in order to secure contracts and financing for these containerships, but without success. Based on the current new order prospects, market conditions and other circumstances, Philly Shipyard has canceled the CV3700 project. The accounting impact of this cancellation is described below in the Financial Information section.

Shipping Investments

Philly Tankers, a Jones Act shipping company that is majority-owned by Philly Shipyard, is proceeding with an orderly liquidation 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 Q3 2018 was 0.13 compared to 1.08 at the end of Q3 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 Q3 2018 was 3.61 compared to 4.81 at the end of Q3 2017. Philly Shipyard continues to work proactively to further improve safety and reduce the number of incidents at the shipyard.

Financial Information

Third Quarter and Year-to-Date 2018 Results
Operating revenues and other income for the third quarter of 2018 were USD 26.5 million compared to operating revenues and other income of USD 200.8 million for the third quarter of 2017. Q3 2018 operating revenues and other income were driven by the continued progress on the Matson vessels (Hulls 029-030) whereas Q3 2017 operating revenues and other income were driven mainly by the delivery by Philly Shipyard of Hull 027 to Kinder Morgan and the related sale by Philly Tankers of its Hull 027 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).

Net loss for Q3 2018 was USD 30.8 million compared to net income of USD 17.1 million for Q3 2017. The net loss for Q3 2018 was driven partly by an impairment charge of USD 17.3 million due to the write-off of the full amount of the work-in-process assets pertaining to the two CV3700 vessels (Hulls 031-032) in connection with the cancellation of the CV3700 project. The net loss for Q3 2018 was also driven by an additional loss of USD 7.3 million incurred and recognized in Q3 2018 on the Matson project as well as overhead expenses incurred in Q3 2018 not allocated to projects.

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.

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 third quarter of 2018 was negative USD 28.9 million compared to EBITDA of USD 31.6 million in the third quarter of 2017. The decrease in EBITDA was mainly driven by the one-time impairment charge of USD 17.3 million and significant under-recovered overhead costs (i.e., overhead costs not allocated to projects) in Q3 2018 and additional loss on the Matson project as described above. In addition, in Q3 2017, Philly Shipyard delivered Hull 027 to Kinder Morgan and, as a result, recognized 100% of the profit from the sale by Philly Shipyard of Hull 027 along with 53.7% of the profit and deferred gain from the related sale by Philly Tankers of its Hull 027 shipping assets. Adjusted EBITDA for the third quarter of 2018 was negative USD 28.0 million compared to Adjusted EBITDA of USD 6.2 million in the third quarter of 2017. The decrease in Adjusted EBITDA was driven primarily by the one-time impairment charge of USD 17.3 million and under-recovered overhead costs (i.e., overhead costs not allocated to projects) in Q3 2018 described above, as well as the additional loss of USD 7.3 million incurred and recognized in Q3 2018 on the Matson project compared to the significantly higher margin recognized in Q3 2017 on the Philly Tankers project.

Net financial items in Q3 2018 was expense of USD 0.1 million compared to income of USD 0.1 million in Q3 2017.

Operating revenues and other income in the first nine months of 2018 ended at USD 109.8 million compared to operating revenues and other income of USD 415.9 million in the first nine months of 2017. September 2018 year-to-date operating revenues and other income were primarily driven by the continued progress on the

[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.

Matson vessels (Hulls 029-030) whereas September 2017 year-to-date operating revenues and other income were primarily driven by the delivery by Philly Shipyard of Hull 026 and Hull 027 to Kinder Morgan and the related sale by Philly Tankers of its Hull 026 and Hull 027 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).

The operating revenues in the first nine months of 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 notes 4 and 11 for further details. Net loss for the first nine months of 2018 was USD 36.4 million compared to net income of USD 36.5 million in the same period of 2017.

EBITDA for the first nine months of 2018 was negative USD 30.1 million compared to EBITDA of USD 65.8 million in the same period of 2017. Adjusted EBITDA in the first nine months of 2018 totaled negative USD 29.4 million compared to Adjusted EBITDA of USD 31.4 million in the same period of 2017

Statement of Financial Position

Total assets were USD 202.2 million at 30 September 2018 compared to USD 253.0 million at 31 December 2017.

Total interest-bearing debt was USD 59.7 million at 30 September 2018 compared to USD 59.6 million at 31 December 2017.

Cash and cash equivalents (excluding restricted cash) were USD 56.2 million at 30 September 2018 compared to USD 110.1 million at 31 December 2017. The decrease of USD 53.9 million was primarily due to operating activities and USD 26.2 million of additional restricted cash 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. As of 30 September 2018, restricted cash consisted of USD 39.5 million related to the Welcome Fund loan, which is expected to be released in 2020 when the loan matures. For further details, see note 8.

Work-in-process was USD 0 at 30 September 2018 compared to USD 13.4 million at 31 December 2017. As noted above, the full amount of the work-in-process assets pertaining to the two CV3700 vessels (Hulls 031-032), totaling USD 17.3 million, was written off in connection with the cancellation of the CV3700 project in Q3 2018.

Total equity decreased to USD 119.2 million at 30 September 2018 from USD 155.6 million at 31 December 2017 due to the net loss of USD 36.4 million.

Financing

The Company has a secured five-year term loan for up to USD 60.0 million from PIDC Regional Center, LP XXXI through the Welcome Fund loan program. The loan matures in March 2020. The entire USD 60.0 million amount was drawn under this facility as of 30 September 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 8.8 million of this facility was utilized as of 30 September 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 contracts with Matson (Hulls 029-030) provides for shipbuilding activity with delivery dates through Q1 2019. As of 30 September 2018, Philly Shipyard had an order backlog of USD 39.0 million. The key focus area for Philly Shipyard's operations continues to be the completion and delivery of the last Matson vessel.

Philly Shipyard expects it will recognize revenues in 2018 only for the continued progress on the Matson project (Hulls 029-030). Philly Shipyard currently forecasts the Matson vessels to be a loss-making project. Further, Philly Shipyard expects that there will be no margin in 2018 from the Matson project 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; however, this is not expected to 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.

Philly Shipyard is in active discussions related to several potential new construction projects for U.S. built vessels. In the near term, Philly Shipyard is focusing its efforts on the following two projects:

1. Philly Shipyard is continuing discussions 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. As previously disclosed, Philly Shipyard and the undisclosed potential buyer signed a term sheet for the transaction in July 2018. 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 remains 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.

2. Philly Shipyard is pursuing an 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 U.S. Maritime Administration (MARAD) has released a request for proposal (RFP) for a vessel construction manager (VCM) for the NSMV program. The RFP response is due by the end of November and expected to be awarded by the end of December or early January. 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 within Q1 2019. MARAD has received USD 300 million in federal funding for the first vessel. Delivery of the first vessel is desired by the end of Q4 2021.

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.

As previously reported, among other long-term endeavors, Philly Shipyard had 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 program. The teaming agreement for these vessels (which were recently renamed as Polar Security Cutters) is no longer in effect. However, Philly Shipyard is exploring its alternatives in order to pursue this and other future opportunities with the U.S. Coast Guard as a prime contractor or a subcontractor.

Although the Company faces many challenges and risks, Philly Shipyard believes it is well-positioned to capitalize on any newbuild opportunities that create value for its shareholders due to its strong cash position. As a testament to its belief in the future, Philly Shipyard is making an investment in preliminary design activities for both the product tanker and the NSMV projects. Philly Shipyard remains committed to building the most cost efficient and environmentally friendly vessels in the U.S. market and believes that it will be the supplier of choice when these vessels are ordered.

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. Furthermore, none of the possible projects it is presently pursuing alone will fully cover the estimated under-recovered overhead costs (i.e., overhead costs not allocated to projects) due to the lack of work.

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 all production activities in its fabrication shops and lay off more than 40% of its employees since the beginning of the year. 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 Hull 030 is delivered, then it is expected that the Company would incur significant expenses and it would be challenging for Philly Shipyard to continue shipbuilding operations after delivery of Hull 030. In particular, the extended gap in production activities increases the risk that the Company is unable to mobilize the shipyard's workforce for future shipbuilding projects. Moreover, under these circumstances, there is a risk that Philly Shipyard will no longer qualify as a going concern and, as such, Philly Shipyard will need to do an impairment charge against its fixed assets.

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. This loss incurred on the Matson project is attributable in part to this prototype risk. This prototype risk will remain until Hull 030 is delivered; however, with the recent delivery of Hull 029, the degree of this prototype risk is reduced going forward.

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

CONDENSED CONSOLIDATED INCOME STATEMENT

Amounts in USD millions (except number of shares and earnings per share)	Q3 Unaudited 2018	Q3 2017	Nine Months Ended 30 Sept. Unaudited 2018	Nine Months Ended 30 Sept. 2017	Full Year 2017 *
Operating revenues and other income	26.5	200.8	109.8	415.9	614.6
Operating expenses	(55.4)	(169.2)	(139.9)	(350.1)	(509.5)
Operating (loss)/income before depreciation - EBITDA	**(28.9)**	**31.6**	**(30.1)**	**65.8**	**105.1**
Depreciation	(2.0)	(4.0)	(5.9)	(8.3)	(5.8)
Operating (loss)/income - EBIT	**(30.9)**	**27.6**	**(36.0)**	**57.5**	**99.3**
Net financial items	(0.1)	0.1	(0.5)	1.0	0.6
(Loss)/income before tax	**(31.0)**	**27.7**	**(36.5)**	**58.5**	**99.9**
Tax benefit/(expense)	0.2	(10.6)	0.1	(22.0)	(32.7)
**(Loss)/income after tax ** **	**(30.8)**	**17.1**	**(36.4)**	**36.5**	**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)	**(2.55)**	**1.41**	**(3.01)**	**3.02**	**5.55**

CONDENSED CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Amounts in USD millions	Q3 Unaudited 2018	Q3 2017	Nine Months Ended 30 Sept. Unaudited 2018	Nine Months Ended 30 Sept. 2017	Full Year 2017 *
(Loss)/income after tax	(30.8)	17.1	(36.4)	36.5	67.2
Other comprehensive income, net of income tax	-	-	-	-	-
**Total comprehensive (loss)/income for the period ** **	**(30.8)**	**17.1**	**(36.4)**	**36.5**	**67.2**

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

Amounts in USD millions	Unaudited 30 Sept. 2018	31 Dec. 2017 *
Assets		
Non-current assets		
Property, plant and equipment	46.0	50.1
Equity-accounted investments	44.4	47.3
Restricted cash	39.5	13.2
Deferred tax asset	0.9	0.9
Other non-current assets	0.2	0.2
Total non-current assets	**131.0**	**111.7**
Current assets		
Cash and cash equivalents	56.2	110.1
Vessels-under-construction receivable	6.2	7.3
Work-in-process	-	13.4
Income tax receivable	3.9	5.9
Other current assets	4.9	4.6
Total current assets	**71.2**	**141.3**
Total assets	**202.2**	**253.0**
Equity and liabilities		
Total equity	**119.2**	**155.6**
Non-current liabilities		
Interest-bearing long-term debt	59.6	59.4
Deferred tax liability	0.8	0.7
Total non-current liabilities	**60.4**	**60.1**
Current liabilities		
Trade payables, accrued liabilities and provisions	21.8	36.1
Income tax payable	0.7	1.0
Interest-bearing short-term debt	0.1	0.2
Total current liabilities	**22.6**	**37.3**
Total liabilities	**83.0**	**97.4**
Total equity and liabilities	**202.2**	**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	Nine Months Ended 30 Sept. Unaudited 2018	2017
As of beginning of period	155.6	91.4
Total comprehensive (loss)/income for the period *	(36.4)	36.5
Dividend paid	-	(3.0)
As of end of period	**119.2**	**124.9**

CONDENSED CONSOLIDATED CASH FLOW STATEMENT

Amounts in USD millions	Nine Months Ended 30 Sept. Unaudited 2018	2017
Net cash (used in)/from operating activities	(28.5)	57.7
Investment in property, plant and equipment	(1.8)	(5.7)
Dividend received from equity-accounted investments	2.2	39.9
Investment in equity-accounted investments	0.7	-
Net cash from investing activities	1.1	34.2
Proceeds from construction loans	-	127.0
Repayment of construction loans	-	(150.0)
Portion of interest-bearing debt held in escrow	(26.3)	-
Repayment of capital lease	(0.2)	(0.2)
Dividend paid	-	(3.0)
Net cash used in financing activities	(26.5)	(26.2)
Net change in cash and cash equivalents	**(53.9)**	**65.7**
Cash and cash equivalents at beginning of period	110.1	69.1
Cash and cash equivalents at end of period	**56.2**	**134.8**

* All attributed to the equity holders of PHLY.

Notes to the condensed interim consolidated financial statements for the 3rd 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 nine-month periods ended 30 September 2018 and 30 September 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 nine-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 third 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 USD 0 margin contract and there was no effect on equity in the opening balance related to IFRS 15. In Q3 2018, the contract is estimated to be a loss-making contract. The estimated loss is provided for per Q3 2018.

Although IFRS 15 had no impact on the Matson vessels in 2017, it has had an impact on those vessels in the first nine months of 2018 and will continue to have an impact on those vessels in the remaining three months 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 Q3 2018, measuring progress and revenue recognition is based on the restated revenue and cost numbers as if IFRS 15 was applied in 2017 without restatement of 2017 comparative amounts, with the cumulative effect of applying the new standard as an adjustment to equity as at 1 January 2018.

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 September 2018 and 30 September 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 September 2018 or 30 September 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 September 2018 and 30 September 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	0.2	-	0.2
Balance 30 September 2018	**59.6**	**0.1**	**59.7**

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 39.5 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 30 September 2018; and (3) ATH II's shares in Philly Tankers AS (PTAS), representing 53.7% of the total outstanding shares of PTAS as of 30 September 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 Q4 2018 in connection with the liquidation of PTAS. USD 60.0 million is drawn under this term loan at 30 September 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 8.8 million of this facility was utilized as of 30 September 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 September 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 September 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 September 2018 were USD 30 thousand (USD 30 thousand for the same period in 2017) and for the nine-month period ending 30 September 2018 were USD 90 thousand (USD 90 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 September 2018 were USD 30 thousand (USD 30 thousand for the same period in 2017) and for the nine-month period ending 30 September 2018 were USD 90 thousand (USD 90 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

	Q3		Nine Months Ended 30 Sept.	
Amounts in USD millions	**2018**	**2017**	**2018**	**2017**
Interest expense	(0.5)	(1.3)	(1.4)	(4.3)
Interest capitalized on construction contracts	-	0.8	-	2.9
Net interest expense	**(0.5)**	**(0.5)**	**(1.4)**	**(1.4)**

11. Construction contracts

The order backlog is USD 39.0 million at 30 September 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 Sept. 2018	Order intake 9 months to 30 Sept. 2018	Order backlog 31 Dec. 2017
	39.0	**0.3**	**187.7**

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

Amounts in USD millions	Actual 30 Sept. 2018	Restated IFRS 15 31 Dec. 2017	Adjustment Q1 2018
Contract revenue recognized to date	370.7	260.1	(38.4)
Less: contract expenses recognized to date	(381.7)	(260.1)	38.4
Loss recognized to date (Hulls 029-030)	**(11.0)**	**-**	**-**

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	221.7
Incurred contract expenses included in the balance	38.4
Total incurred contract expenses thru 31 December 2017	**260.1**
Contract costs incurred thru 30 September 2018 (Hulls 029-030)	**381.7**

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

The progress and the revenue recognition thru Q3 2018 is the difference between the accumulated revenue per 30 September 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 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 for its own account.

As of 30 September 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 September 2018, the Matson project is approximately 90% complete. The estimated contract loss is provided for as of Q3 2018.

Customer milestone payments as of 30 September 2018 and 31 December 2017 totaled USD 363.6 million and USD 253.8 million, respectively.

Vessels-under-construction receivable as of 30 September 2018 and 31 December 2017 totaled USD 6.2 million and USD 7.3 million, respectively. As of 30 September 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 September 2018 and 31 December 2017 totaled USD 0 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.

The full amount of the work-in-process assets pertaining to the two CV3700 vessels (Hulls 031-032), totaling USD 17.3 million, was written off in connection with the cancellation of the CV3700 project in Q3 2018.

As of 30 September 2018, PSI has non-cancellable purchase commitments for materials and equipment of approximately USD 8.8 million for the construction of Hulls 029-030.

12. Operating revenues and other income

	Q3		Nine Months Ended 30 Sept.	
Amounts in USD millions	**2018**	**2017**	**2018**	**2017**
Operating revenues	27.4	192.8	110.5	400.2
(Loss)/profit in equity-accounted investments (Hulls 025-028)	(0.9)	6.5	(0.7)	12.8
Recognized deferred net gain in equity-accounted investments (Hulls 025-028)	-	1.5	-	2.9
Operating revenues and other income	**26.5**	**200.8**	**109.8**	**415.9**

(Loss)/profit in equity-accounted investments (Hulls 025-028) represents the Company's 53.7% share of the total comprehensive (loss)/income of Philly Tankers, which for the nine months ending 30 September 2018 and 30 September 2017 amounted to negative USD 0.7 million and USD 12.8 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 nine months ending 30 September 2018 and 30 September 2017 amounted to USD 0 and USD 2.9 million, respectively. USD 1.4 million was fully recognized at delivery of Hull 026 in Q1 2017 and USD 1.5 million was fully recognized at delivery of Hull 027 in Q3 2017.

13. Financial instruments

As of 30 September 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 last vessel in its order backlog (Hull 030) is delivered, then it would be challenging for PSI to continue shipbuilding operations after delivery of Hull 030, which is scheduled in Q1 2019.

15. Use and reconciliation of non-GAAP financial measures

	Q3		Nine Months Ended 30 Sept.	
	Unaudited		Unaudited	
Amounts in USD millions	**2018**	**2017**	**2018**	**2017**
EBITDA	(28.9)	31.6	(30.1)	65.8
plus/(less): loss/(profit) in equity-accounted investments (Hulls 025-028)	0.9	(6.5)	0.7	(12.8)
plus: deferred shipbuilding profits (Hulls 025-028)	-	8.3	-	29.5
plus: capitalized Welcome Fund interest expense	-	-	-	0.2
less: recognized shipbuilding profits previously deferred (Hulls 025-028)	-	(25.7)	-	(48.4)
less: recognized deferred net gain in equity-accounted investments (Hulls 025-028)	-	(1.5)	-	(2.9)
Adjusted EBITDA	**(28.0)**	**6.2**	**(29.4)**	**31.4**

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 September 2018

On 31 October 2018, PSI delivered the first vessel (Hull 029) in the two-containership order for Matson.

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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