NAM CHEONG LIMITED
(Incorporated in Bermuda)
(Company Registration Number 25458)

RESPONSE TO SIAS QUERIES IN RELATION TO THE 2017 ANNUAL REPORT

The Board of Directors (the "**Board**") of Nam Cheong Limited (the "**Company**" or "**NCL**") and its subsidiaries (together the "**Group**") refers to its announcement made on 24 July 2018 in relation to 2017 Annual Report ("**Announcement**"). Unless otherwise defined, capitalized terms used herein shall bear the same meaning ascribed to them in the Announcement.

The Board would like to provide the following additional information in reply to the queries raised by Securities Investors Association (Singapore) ("**SIAS**") on 14 August 2018:

<u>SIAS's Query 1</u>

On 24 July 2018, the Company announced that its independent auditors have issued a disclaimer of opinion in the Independent Auditor's Report with respect to the use of the going concern basis of accounting in the preparation of the financial statements of the Group for the financial year ended 31 December 2017 ("**FY2017**").

As noted in the basis for disclaimer of opinion (Going concern), the Group has various obligations owed to bank lenders and trade creditors that have fallen due and will fall due from time to time in the near future. The Group and the Company are in net capital deficit of RM1,660,411,000 and RM1,577,803,000 respectively as at 31 December 2017. These conditions, together with other matters disclosed in Note 4 to the financial statements, indicate the existence of material uncertainties that may cast significant doubt on the Group's and Company's ability to continue as a going concern.

In addition, the independent auditors have stated the following (page 51):

- *We were unable to obtain sufficient appropriate audit evidence to satisfy ourselves on certain key assumptions supporting the cash flow forecast. In particular, we were unable to evaluate the validity, feasibility and effectiveness of the debt settlement arrangement with the other shipyards as we were not provided with supporting documents to corroborate management's representation on the terms of the arrangement and status of the negotiations.*

(i) Would the audit committee (AC) help shareholders understand why key documents relating to the debt settlement arrangement with the other shipyards were not provided to the independent auditors?
(ii) Did the AC review the level of cooperation and assistance given by management to the independent auditors? If so, was the AC satisfied with the level of cooperation and assistance given by management to the independent auditors?
(iii) What are the AC's efforts to further improve the annual audit plan and to ensure that the independent auditors able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the group's financial statements?

As disclosed in the Directors' statement (page 46), in the opinion of the Board, the consolidated financial statements of the Group and the statement of financial position of the Company together with notes thereon were drawn up so as to give a true and fair view of the financial position of the Group and of the Company as at 31 December 2017, and the financial performance, changes in equity and cash flows of the Group for the financial year then ended.

(iv) Given that the independent auditors have issued a disclaimer of opinion, can the AC justify its opinion that the consolidated financial statements of the Group and the statement of financial position of the Company together with notes thereon are drawn up so as to give a true and fair view of the financial position of the Group and of the Company as at 31 December 2017?

Company's Response

As at the date of the Independent Auditor's Report, the Group was still in the process of discussing a debt settlement arrangement with the certain shipyards. Hence the key documents relating to the debt settlement arrangement with these shipyards were not available to both the Company and the Independent Auditors at the relevant time. Nevertheless, parties are still in active discussion, and nothing has come to the Board's attention that the Group will not be able to reach an amicable resolution of its debt obligations with these shipyards.

The Independent Auditors had confirmed to the AC that they had received the full co-operation and full access to Management and that there were no matters that the Independent Auditors considered should be brought to the attention of the AC.

As mentioned in the Independent Auditor's Report, the basis of disclaimer of opinion by the Independent Auditors, BDO LLP, on the use of going concern basis in the preparation of the FY2017 audited financial statements was mainly due to the indication of the existence of material uncertainty, on the date of the Independent Auditor's Report, in relation to the key assumptions that favourable outcomes will be collectively achieved for the Schemes of Arrangement, the Master Framework Agreement entered with certain shipyards, negotiations with other shipyards and that sufficient cash inflows will be generated by the Group. At the time of the Independent Auditor's Report, these key assumptions were work-in-progress. The Directors' basis of opinion in relation to the preparation of the FY2017 audited financial statements was further elaborated in Note 4 to the financial statements.

Subsequent to the date of the Independent Auditor's Report, the Company announced on 3 August 2018 that the Singapore Court has sanctioned the NCL Scheme of Arrangement ("NCL Scheme") with the Amendments and granted orders relating to the sanction of the NCL Scheme. The NCL Scheme, together with Scheme of Arrangement of the subsidiaries (collectively the "Schemes"), are expected to be implemented in 2018. The successful implementation of the Schemes will enable the Group to strengthen its financial position and operate as a going concern.

SIAS's Query 2

As shown in the Consolidated statement of comprehensive income, the Group reported a loss for the financial year of RM3.018 billion. As disclosed in Note 9 (page 85 – Loss before income tax), the loss was attributed to:

- Write down of inventories: RM2.086 billion
- Impairment on property, plant and equipment: RM346.8 million
- Impairment on amount due from customers on contracts: RM198.7 million
- Prepayments for inventories written off: RM105.9 million
- Provision for corporate guarantee: RM32.4 million

(i) Write down of inventories: As disclosed in Note 20 (page 106 – Inventories), the Group wrote down the value of the work-in-progress inventories of RM2,085,877,000 after consideration of additional construction cost to incur and financial difficulty in settling the cost to respective shipyards. Would the Board/management elaborate further on the specific reasons for the write down of RM2.086 billion? Please provide a breakdown by vessel/vessel type. How much of the write-down is attributed to the build-to-stock programme? Can the Board/management elaborate further on the magnitude of the write-down?

(ii) Impairment on property, plant and equipment: Based on Note 12 (page 89 – Property, plant and equipment), the impairment charge on vessels amounted to RM342.99 million (before exchange differences) in FY2017. Similarly, can management provide shareholders with a breakdown of the RM342.99 million impairment charge by vessel? After the impairment charge, the independent professional valuation of the vessels amounted to just RM232.7 million as at 31 December 2017. This implies that the impairment accounted for 60% of the value of the vessels prior to the impairment. In FY2016, the Group recognised an impairment loss of RM3,554,000. Can the AC help shareholders understand the near 100x jump in impairment in FY2017? Would the AC justify the use of a discount rate of 5.36% in FY2016 to estimate the value in-use of the vessels? Can the AC confirm and justify that the carrying value of vessels as at 31 December 2016 was a true and fair view of the value of the group's vessels?

Company's Response

As mentioned on page 106 of the Annual Report, the work-in-progress inventories represents costs incurred for unsold vessels by the Group, which are under construction at the shipyards. As a result of the significant market downturn, agreements were reached to terminate shipbuilding contracts entered into with certain shipyards that were deemed no longer financially viable to continue. Debt settlement arrangements which are being discussed with these shipyards also contemplated the cancellation or termination of construction of other vessels deemed no longer financially viable to continue as well. Accordingly, the Group has carried out a detailed review to determine the net realisable value of its unsold vessels. Pursuant to this exercise, the Group has written down the value of those work-in-progress inventories of RM2,085,877,000 after consideration of additional construction cost that will be incurred and the Group's financial ability in settling the cost with respective shipyards. Included in the work-in-progress inventories that have been written down is an amount of RM699,750,000, the estimated additional cost to complete the construction of the following vessels (please see table below). The net realisable values of these vessels are estimated with reference to the valuation report prepared by an independent valuer.

The breakdown of the write-down of work-in-progress inventories by vessel type is as follows:

Vessel type	**%**
Anchor Handling Tug Supply Vessel	28
Platform Supply Vessel	51
Accommodation Work Boat / Barge	21

91% of the write-down is attributed to the built-to-stock programme.

As a result of the oversupply of offshore vessels and low charter rates, the value of a completed vessel dropped significantly below its cost of construction. As the work-in-progress vessels are already suffering negative net realisable value, there is no justification for the Group to provide further funding to complete these work-in-progress vessels.

The breakdown of the impairment by vessel type is as follows:

Vessel type	**%**
Anchor Handling Tug Supply Vessel	55
Platform Supply Vessel	28
Accommodation Work Boat / Barge	11
Others	6

During the financial year ended 31 December 2016 ("**FY2016**"), the vessels were valued based on their respective value-in-use. However, during FY2017, as disclosed on page 92 of the Annual Report, pursuant to the restructuring exercise and to reflect the value of the asset that may need to be realised to discharge its liabilities, the vessels were valued on a "as is, where is" sales basis at their current locations between a willing buyer and willing seller. The significant decrease in the market value of the vessels has caused the drastic increase in vessels' impairment in FY2017.

The discount rate of 5.36% applied in FY2016 was in line with the weighted average cost of capital of the Company extracted from Bloomberg Finance L.P. during the corresponding period.

On the date that the audited financial statements for FY2016 were authorised for issue, the Independent Auditors and the Directors were of the opinion that the carrying value of vessels as at 31 December 2016 was a true and fair view of the value of the Group's vessels as at 31 December 2016.

SIAS's Query 3

As mentioned in the Chairman's Statement, the Group is going through a major restructuring through Schemes of Arrangement and a proposed rights issue to recapitalise the Group's balance sheet.

The Board has disclosed in the Company's Corporate Governance Report that it sets the overall strategy of the Group, including:

- *providing entrepreneurial leadership*
- *setting strategic objectives and directions*
- *establishing a framework of prudent and effective controls to assess and manage risks*
- *identifying principal risks of the Group's business and ensuring the effective*
- *implementation of appropriate systems to assess and manage the risks, including*
- *safeguarding of shareholders' long-term interests and the Group's assets*

(i) Given that the Group reported a net loss of RM(3.0) billion in FY2017 and is now in a capital deficit position of RM(1.66) billion, has the Board evaluated its effectiveness at identifying the Group's principal risks?

(ii) What were the directors' individual and collective efforts in ensuring the effective implementation of appropriate systems to assess and manage the risks?

(iii) Has the Board evaluated the return of its build-to-stock programme over an entire business cycle? Would the Board be reviewing the build-to-stock programme?

(iv) Can the Board help shareholders understand the optimal capital structure required to support the Group's operations given that the Company is in a net capital deficit position of RM(1.66) billion as at 31 December 2017?

(v) Considering the performance of the Group, does the Board consider it timely to carry out a strategic review to assess the performance of the Board, the core competencies of the Group, its management team, its financial strength and to fine-tune the Group's strategy so as to create long-term sustainable value for all shareholders?

Company's Response

The protracted low oil price since 2014, which has caused the global oversupply of offshore support vessels, has significantly changed the entire industry economic landscape and has claimed casualties across the industry worldwide, regardless of the players' size and business models. To mitigate the negative effect of this major market downturn, management and the Board have been actively reviewing and assessing the core competencies of the Group, its financial capability and the Group's strategy to create a broader business platform focusing on long-term sustainable value for all shareholders.

From a balance sheet perspective, the Board has focused on reducing business and financial risks by way of negotiations with the creditors for a reduction of liabilities such that the Group is able to operate in a sustainable manner post-restructuring. As mentioned on page 132 of the Annual Report, the Group has managed to obtain waiver of a substantial portion of liabilities previously owed to trade creditors (including the shipyards) amounting to RM558.2mil. In addition, through the debt restructuring which has started since the beginning of 2017, and assuming the successful implementation of the Schemes in 2018, the Group's liabilities are expected to further reduce by over RM500 million. In addition, the proposed rights issue is also expected to increase the Company's share capital by up to RM88 million, assuming full subscription. The Group's net tangible asset is expected to improve by at least RM1.1 billion upon the successful implementation of the initiatives mentioned above.

From an operational perspective, the Group has expanded its vessel chartering segment. Since 2017, the Group has started to put a higher concentration on optimising idle assets through vessel chartering. The Group has built-up on its vessel chartering segment (established way back in 2007) through the set-up of its own full-fledge chartering operation and have established its position as a key player in the Malaysian market. This operational strategy, together with the Schemes (including the projections made in the context of the Schemes and the assumptions thereto), have been thoroughly reviewed by the Board and our financial advisers. The Schemes finally received overwhelming support from the Group's bank creditors and bondholders. Nevertheless, the Company cautions that cashflow projections are by nature estimates based on assumptions adopted by management.

This announcement is to be read in conjunction with the Annual Report.

Trading in the Company's securities on the SGX-ST has been voluntarily suspended by the Company on 21 July 2017. Pending the completion of the restructuring, stakeholders and potential investors should exercise caution when trading in the Company's securities. When in doubt as to the action they should take, stakeholders and potential investors should consult their financial, tax or other advisers.

BY ORDER OF THE BOARD
NAM CHEONG LIMITED

Tan Sri Datuk Tiong Su Kouk
Executive Chairman
22 August 2018