Responses to questions on Vard Holdings Limited from Securities Investors' Association Singapore (SIAS)
29 June 2018

Vard Holdings Limited has received questions from Securities Investors' Association Singapore (SIAS) relating to the Annual Report for the financial year ended 31 December 2017 ("FY2017") as part of their initiative to improve the quality of annual general meetings. Our responses to the questions are as follows:

Question 1.

As noted in the CEO Letter, the group is executing on its turnaround plans to overcome the severe and prolonged downturn. The strategy/achievements of the group included:

- diversify into engineering and technology-intensive vessels in new market segments and geographies
- increasing the order book to NOK 13.2 billion, a higher level than 2015 and 2016 (comprises 48 newbuildings, in addition to maintenance and conversion of vessels, and other assignments within ship design, equipment and solutions)
- contract of the research expedition vessel for Rosellinis Four-10 and the very first electric hybrid cruise icebreaker with LNG propulsion for PONANT

Although the group reported revenue of NOK 8.6 billion (up 9% year-on-year), it still reported a net loss of NOK 233 million attributable to equity holders of the company, up from NOK 163 million in FY2016.

The group has 9 shipyards (5 in Norway, 2 in Romania, 1 in Vietnam and 1 in Brazil).

(i) Can management help shareholders understand how cost efficient are the group's shipyards?

Response

At VARD, cost efficiency is a key focus element in everything we do. The management structure is very lean, and through the downturn in the last couple of years, investments have been kept to a bare minimum with the exception of Vard Tulcea, where the Group is executing an investment program to enable the yard to deliver larger and more complex hulls than before, in order to serve the new market segments.

(ii) Are there differences in the technical capability and the cost structure of the group's nine yards in the different regions?

Response

Yes. The various yards vary in terms of size, docking capabilities, cranes and even the composition of skills within the workforce at the different yards. This is fundamental when deciding on which yards to build new order wins.

(iii) What are the utilisation rates of the group's nine shipyards?

Response

The utilisation rate will vary significantly between the yards through different periods. Managing a steady flow of work securing high utilisation rates at all nine yards is extremely challenging and to a large extent dependent on the market and which vessels are in demand. During the period of very high activity in the offshore segment, the Group was able to maintain a high load of offshore service vessels in various sizes, which secured a steady flow of hulls from Romania to Norway for outfitting, coupled with the same demand in both Asia/Vung Tau and Brazil/Niteroi. Through the downturn and with the diversification into new segments, the flow from Romania to Norway is more challenging as the hulls have a longer production period, resulting in the Norwegian yards to experience periods with less activity in anticipation of a new hull to arrive from Romania. This is then coupled with a less steady flow of projects also for our other yards in Vietnam and Brazil.

In addition, the group has reported EBITDA of 1.9% and 2.1% in FY2017 and FY2016 respectively.

(iv) How does management intend to significantly improve the group's profitability?

Response

Management will continue to focus on cost efficient production, while utilising our competence, to obtain profitable contracts.

(v) Has the board set any operational and financial targets for management to achieve in the next 2-3 years?

Response

Yes, the Board has (after discussion with Management) set key performance indicators relating to the Group. However, the Board does not believe it is appropriate to provide detailed figures of such KPIs as these are prepared for internal management purposes and contain commercially sensitive information.

(vi) At the end of 2017, the group's order book stood at NOK 13.2 billion, comprising 48 vessels. What is the projected/minimum profit margin when the group takes on new orders?

Response

The project margin will vary from project to project and between geographical regions. Depending on market circumstances and current workload, entering into a low margin contract can sometimes be beneficial when weighed against the alternative of the cost related to no activity.

Separately, the group has interested person transactions amounting to NOK 1.9 billion in FY2017 (2016: NOK 1.5 billion).

(vii) Can the audit committee explain its efforts in the oversight and review of such interested person transactions to ensure that the transactions are carried out at arm's length, on normal commercial terms and will not be prejudicial to the interests of the Company and its minority Shareholders?

Response

*The Company has obtained general mandates from its shareholders for the interested person transactions (the "**IPTs**") of the Group in FY2017. In general, the audit committee (the "**AC**") reviews all IPTs to ensure that all rules and regulations of the SGX-ST (in particular, Chapter 9 of the Listing Manual) are complied with. In particular:*

(a) the AC is kept updated of and reviews all recorded IPTs and the basis of such IPTs, which is monitored by the compliance committee, in light of the review procedures of IPTs as set out in the relevant IPT mandate; and

(b) from time to time, the AC reviews the Company's internal controls and review procedures for IPTs to determine if they are adequate and/or commercially practicable in ensuring that the transactions between the Group and interested persons are conducted on normal commercial terms and not prejudicial to the interests of the Company and the minority shareholders. In conjunction with such review, the AC will also ascertain whether the established review procedures have been complied with. If, during the periodic reviews by the AC, the AC is of the view that the review procedures which are in force are inadequate or inappropriate to ensure that the mandated transactions will be carried out on normal commercial terms and will not be prejudicial to the interests of the Company and its minority shareholders, it will in consultation with the Board take such action as it deems proper in respect of such procedures and/or modify or implement such procedures as may be necessary and direct the Company to revert to shareholders for a fresh mandate based on new guidelines and procedures for IPTs.

Question 2.

From the Consolidated Statement of Comprehensive Income (page 63), it is shown that materials and subcontract costs amounted to NOK 5.6 billion, salaries and related costs added up to NOK 2.3 billion while other operating expenses was NOK 541 million.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

(All amounts in NOK millions unless otherwise stated)

	Note	Group 2017	Group 2016
Revenue	24,30	8,603	7,894
Materials and subcontract costs		(5,601)	(5,049)
Salaries and related costs	25,35	(2,298)	(2,162)
Other operating expenses	26	(541)	(515)
Depreciation, impairment and amortization	4,5	(221)	(205)
Restructuring cost	13	(33)	(105)
Operating profit/(loss)		**(91)**	**(142)**

(Source: Company annual report) [font size was reduced]

In FY2017, material and subcontract costs accounted for 65% of revenue while salaries and related costs accounted for a further 27%.

The group's revenue and salaries and related costs over the past financial years are shown below:

	2017 NOK millions	2016 NOK millions	2015 NOK millions	2014 NOK millions	2013 NOK millions	2012 NOK millions
Revenue	8,603	7,894	11,307	12,923	11,155	11,129
Salaries and related costs	2,298	2,162	2,461	2,486	2,129	1,953
Remuneration to key management	18.8	18.5	22.2	27.2	31.9	21.7

In FY2013, the group had 10,696 employees. As at 31 December 2017, the group still has 9,172 employees worldwide even though revenue has fallen by about 25% from the 2012/2013 levels.

(i) Would management help shareholders understand the group's efforts in streamlining its operations in view of the difficult market conditions in the recent years?

<u>Response</u>

The Group has rightsized the organisation in line with the activity level, and to the extent possible within the regulatory limitations, while at the same time considering the soft backlog/contracts in pipeline. For the Norwegian yards, the Group has utilised the possibility to temporarily lay off workers in periods with low activity. In Romania, the Group laid off net 1,733 employees between 2014 and 2015 (2015 4,665 vs 2014 6,398), and with the success of the diversification strategy during 2016 the Group had to start rehiring. This has been challenging as the Romanian workforce is very mobile and many goes abroad to find work. Hence, the Group has had to resort to a larger share of subcontractors than planned in order to cover the shortage of own manning.

(ii) How agile has the group been in its restructuring efforts? Other than the rightsizing being carried out in Vard Promar in Brazil, has management reviewed how it could further rightsize the shipyards with higher cost base?

<u>Response</u>

The rightsizing has been across the entire Group and not just Brazil. See also the previous response above.

(iii) Specifically, salaries and related costs over the years have remained fairly stable despite the market conditions and the severe drop in revenue. Even with the smaller labour force, the group's salary costs in FY2017 is nearly 20% than the salary costs in FY2012. Would management explain why this is so?

Response

When comparing salary costs in FY2017 vs FY2012 the increase is 17.7% and not 20%. However, salaries in absolute numbers reached its peak in 2014 (with the peak in number of employees as well), hence it would be more relevant to compare salary costs in FY2017 to those in FY2014 (as opposed to FY2012). We would clarify that the increased level of salary costs is also reflective of the mixed expertise required. For example, when the Group implemented its diversification strategy in 2016, the immediate effect in terms of workload were in the design and engineering phase of the projects. Hence, the hiring was primarily focused in these areas, with relatively higher salaries than the average blue collar employees. Finally, one cannot disregard the inflation and annual increase in salaries following the negotiations with the workers unions.

(iv) Can the remuneration committee also help shareholders understand how it determines the discretionary bonus to be paid to key management (including the CEO)? What are the performance targets and the criteria used in the determination of executive bonuses? The CEO and key management personnel continue to receive discretionary bonus as high as 15% of their annual packages when the group has been reporting losses for the last three financial years.

Response

The bonus criteria are not only linked to net profit/loss, but also several other criteria. It should be noted that while the 15% referenced above relates to one member of management in 2017, other members of the Executive Team received zero.

Question 3.

Guideline 2.2 of the 2012 Code of Corporate Governance (CG Code) states that independent directors should make up at least half of the Board where, inter alia, the chairman of the board is not an independent director.

As Mr. Coronella, the chairman of the board is considered a non-independent non-executive director of the company, Guideline 2.2 of the CG Code applies to the company.

The company has stated the following:

“On 13 November 2017, Fincantieri Oil & Gas S.p.A., the parent company of Vard Holdings Limited, presented a proposal to the Board of Directors of the Company, to seek the privatization of the Company by way of a voluntary delisting from SGX-ST. In view of this development, the Company has not yet implemented Guideline 2.2(d) of the Code which requires that independent directors should make up at least half of the Board where the Chairman is not an independent director. The composition of the Board will be re-assessed in due course.”

The board presently consists of six directors, with only two independent directors.

(i) Are there any other reasons for the delay in implementing Guideline 2.2 of the Code?

Response

No.

(ii) Would a strong(er) independence element on the board be more crucial in view of the proposal to privatise the company by the parent company?

Response

*The independence of directors in the context of the privatisation / exit offer is regulated under the Singapore Code on Take-overs and Mergers (the "**Takeover Code**"), and the concept of independence of directors under the Takeover Code is different from that in Code of Corporate Governance. We would highlight that the Takeover Code does not stipulate a minimum number of directors who are independent for the purposes of making a recommendation on the exit offer.*

(iii) Would the board, especially the nominating committee and the independent directors, reconsider the deviation from the CG Code and to reconstitute the board to have independent directors make up at least half of the board since the company remains listed and should comply with the CG Code?

Response

This is for the Board of Directors, and the nominating committee and the independent directors to consider depending on the outcome of the delisting process.