



CHINA
DEVELOPMENT
FINANCIAL

First Ship Lease Trust

(FSLT SP/FSLT.SI)

BUY

Price as of 10 Aug 2017	0.08
12M target price (S\$)	0.13
Previous target price (S\$)	na
Upside (%)	65.0

Trading data

Market Cap (S\$m)	51.0
Issued Shares (m)	637.5
Ave Daily Traded (3-Month) Vol / Val	1.0m / \$0.1m
52 week lo / hi	\$0.07 / \$0.19
Free Float	74.7%

Major Shareholders

FSL Trust Mgt	24.2%
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FSLT SP (1yr) VS STI



Source: Bloomberg

Bargain-basement price; Opportunity to accumulate

Event

FSLT reported a dismal set of 2Q17 results due mainly to US\$24m of impairment charge on eight vessels. 2Q17 revenue declined 17% YoY to US\$21m due to weaker rates across all its shipping segments. Furthermore, two crude tankers were only partially contributing in the quarter as they were sent for dry-docking.

Impact

Despite the loss, Value-to-Loan (VTL) ratio remains >1.4x, a very healthy level compared to peers. FSLT continued to generate a healthy US\$12m of free cash flow in the quarter.

Valuation & Action

We recommend a BUY and a target price of S\$0.132, which implies a 65% upside. We believe this is the minimum value that FSLT should be trading at. Our target price is based on a conservative estimate of its portfolio of vessels using current market prices (liquidation value if it were to sell all its assets in the market). We also derived a DCF-backed valuation of S\$0.18 based on conservative assumptions of 1) 8 years remaining operational life of its vessels - current average fleet age is ~12 years old, and 2) 20% decline in FCF from FY21 to FY25 and 3) a WACC of 11.0%.

Based on our sensitivity analysis, upside can range from 60% to 158% in the next few quarters (Figure 2).

The short-term catalyst would include the refinancing of its US\$181m debt, which is still on hold pending the change of major shareholder. If the deal (convertible loan and equity sale) goes through by end September 2017, it could see Navios Maritime Holdings (NM US) hold at least 50.1% of the fully-diluted units of FSLT.

Risks

Continued decline in charter rates for its key shipping segments – mainly in product and chemical tanker rates. In the event that FSLT is unable to refinance, we believe the best option would be to liquidate the trust and return the funds to unitholders. In this scenario, FSLT should be worth at least S\$0.13 based on the current market value of its vessels.

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See the last page for important disclosures.

Financials & Key Operating Statistics

YE Dec (US\$ m)	2012	2013	2014	2015	2016
Revenue	25.3	22.9	23.2	21.9	20.9
Net Income	5.5	3.5	-42.3	3.4	-21.8
EPS (Cents)	0.9	0.6	-6.6	0.5	-3.4
EPS grth (%)	-9.5	25.0	na	50.0	na
P/E (x)	9.3	14.5	0.0	14.8	0.0
DPS (SG Cents)	0.1	0.0	0.0	0.0	0.0
Div Yield (%)	1.3	0.0	0.0	0.0	0.0
FCF Margin (%)	47.6	41.0	54.8	42.5	58.5
Net Debt (\$m)	203.8	193.1	179.4	166.7	157.3
Price / Book (x)	0.2	--	0.2	0.3	0.3
ROE (%)	-2.6	-22.4	1.5	5.2	-11.8

Source: Company Data, KGI Research (negative net debt=net cash)

FSLT's vessels have an average age of around 12 years. Based on market values for vessels that are 10-15 years old, FSLT's MR tankers are worth US\$12-14m, LR2 are around US\$16m, Chemical tankers around US\$12m and Aframax worth US\$18m.

Figure 1: FSLT's portfolio of product tankers, container vessels and chemical tankers

Vessel Name	Type		Year	Capacity	Age	Value (US\$m)
FSL Hamburg	Product	MR	2005	47496	13	12
FSL Singapore	Product	MR	2006	47470	12	12
FSL Osaka	Product	MR	2007	45998	11	14
Cumbrian Fisher	Product	Specialised tanker	2004	12921	14	9
Clyde Fisher	Product	Specialised tanker	2005	12984	13	9
Shannon Fisher	Product	Specialised tanker	2006	5421	12	6
Solway Fisher	Product	Specialised tanker	2006	5421	12	6
Speciality	Product	Specialised tanker	2006	4426	12	6
Seniority	Product	Specialised tanker	2006	4426	12	6
Superiority	Product	Specialised tanker	2007	4426	11	6
Margrethe	Product	LR2	2006	109672	12	16
Marie	Product	LR2	2006	109672	12	16
YM Eminence	Container	Panamax	2008	4250	10	7
YM Elixir	Container	Panamax	2008	4250	10	7
YM Enhancer	Container	Panamax	2008	4250	10	7
FSL Busan	Container	Feeder	2003	1221	15	4
FSL Santos	Container	Feeder	2003	1221	15	4
FSL New York	Chemical	Chemical tanker	2006	19970	12	12
FSL London	Chemical	Chemical tanker	2006	19966	12	12
FSL Tokyo	Chemical	Chemical tanker	2006	20938	12	12
FSL Hong Kong	Tanker	Aframax	2007	115000	11	18
FSL Shanghai	Tanker	Aframax	2007	115000	11	18
Average age					12	
Total value						219

Source: VesselValues, KGI Research

Our estimates are conservative compared to FSLT's VTL valuation. FSLT had a LTV of 1.4x – 1.8x as at end 2Q17. Based on the minimum VTL of 1.4x, FSLT is worth S\$0.206 compared to our conservative estimate of S\$0.132.

Figure 2: Our scenario analysis shows a minimum fair value of 13 Singapore cents based on market value for its fleet

	Vessel value (VV)	VV + other net asset	Debt	NAV (USD)	NAV (SGD)	NAV/share	Upside
KGI estimates	219	243.8	181.4	62.4	84.2	0.132	65.1%
VTL x 1.4	254.0	278.7	181.4	97.3	131.4	0.206	157.6%
VTL x 1.2	217.7	242.4	181.4	61.1	82.4	0.129	61.6%

Source: KGI Research

The FSLT secured a 6-year amortising term loan facility in December 2011 and the outstanding face value of the loan balance was US\$181.8m as at 30 June 2017. For 2Q 2017, the applicable margin over US\$ 3-month LIBOR was 2.8%. The VTL ratio is assessed semi-annually. FSLT has improved its gearing by repaying over US\$60m of debt over the past 12 months.

Figure 3: FSLT's VTL ratio is 140% to 180%, based on its 2Q17 results

VTL ratio	Margin over US\$ 3-month LIBOR
>100% to 140%	3.0%
>140% to 180%	2.8%
>180%	2.6%

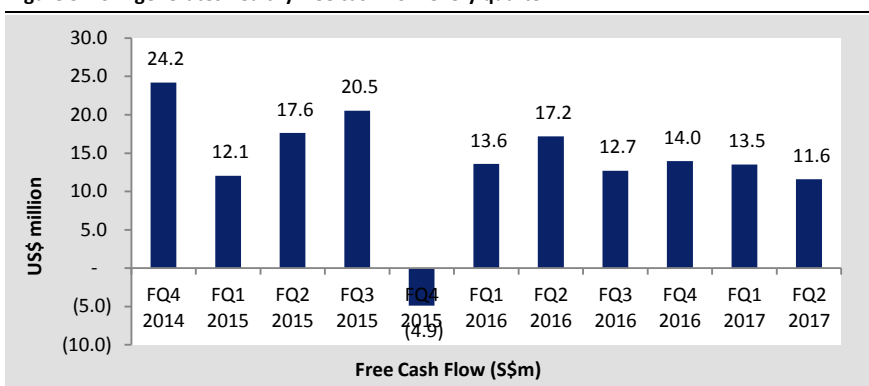
Source: Company Data

DCF valuation of S\$0.182. FSLT generated US\$11-15m free cash flow per quarter in 1H17, which would yield an annualised free cash flow of US\$47-61m. We utilised a free cash flow of US\$47m per annum from FY18 to FY20. From FY21 onwards, free cash flow may be expected to decline 20% due to the expiry of high value contracts.

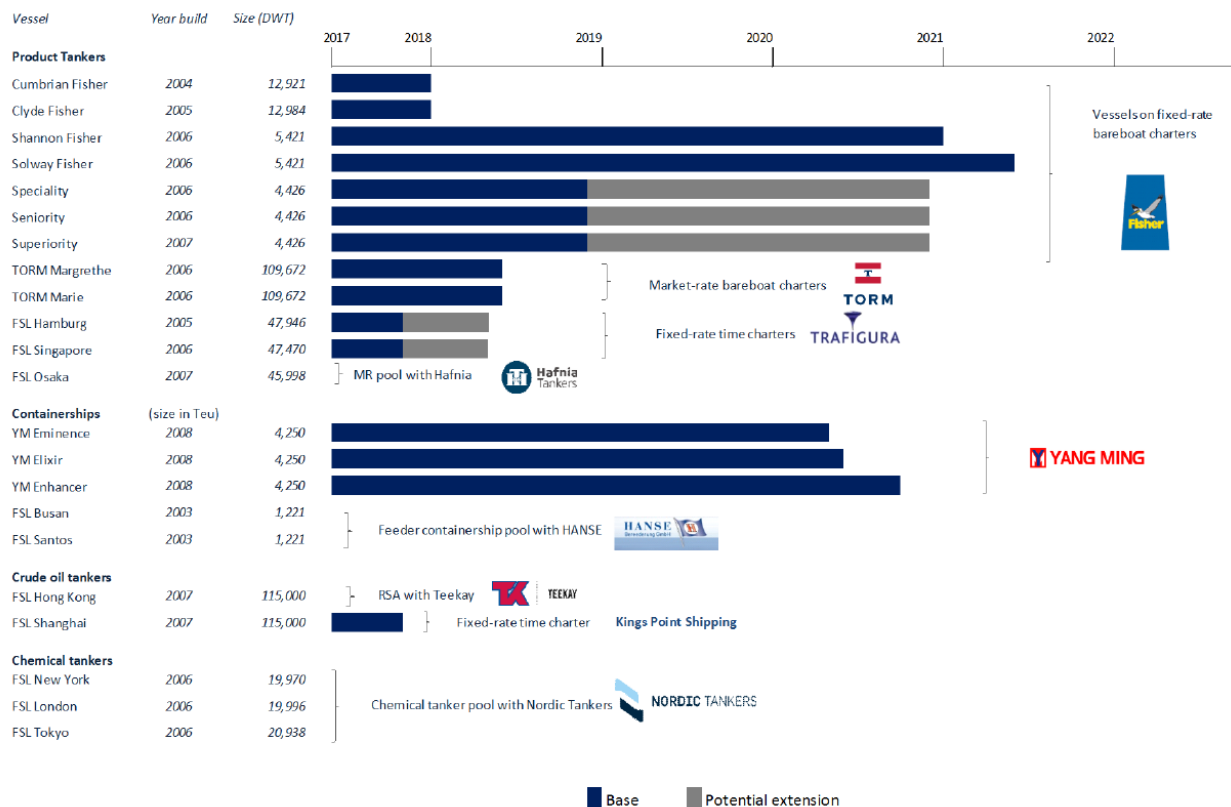
Figure 4: DCF-backed valuation

	2017	2018	2019	2020	2021	2022	2023	2024	2025	
FCF US\$m	47	47	47	47	37	37	37	37	37	
FCF US\$m (discounted)		42	38	34	25	22	20	18	16	
FCF US\$m (discounted)	215									
- Less net debt US\$m	157	US\$181m debt; US\$24m cash as at end 2Q17								
+ Add scrap value US\$m	29	Average US\$3m scrap value per vessel, discounted after scrapping when 20 years old								
Equity value US\$m	86									
Equity value S\$m	116	1.35 SGD/USD								
Equity value per share S\$	0.182									
Upside	127%									
WACC	11.0%									

Source: KGI Research

Figure 5: FSLT generates healthy free cash flow every quarter


Source: Bloomberg, KGI Research

Figure 6: Charter profile of FSLT's fleet


Source: Company Data, KGI Research

Figure 7: Most of the dry-docking is complete, at least over the next four years

FSL managed fleet - Vessels planned for dry docking

Vessel	Date
FSL Osaka	3Q FY2017
FSL Santos	1Q FY2018

Latest dry dockings

Vessel	Date
FSL Hong Kong	2Q FY2017
FSL Shanghai	2Q FY2017

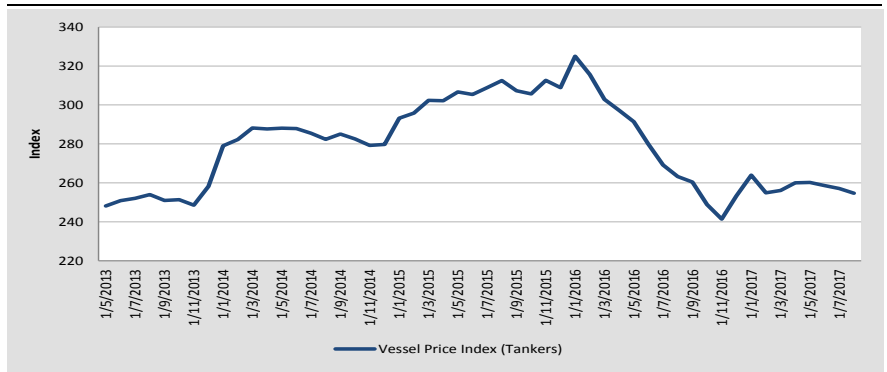
Source: Company Data

Industry review – product tankers

The product tanker fleet comprises of LR2, LR1 and MR product tankers, which are similar to Aframax, Panamax and Handymax crude oil tankers, respectively in terms of specification with the main difference being the coating of the tanks.

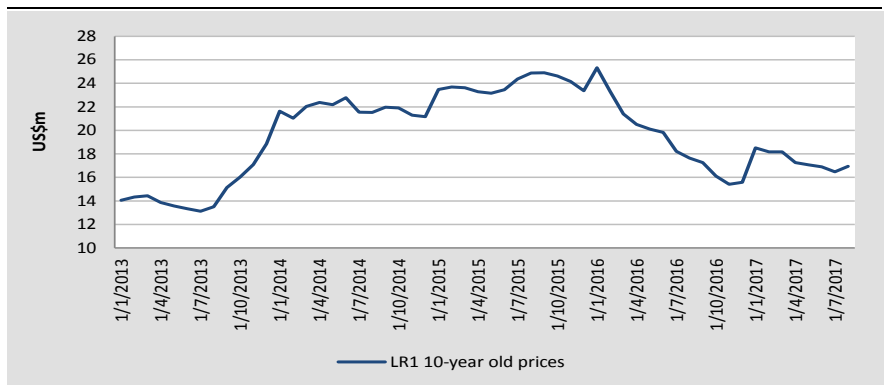
Based on the tanker price index, second hand prices, and orderbook profile, the tanker market seems to have bottomed in 1H17. The decline in the product tanker market in 2H16 was mainly due to the large amount of new tonnage entering the market resulting in a supply-side driven market disequilibrium. However, new orders for product tankers have fallen to a more sustainable level of 10% in 1H17 compared to 15% in 1H14 (see Figure 10).

Figure 8: Tanker prices seem to have bottomed in 1Q17



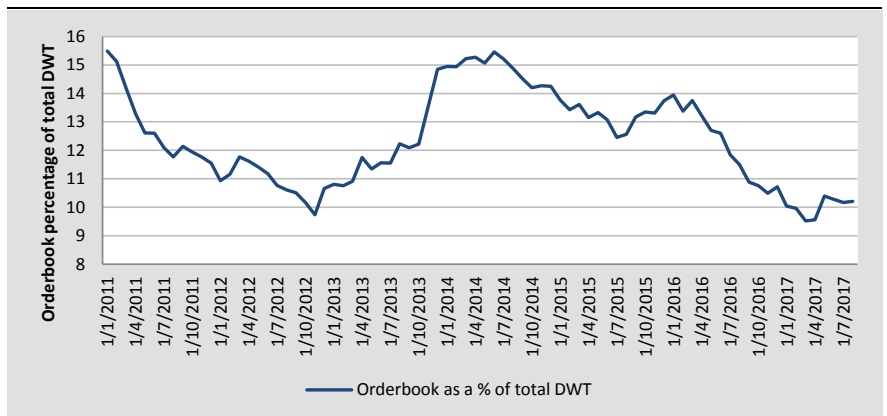
Source: Bloomberg, KGI Research

Figure 9: LR1 10-year old prices are also showing signs of bottoming



Source: Bloomberg, KGI Research

Figure 10: Tankers orderbook as a percentage of DWT are back to more sustainable levels after an ordering binge in 2014 and 2015



Source: Bloomberg, KGI Research

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Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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