



First Ship Lease Trust

(FSLT SP/FSLT.SI)

BUY

Price as of 12 Dec 2017	0.08
12M target price (S\$)	0.15
Previous target price (S\$)	0.13
Upside (%)	82.9

Trading data

Market Cap (S\$m)	52.3
Issued Shares (m)	637.5
Ave Daily Traded (3-Month) Vol / Val	0.3m / \$0.0m
52 week lo / hi	\$0.07 / \$0.17
Free Float	74.7%

Major Shareholders

HSH Nordbank AG	24.2%
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Previous Recommendations

Date	Rating	Share Price (S\$)	Target Price (S\$)
13-Aug-17	BUY	0.080	0.130

FSLT SP (1yr) VS STI



Source: Bloomberg

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See the last page for important disclosures.

Sale of 14-year old vessel 55% above our estimates

Event

FSLT announced on 11 December that it had sold FSL Santos, a German-built, 1221 TEU vessel built in 2013 for a cash consideration of US\$6.2m. FSLT will record a gain on disposal of around US\$0.8m in its 4Q17 results.

Impact

This is a positive development as the US\$6.2m sale price is 55% higher than our market-based valuation of US\$4.0m (Figure 1).

Valuation & Action

We maintain our BUY recommendation and raise our target price to S\$0.15, which implies an 88% 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). To back up our market-based valuation, we utilised a DCF valuation based on FSLT's healthy free cash flow, and derived a fair value of S\$0.13 (WACC 11.0%).

Based on our sensitivity analysis, upside can range from 51% to 141% over the next few quarters (Figure 2).

The short-term catalyst would include the successful refinancing of its US\$171m debt, which is due by the end of this month.

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\$0.15 based on the current market value of its vessels.

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)

Vessel portfolio value based on market prices

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. We had originally estimated that its 14 year old Feeder vessels (FSL Busan and FSL Santos) were only US\$4.0m, but the recent sale of FSL Santos at >50% premium may indicate that our estimates are on the conservative side.

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	Sold for US\$6.2m
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, Bloomberg, KGI Research

Our estimates are conservative compared to FSLT's VTL valuation. FSLT had a VTL of 1.4x – 1.8x as at end 3Q17. Based on the minimum VTL of 1.4x, FSLT is worth S\$0.19 compared to our conservative estimate of S\$0.15.

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	241.8	170.9	70.8	95.6	0.150	87.5%
VTL x 1.4	239.3	262.1	170.9	91.1	123.0	0.193	141.2%
VTL x 1.2	205.1	227.9	170.9	57.0	76.9	0.121	50.8%

Source: KGI Research

FSLT secured a 6-year amortising term loan facility in December 2011 and the outstanding face value of the loan balance was US\$170m as at end-Sep 2017. For 3Q 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

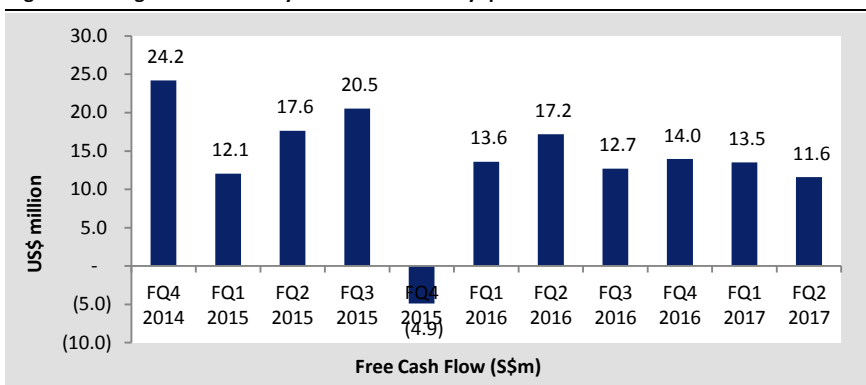
DCF valuation of S\$0.13. FSLT generated US\$10-15m free cash flow per quarter in 1H17, which would yield an annualised free cash flow of US\$47-61m. We assumed a much more conservative free cash flow of US\$40m per annum from FY18 to FY20. From FY21 onwards, we estimate FCF to decline 20% due to the expiry of high value contracts.

Figure 4: DCF-backed valuation

	2017	2018	2019	2020	2021	2022	2023	2024	2025	
FCF US\$m	40	40	40	40	32	32	32	32	32	
FCF US\$m (discounted)		36	32	29	21	19	17	15	14	
FCF US\$m (discounted)	184									
- Less net debt US\$m	151	US\$171m debt; US\$20m cash as at end 3Q17								
+ Add scrap value US\$m	29	Average US\$3m scrap value per vessel, discounted after scrapping when 20 ye								
Equity value US\$m	62									
Equity value S\$m	84	1.35 SGD/USD								
Equity value per share S\$	0.131									
Upside	64%									
WACC	11.0%									

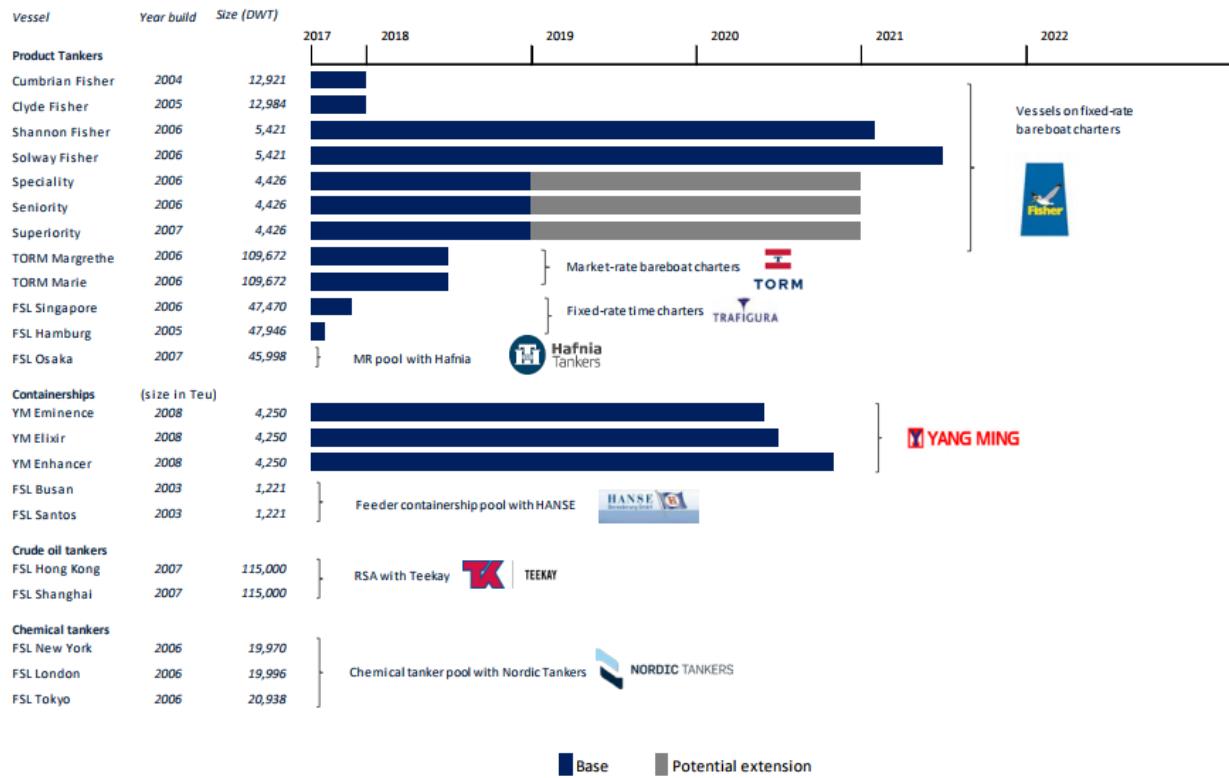
Source: KGI Research

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 Busan	2Q FY2018

Latest dry dockings

Vessel	Date
FSL Osaka	3Q FY2017

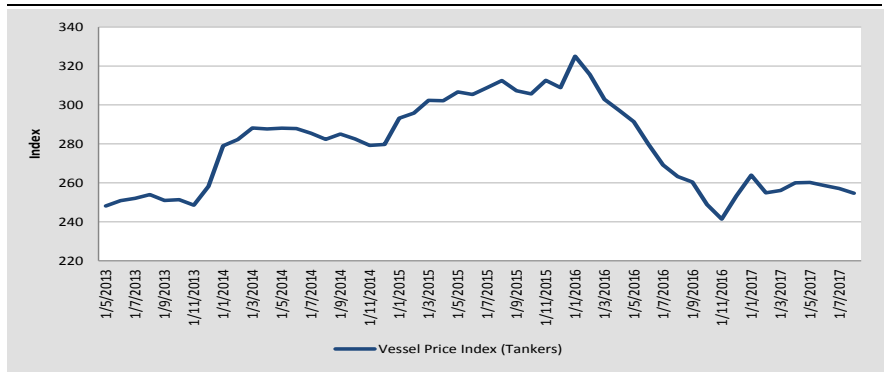
Source: Company Data

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.

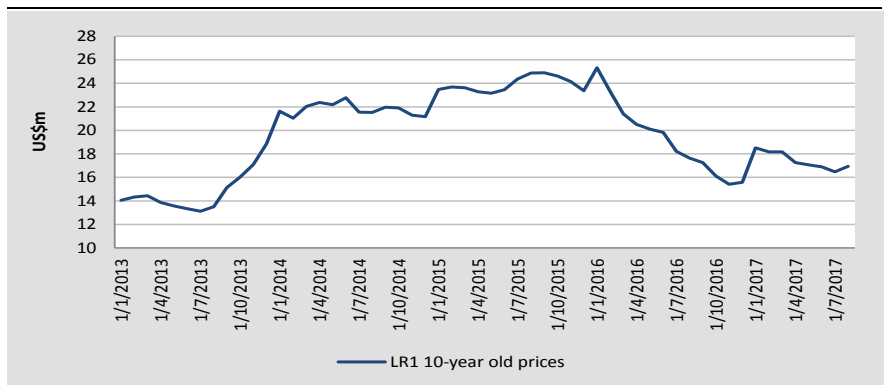
Based on the tanker price index, second hand prices, and orderbook profile, the tanker market seems to have bottomed in 1H17. The decline in the product tanker market in 2H16 was mainly due to the large amount of new tonnage entering the market resulting in a supply-side driven market disequilibrium. 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



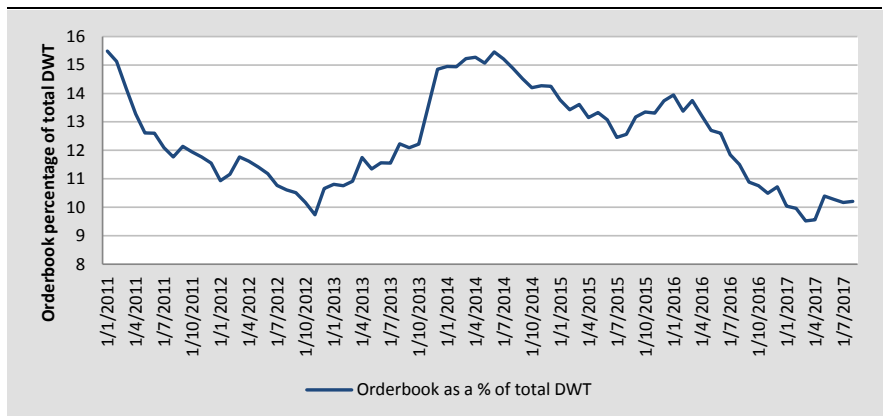
Source: Bloomberg, KGI Research

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

KGI's Ratings

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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