OCBC Investment Research

MITA No. 010/06/2008

23 April 2009

First Ship Lease Trust

Reinvestment scheme in play for 1Q09 distributions

Maintain

HOLD

Previous Rating: HOLD

S$0.425

Fair Value: S$0.45

Stock Code:	
Reuters:	FSLT.SI
ISIN Code	D8DU
Bloomberg:	FSLT SP
Event:	Results

General Data	
Issued Capital (m)	503
Mkt Cap (Sm/USm)	214/142
Major Shareholder	
FSL Holdings Pte Ltd	29.95%
American International Group	11.20%
DWS Investment GMBH	7.95%
Free Float (%)	50.9%
NAV per share (US$)	0.73
Daily Vol 3-mth ('000)	806
52Wk High (S$)	1.320
52Wk Low (S$)	0.320

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Results in line. FSL Trust (FSLT) posted US$24.8m in revenue, down 3.3% QoQ and up 49.5% YoY thanks to acquisitions made over the course of 2008. Note that, as previously guided, this is the first quarter where FSLT will not distribute 100% of cash earnings. Instead, the trust will distribute about 73% of cash earnings, or 2.45 US cents per unit, down 5.4% YoY and 20.4% QoQ because of the lower payout. The results were in line with our expectations. The trust guided for a 2Q09 DPU of 2.45 US cents as well.

Voluntarily prepaying loans. FSLT used US$4m of the retained US$4.6m to voluntary prepay loans. We have noted previously that shipping trusts have to re-align their debt tolerance and business model in light of a 'new world order' of falling asset values and low lender risk appetite. FSLT's decision to voluntarily reduce its payout ratio is in that vein - a preemptive gesture of good faith to lenders. FSLT is geared at a still high 1.38x debt-to-equity. A US$4m per quarter prepayment is a small number compared to the absolute US$509m outstanding loan amount. This is a gesture - not a game-changer, in our view.

Reinvestment scheme in play. The distribution reinvestment scheme (DRS) will apply in 1Q09, giving unitholders the option to receive 1Q09 distributions in units instead of cash. Any proceeds from the DRS (that is, the saved cash earnings) will also be used to prepay loans. This scheme is an attempt to balance the needs of investors demanding cash yield against concerns of sustainability and gearing. But it is unclear just how many investors will voluntarily "do the right thing" for the trust and elect to receive units instead of cash. The success of the scheme in 1Q09 may significantly affect FSLT's course of action going forward - if the DRS fails and market conditions persist, FSLT may ultimately have to cut the distribution payout further, effectively making the "right" choice for unitholders.

Valuation. FSLT has a diversified portfolio with exposure to different shipping sub-sectors, and with no charterer contributing more than 20% of annual revenue. Our key concern is counterparty performance and any resulting disruption of cash flows. The current share price is quite clearly pricing in a distressed scenario, in our opinion. However, we would prefer to wait until the shipping industry shows concrete signs of stabilizing before we turn buyers. Our fair value estimate is S$0.45 (previously under review). Maintain **HOLD.**

Year to 31 Dec	Turnover (US$m)	EBIT (US$m)	Net Profit (US$m)	DPU (US cents)	DPU Growth (%)	P/NAV (x)	Div Yield (%)
FY 07	40.7	9.4	6.3	7.0	-	0.3	24.7
FY 08	86.6	24.1	4.8	11.5	-26.7	0.4	40.9
FY 09F	100.6	24.8	-3.0	9.3	-19.3	0.4	33.0
FY 10F	100.6	24.8	-2.8	8.8	-5.0	0.5	31.3

Please refer to the important disclosures at the back of this document.

ADDITIONAL DETAILS ON THE DRS

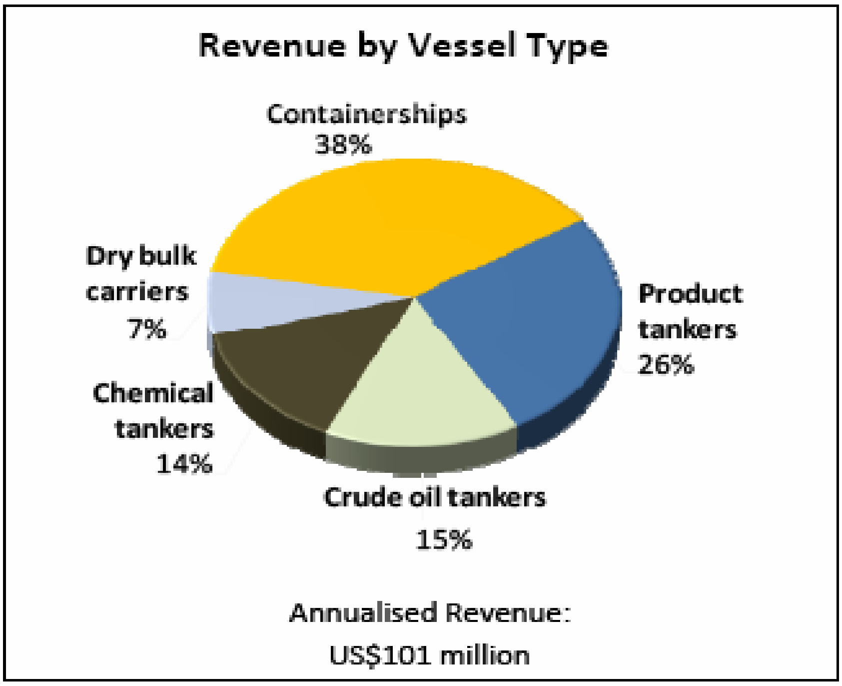
1Q09 marks a milestone for FSLT: the distribution reinvestment scheme (DRS) will apply for the first time this quarter. Under the scheme, unitholders have the option to receive their 1Q09 distributions in the form of new units in lieu of cash, or a combination of both. Any proceeds from the DRS (that is, the saved cash earnings) will be used to reduce the outstanding loan balance. The issue price of new units under the DRS will be based on the volume-weighted average traded price per unit from 27 to 29 April, once units trade ex-distribution. The manager declined to predict a take-up rate. We are not including any effects of the DRS in our estimates for now.

Exhibit 1: Important dates for DRS

Important date	Event
27 April (Mon)	Units trade ex-Distribution (XD)
29 April (Wed); 5pm	Books Closure Date
30 April (Thu)	Announcement of new units issue price (in US$) and applicable discount rate under DRS
Abt. 6 May (Wed)	Currency Election Notice* and Notice of Election (eligible unitholders only) to be mailed out to unitholders as per their CDP-registered address.
13 May (Wed); 5pm	Cut-off date to return Currency Election Notice and Notice of Election (as appropriate) to CDP.
29 May (Fri)	- Payment of Distribution in cash - New units credited in participating unitholders' CDP accounts

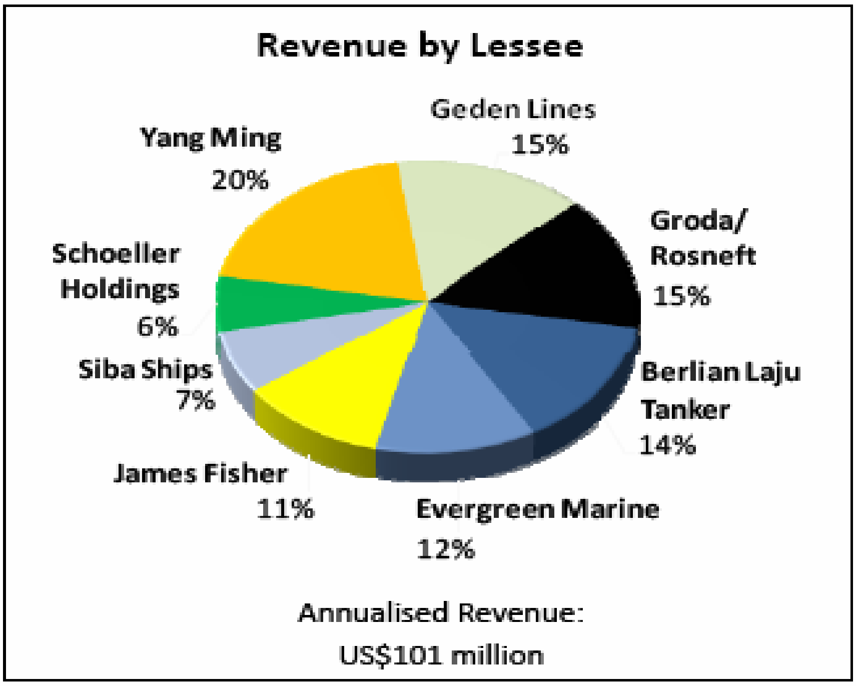
Source: Company

Exhibit 2: Revenue by vessel type



Source: Company

Exhibit 3: Revenue by lessee



Source: Company

Exhibit 4: Shipping trusts at a glance

	Rickmers Maritime	Pacific Shipping Trust	First Ship Lease Trust
IPO	2007	2006	2007
Sponsor	Rickmers Group	Pacific Intl Lines	Schoeller Holdings/ HSH Nordbank AG/ Bayerische Hypo-und Vereinsbank
Sponsor role	Acquisition pipeline, ship management	Acquisition pipeline, ship management, customer	Customer, ship management if needed
Sub-segment focus (as of today)	Containerships	Containerships	None. Owns containerships, dry bulk carriers and tankers
Charter type	Time charters	Bareboat & time charters	Bareboat charters
Charter duration	7 - 10 yrs	5 - 10 yrs	7 - 12 yrs
Leases include vessel purchase option	No	No	Yes (end of lease/early buy-out)
Leases include early termination option	Yes (one)	No	Yes (most)
Customers	Maersk, CMA CGM, Hanjin Shipping, Evergreen, Mitsui O.S.K Lines	Pacific Intl Lines, CSAV	Evergreen, Geden, Groda Shipping, James Fisher, PT Berlian Laju, Schoeller Holdings, Siba Ships, Yang Ming
Distributions	USD/quarterly	USD/quarterly	USD/quarterly
Pay out policy	Fixed DPU amount	90% of cash earnings after debt repayment (~about 50% of cash income)	73% of cash income in 1Q09, ~75% guidance for 2Q09 (100% previously)
Cash earnings retained	Yes	Yes	Yes (from 1Q09 onwards)
Growth plans	US$988m of acquisitions contracted over 2009-2010	No explicit target set for 2009 (prev: US$200m p.a.)	No explicit target set for 2009 (prev: US$300m p.a.)
Debt repayment	No (not immediately)	Yes (immediately amortizing)	No (bullet repayment) except for latest loan. Voluntarily prepaying debt with retained cash from 1Q09.

Source: OIR, Companies

FSLT's Key Financial Data

FSLT Results **Year Ended 31 Dec (US$ m)**	**1Q09 (US$m)**	**1Q08 (US$m)**	**% Chg (YoY)**	**4Q08 (US$m)**	**% Chg (QoQ)**
Revenue	24.8	16.6	49.5%	25.7	-3.3%
Depreciation	-15.3	-11.2	36.4%	-15.5	-1.2%
Management and trustee fees	-1.0	-0.7	47.3%	-1.1	-2.8%
Incentive fees	0.0	-0.1	n.m.	-0.6	n.m.
Other trust expenses	-0.6	-0.5	15.5%	-0.2	173.6%
Finance income	0.1	0.2	-61.4%	-0.1	-201.6%
Finance expenses	-6.4	-2.5	153.2%	-7.8	-18.9%
Net profit before tax	1.5	1.7	-9.6%	0.4	318.5%
Income tax write-back/(expense)	0.0	0.0	n.m.	0.1	-105.7%
Net profit after tax	1.5	1.7	-10.0%	0.5	236.6%
Distributed amount	12.3	13.0	-4.8%	15.4	-20.1%
DPU (US cents)	2.5	2.6	-5.4%	3.1	-20.4%
NAV (US$)	0.7	0.9	-17.6%	0.8	-2.9%

EARNINGS FORECAST **Year Ended 31 Dec (US$ m)**	**FY07**	**FY08**	**FY09F**	**FY10F**
Charter income	40.7	86.6	100.6	100.6
Depreciation	-28.6	-54.7	-66.2	-66.2
Management fees	-1.6	-3.5	-4.0	-4.0
Other expenses	-1.1	-2.8	-3.4	-3.4
Incentive fees	0.0	-1.5	-2.1	-2.1
EBIT	9.4	24.1	24.8	24.8
Finance costs	-3.0	-19.3	-27.9	-27.6
Pre-tax profit	6.4	4.8	-3.0	-2.8
Income tax	-0.1	0.0	-	-
Net profit	6.3	4.8	-3.0	-2.8
Cash earnings	34.8	57.7	63.2	63.4
Distributed income	34.8	57.7	46.7	44.4

Note: Cash earnings, an OIR estimate, is net profit adjusted for non-cash items - depreciation expense is added back, for instance. It reflects all cash expenses, including any incentive fees charged by the manager.

BALANCE SHEET As at 31 Dec (US$ m)	FY07	FY08	FY09F	FY10F
Cash and bank balances	18.5	26.7	26.7	26.7
Other current assets	0.9	0.3	0.3	0.3
Vessels, net accumulated depreciation	609.8	905.6	839.4	773.2
Total assets	629.2	932.7	866.5	800.2
Current liabilities	11.7	45.3	45.3	45.3
Secured bank loan	158.1	509.2	492.8	473.8
Total liabilities	169.8	554.5	538.1	519.0
Net assets	459.4	378.2	328.4	281.2
Units in issue	490.0	477.6	477.6	477.6
Unit issue costs	-13.2	0.0	0.0	0.0
Reserves	-17.4	-99.5	-149.3	-196.4
Total equity	459.4	378.2	328.4	281.2
Total equity and liabilities	629.2	932.7	866.5	800.2
NAV per share (US$)	0.9	0.8	0.7	0.6

CASH FLOW Year Ended 31 Dec (US$ m)	FY07	FY08	FY09F	FY10F
Profit before tax	6.4	4.8	-3.0	-2.8
Add: depreciation and amortization	28.8	54.7	66.2	66.2
Add: interest expense	2.7	19.0	27.9	27.6
Other adjustments	2.1	2.2	0.0	0.0
Net cash from operations	40.0	80.7	91.1	91.1
Capex	-629.3	-354.1	0.0	0.0
Net cash from investing	-631.0	-353.5	0.0	0.0
Proceeds from issuance of units	490.0	0.0	-	-
Loan drawdown	157.9	350.5	0.0	0.0
Loan repaid	0.0	0.0	-16.4	-19.0
Interest paid	-2.6	-15.2	-27.9	-27.6
Distribution to unitholders	-22.7	-54.3	-46.7	-44.4
Net cash from financing	609.5	281.0	-91.1	-91.1
Net cash flow	18.5	8.2	0.0	0.0
Cash at beginning of year	0.0	18.5	26.7	26.7
Cash at end of year	18.5	26.7	26.7	26.7

Key Rates

Year to 31 Dec	FY07	FY08	FY09F	FY10F
Units outstanding (m)	500.0	501.3	503.1	503.1
EPU (US cents)	1.3	1.0	(0.6)	(0.5)
CEPU (US cents)	7.0	11.5	12.6	12.6
DPU (US cents)	7.0	11.5	9.3	8.8
DPU growth (%)	-	26.7%	-19.3%	-5.0%

Key Ratios

Year to 31 Dec	FY07	FY08	FY09F	FY10F
Price/NAV (x)	0.3	0.4	0.4	0.5
Dividend yield (%)	24.7	40.9	33.0	31.3
EBIT margin (%)	23.1	27.8	24.7	24.7
Net profit margin (%)	15.5	5.6	-3.0	-2.7
Distributed income to revenue (%)	85.3	66.6	46.5	44.1
Distributed income to cash earnings (%)	100.0	100.0	74.0	70.0
Total Debt/ Total Assets (x)	0.3	0.5	0.6	0.6
Total Debt/Equity (x)	0.3	1.3	1.5	1.7

Source: Company data, OIR estimates

Note: P/NAV and Dividend Yield based on US-SGD exchange rate of 1.51

SHAREHOLDING DECLARATION:
The analyst/analysts who wrote this report holds NIL shares in the above security.

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