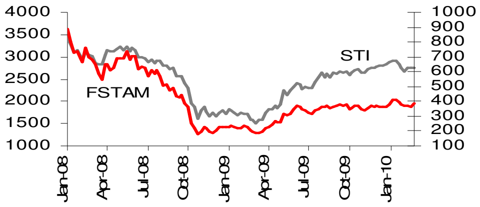
OCBC Investment Research

SINGAPORE Sector Update MITA No. 016/06/2009

2 March 2010

Neutral



	FSL Trust	Pacifc Shipping Trust	Rickmers Maritime
Price	SGD 0.605	USD 0.265	SGD 0.395
FY10F DPU (US-cents)	6.0	3.1	2.4
FY10F yield (%)	13.9	11.6	8.5
P/NAV (x)	0.7	0.7	0.3
Rating	**HOLD**	**HOLD**	**SELL**
Fair Value	SGD 0.53	USD 0.23	SGD 0.180
Upside (%)	-12.4%	-13.2%	-54.4%
Total return (%)	1.5%	-1.6%	-45.9%

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Shipping Trusts

4Q09 results review

Results in line; payouts lower. Full year results for the three Singapore-listed shipping trusts were in line with our expectations, with FY09 distributable income within 4% of our estimate for each trust. The trusts all declared significantly lower payouts for 4Q09 vis-à-vis 4Q08. FSL Trust's (FSLT) payout represented 56% of cash earnings compared to 100% in the corresponding quarter. Pacific Shipping Trust's (PST) 4Q09 payout was equivalent to 43% of cash earnings versus 53% in 4Q08. Meanwhile Rickmers Maritime's (RMT) quarterly distributions amounted to 13% of cash earnings versus 59% a year ago. The trusts used the retained cash to repay loans and/or bolster cash reserves.

No movement on key issues. The results were fairly uneventful with limited or little progress on the outstanding fronts. PST has not re-opened talks with charterer CSAV on the liner's request for rate renegotiations. On a positive note, CSAV's debt re-structuring and equity fund-raising plans are coming along on target, which PST's manager was "encouraged" by. FSLT, meanwhile, continues to scout acquisition opportunities that will utilize the funds raised through the recent placement. The manager also kept its options open for another attempt to diversify its funding sources through a senior unsecured notes offering. RMT is still in talks with its bankers and sponsor on loan-to-value covenants, a US$130m loan facility maturing in April, and large capex commitments. While talks continue, completed newbuilds are being warehoused by sponsor Rickmers Group.

Too soon to call for a recovery. There are arguments for both sides. The bull case for containers: 1) inventory re-stocking; 2) some economic growth; 3) slow steaming; 4) scrapping and order book management. The bear case: 1) uneven economic data pointing to the likelihood of a slow, 'benign' recovery; 2) a still substantial order book; 3) financing difficulties; and 4) precarious industry discipline - laid up vessels are already being re-introduced into service, and it's unclear who controls the tap. The broader industry's stance on the 'knife-edge' of recovery moves us to upgrade our sector view from **UNDERWEIGHT** to **NEUTRAL**. Nevertheless, we leave our ratings on the individual trusts unchanged for now, as we wait to see more sustained evidence of a recovery. A cautious approach in the coming weeks may be prudent considering that RMT's US$130m loan facility is maturing just next month. How that maturity is handled may drive sector valuations and sentiment in the near-term.

Exhibit 1: Use of FY09 cash earnings

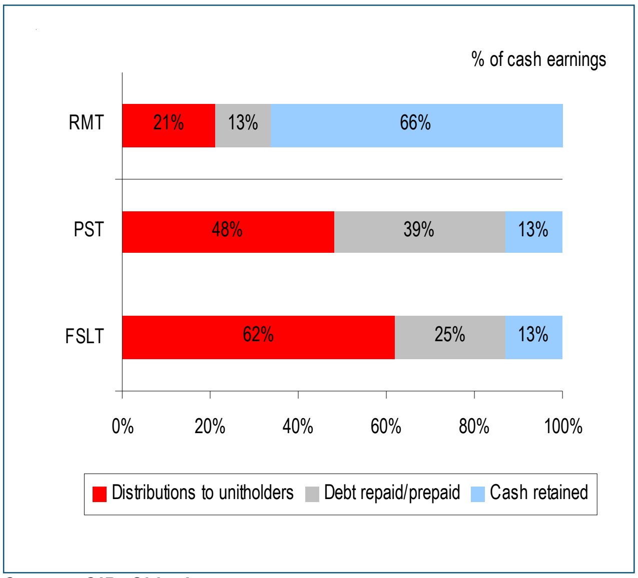
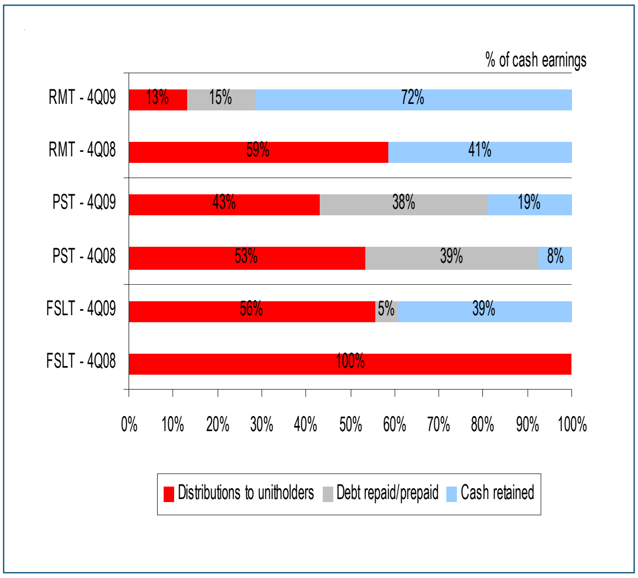


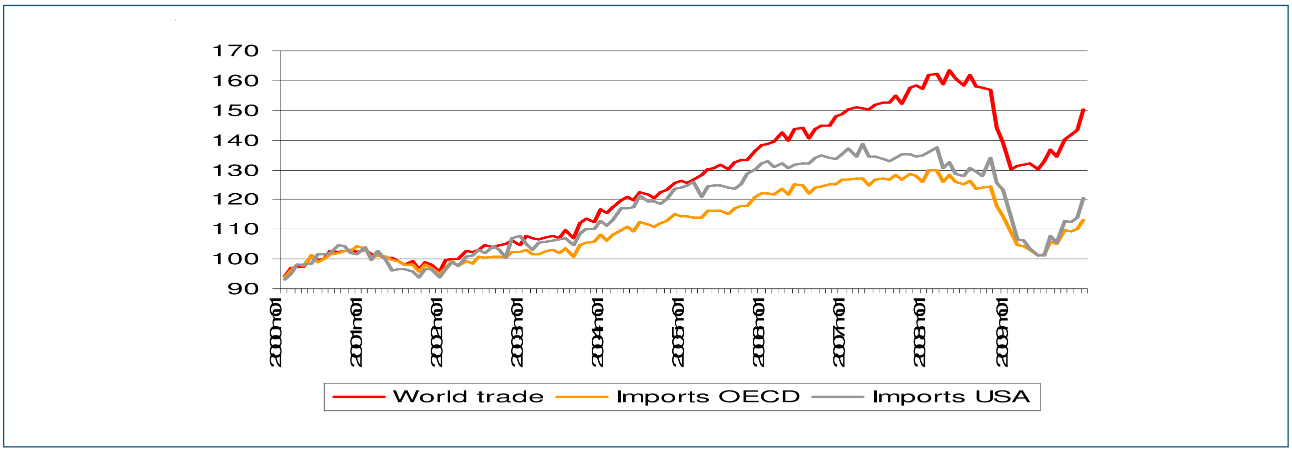
Exhibit 2: Use of 4Q09 cash earnings



Source: OIR, Shipping trusts

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

World trade volumes Jan-00 to Dec-09



Note: Statistically adjusted, 2000=100; OECD ex Turkey, Mexico, Korea

Source: World Trade Monitor, Netherlands Bureau for Economic Policy Analysis

A fragile recovery. FSLT's manager presented a fairly positive outlook of both the industry and its prospects in 2010. FSLT believes it has "moved past the point of highest counterparty default risk in this cycle". For container shipping, the manager argued that following freight rate restoration efforts and capacity reductions, major container liner companies "are at or close to cash flow breakeven levels". It further guided that while 2009 was about "putting its house in order", 2010 would be about slowly returning to a growth strategy. We agree that there have been some encouraging signs of stabilization in the container sector. Rates appear to either be holding or edging up on key routes - but are still at historically low (and typically unprofitable) levels.

This stability is fragile, in our opinion, and it is still unclear how long it can last. At its FY09 results briefing, liner Neptune Orient Lines [**HOLD**, FV: S$1.67] stressed that visibility remains low. Significant tail risk exists, in our opinion, which merits caution on the broader ship finance industry. These include: the risk of a double-dip recession or even of a lacklustre recovery; supply-side risk; the threat of protectionism impacting world trade; financing and re-financing risk. The other vessel sub-sectors face many of the same issues (uncertain demand, significant supply) - with the dry bulk sector now struggling with a much larger order book (60% of fleet) vis-à-vis containers (40% of fleet) or tankers (30% of fleet)[1] .

Ship finance still the weak link. In our 15 Dec strategy report, we had highlighted the challenges overshadowing the alternate ship financing arena. We believe this continues to be an issue. *Lloyd's List* estimates a US$300b funding gap over the next 12 months for the global shipping order book. As an illustration of the extent of the financing problem, the world's third-largest liner (and RMT charterer) CMA CGM is still trying to re-structure its debt[2] . The container shipping line owes US$5.6b in loans to 75 banks. It is also in talks to delay or cancel orders for 30 vessels. According to the *Financial Times*, CMA CGM executive Jean-Yves Schapiro said that "banks don't have any alternative but to back owners who are facing difficulties". This may very well be true for the largest players - but we do not believe this holds across the financing landscape, especially for third party owners such as the Singapore-listed trusts. Ratings agency Moody's said last month that credit metrics will remain subdued this year before starting to recover in 2011. It also expects shipping finance to remain tight. Our view is that the fundamental problem of the steep decline in asset values and large capital commitments is unchanged. Banks are essentially playing a waiting game, in our opinion - if the recovery continues, well and good - but if cash flow stress increases, leveraged third-party asset owners that finance operators may be the first to feel the pinch.

[1] ***Order book estimates sourced from Moody's. We have also seen the 35% figure cited for containers by other industry watchers.***

[2] ***Journal of Commerce***

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- For companies with less than S$150m market capitalization, OIR's Buy = More than 30% upside from the current price; Hold = Trade within +/- 30% from the current price; Sell = More than 30% downside from the current price.

Co.Reg.no.: 198301152E

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Published by OCBC Investment Research Pte Ltd