OCBC Investment Research

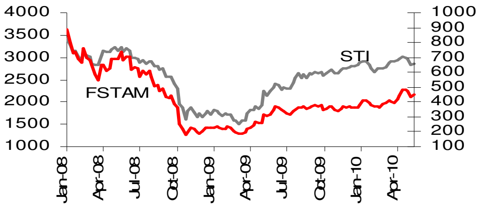
SINGAPORE Sector Update MITA No. 016/06/2009

19 May 2010

Neutral

Shipping Trusts

Not out of the woods yet



1Q10 review: united in YoY DPU declines. 1Q10 results for the Singapore-listed shipping trusts under our coverage were largely in line with our expectations. ***Pacific Shipping Trust*** (PST), ***FSL Trust*** (FSLT) and ***Rickmers Maritime*** [RMT, ***NOT RATED***] all reported YoY declines in DPU ranging from 19.1%-73.4% primarily due to lower distribution payout levels. FSLT, PST, and RMT are currently paying out 55%, 43%, and 13% of cash earnings respectively to unitholders.

RMT concludes negotiations with sponsor and lenders. In Apr, RMT's sponsor agreed to discharge RMT's obligation to purchase seven newbuild vessels for US$918.7m in exchange for a US$64m penalty. Additionally, RMT's lenders also agreed to a loan maturity extension and to waive value-to-loan (VTL) coverage requirements. The agreement with the lenders is fairly restrictive: 1) the US$130m loan is now amortizing; 2) RMT has to pay a higher cost of debt in exchange for the VTL waivers; and 3) RMT cannot pay out more than 0.6 US cents/quarter while its VTL coverage is breached in any of its loan tranches. These agreements do take RMT away from the brink of bankruptcy but also create, in our opinion, a stasis situation where RMT cannot exert much control over its cash flows. The end point is also unclear (as we do not know what the VTL gap is). RMT could just bide its time under these agreements or possibly raise fresh equity (with a much recovered unit price) and get out of these restrictive agreements.

Counterparty issues remain. In sharp counterpoint to the RMT developments, FSLT announced earlier this month that its charterer Groda Shipping has requested the trust to take re-delivery of two of its product tankers that were under a seven-year bareboat charter agreement. The charterer indicated that "it has become increasingly difficult for them to improve their cash flow" due to 1) escalating bunker prices; 2) under-utilization of the vessels under the Contract of Affreightment (CoA); and 3) "limited options to generate incremental revenue given the trading area of the vessels".

Growths plans offset by continuing risks. The sector, in our view, remains highly vulnerable due to counterparty risks - and this incident highlights that the broader shipping industry is not out of the woods yet. We expect both PST and FSLT to acquire new vessels this year but the key challenge will be to secure high quality counterparties and still make an accretive deal. Maintain **NEUTRAL** view. PST is our preferred pick because of its balance sheet strength.

	FSL Trust	Pacifc Shipping Trust	Rickmers Maritime*
Price	SGD 0.480	USD 0.280	SGD 0.345
FY10F DPU (US-cents)	5.3	3.3	2.4
FY10F yield (%)	15.2	11.6	9.5
P/NAV (x)	0.6	0.7	0.3
Rating	**HOLD**	**HOLD**	**NOT RATED**
Fair Value	SGD 0.48	USD 0.29	
Upside (%)	0.0%	3.6%	-

Based on 1.37 USD/SGD rate

*Consensus estimate used for RMT DPU

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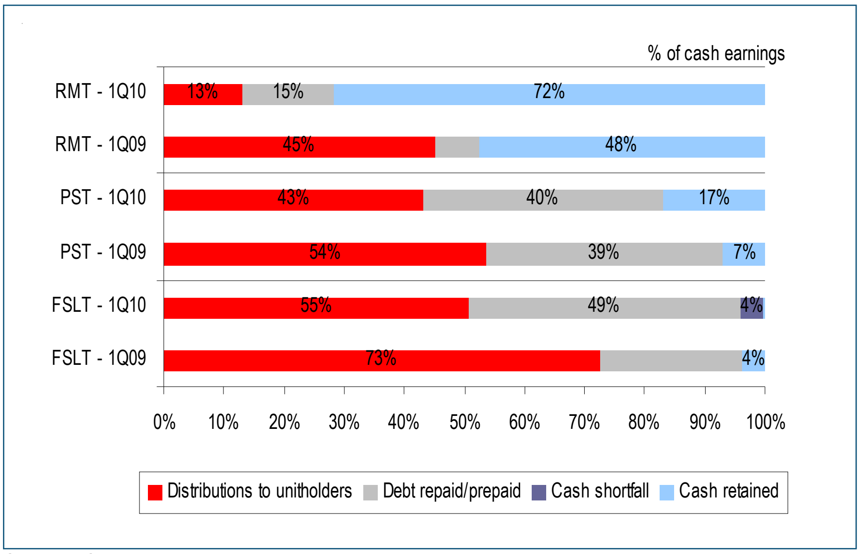
Use of cash earnings. Pacific Shipping Trust (PST) paid out 0.793 US cents per unit to investors, with distributed income slipping 4.1% QoQ and 19.1% YoY. The YoY decline is because PST has lowered its distribution payout level, in line with the rest of the sector. FSL Trust (FSLT)'s 1.5 US cents DPU was flat QoQ and down 38.8% YoY because of a lower payout policy and a larger unit base post-placement. Rickmers Maritime [RMT, **NOT RATED**]'s DPU of 0.57 US cents was flat QoQ and down 73.4% YoY. FSLT, PST, and RMT are currently paying out 55%, 43%, and 13% of cash earnings respectively. In FSLT's case, it had to dip into cash reserves to meet its distributable income guidance due to the timing mismatch between the enlarged unit base after its Sep 2009 placement and the delay in deploying those proceeds towards vessel purchases.

Compared to a year ago, a higher proportion of cash earnings is being used towards debt repayment / prepayment and also just being retained internally (see Exhibit 1).

Exhibit 1: Use of 1Q10 cash earnings



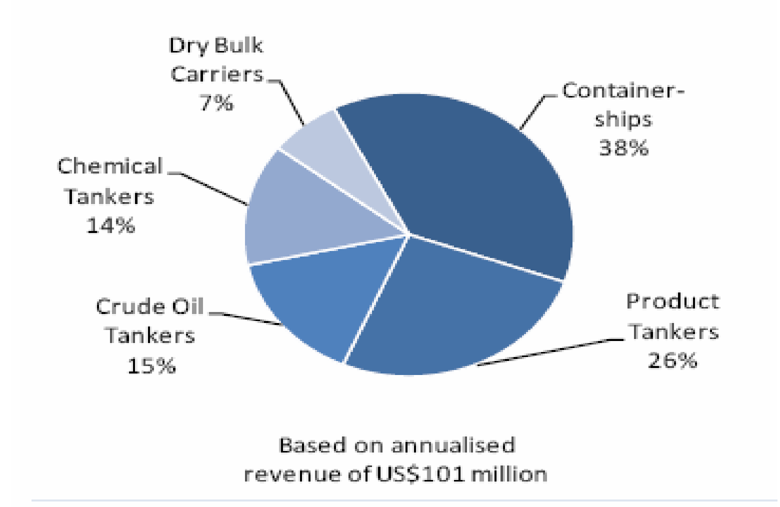
Source: OIR, shipping trusts

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

RMT concludes negotiations with key stakeholders. In Apr, RMT's sponsor Rickmers Group agreed to discharge RMT's obligation to purchase seven newbuild vessels (with long-term charters attached) for US$918.7m (three are already warehoused with the sponsor). RMT will have to pay the sponsor US$64m (about 7% of the acquisition cost) as compensation. Additionally, the US$130m top-up loan facility maturing on 30 Apr has been extended for a period of five years. RMT also has to make a prepayment of US$59m towards its loan facilities. RMT's lenders also agreed to waive the value-to-loan requirements on all of the trust's existing loans for up to three years. As part of the agreement with RMT's lenders, RMT cannot pay out more than 0.6 US cents/quarter while its value-to-loan coverage is breached in any of its loan tranches. Note that RMT did not say what the current value-to-loan coverage is. These developments are contingent on various requirements including unitholders approval for the discharge agreement with the sponsor (an EGM will be convened).

FSLT struggles with vessel re-delivery. FSLT's charterer Groda Shipping recently requested FSLT to take re-delivery of two of its product tankers *Verona I* and *Nika I* as Groda does not intend to continue to make full charter payments. To recap, both vessels are under a seven-year bareboat charter agreement fixed at US$20,700/day each until Nov 2014. FSLT is currently estimating (conservatively) that it can earn US$7,000/day per vessel on a bareboat charter equivalent basis (down 66.2%). The vessels currently have planned voyages under a Contract of Affreightment with Rosneft and FSLT's "immediate priority is the continued smooth operation of the vessels whilst [it explores] alternative commercial solutions". The manager has decided to suspend the management fee it is entitled to receive on the two vessels under further notice. It also said that FSLT's DPU guidance for 2Q FY10 and beyond is under review by the Board.

Exhibit 2: FSLT's revenue by vessel type



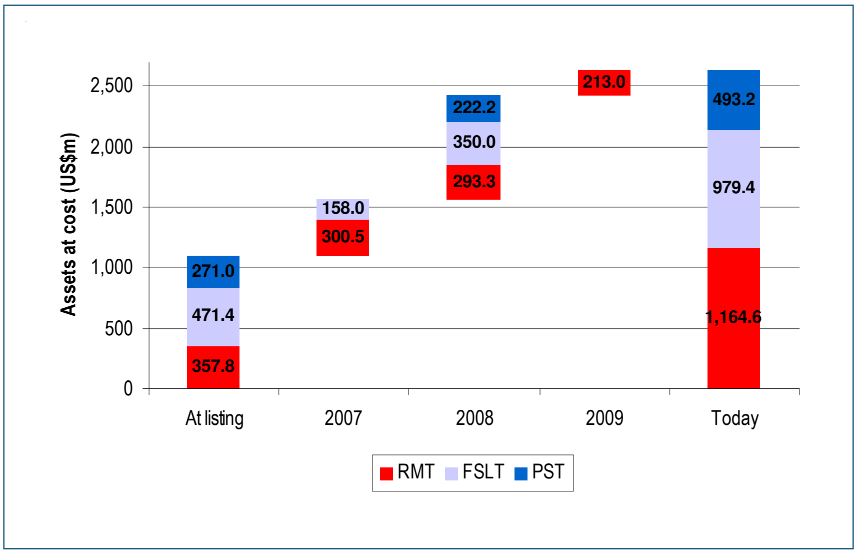
Source: FSL Trust, 1Q10 results

Note: The other two trusts are container-only focused at present

Our key concern is what the redelivery means for the rest of FSLT's product tanker portfolio (26% of total revenue including Groda). FSLT is "presently not aware of any information that would lead it to believe that its other customers would not continue to fulfill their lease payment obligations." On a positive note, we understand that this development does not impact FSLT's loans. Still, any reduction in revenue could affect FSLT's plans to raise unsecured debt.

Acquisition plans on the runway? FSLT has yet to deploy the US$28.3m net proceeds from its Sep 2009 placement. At 1Q10 results, its manager said an announcement was likely in "a matter of weeks / possibly in a month or two". FSLT reiterated its target asset yield of 15% and its plan to further diversify into a previously untapped vessel sub-sector (for example, offshore). A significant change in guidance was that FSLT is "now hopeful of lifting acquisition projects over and above" the placement proceeds because of increasing access to capital.

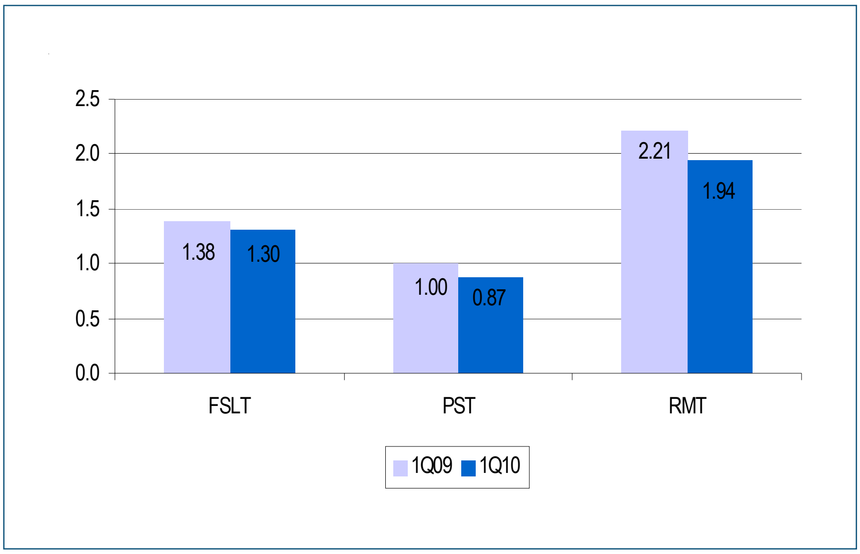
Exhibit 3: Acquisitions since IPO



Source: OIR, Shipping Trusts

PST's manager also emphasized that "PST is actively on the lookout for potential acquisitions that meet [its] investment criteria and add value for [its] unitholders". The manager said a number of deals were on the table, with some in the final stages of due diligence. It also said any deal is likely to diversify PST out of container vessels. PST is currently geared at 0.87x debt-to-equity, and has cash at hand of US$19.6m as of 31 Mar. Assuming US$15m equity is deployed and debt is available at 60% loan-to-value, PST could potentially acquire US$37.5m worth of vessels *without raising additional equity*. This amount should not be underestimated, potentially adding 0.15 US cents to annual DPU (a conservative estimate). The key concerns here are counterparty quality and PST's ability to execute well outside the container space.

Exhibit 4: Debt-to-equity levels (x)



Source: Shipping Trusts, OIR

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