First Ship Lease Trust (FSLT) is trading at about 70% discount to its Net Asset Value (NAV). Yet it is probably overvalued. Here’s why.

As a general rule of thumb, during periods of rising prices of assets, reported NAV tends to understate the “true” NAV. This is particular true of property investment companies in recent years, when property prices have risen significantly but some companies’ property assets are still accounted for in the balance sheet under the original book value established when the property was first purchased. On the other hand, the opposite is also true, when market value of assets declined. The value of ships immediately comes to mind.{loadposition advert1}

Yet Revalued Net Asset Value (RNAV) is seldom calculated for shipping or ship-owning companies, simply because it is difficult for the average investor to assess the market value of a portfolio of ships.

Therefore, it is not always clear which companies’ true NAV have deviated from the reported NAV, even if such information is available to management. These company insiders often hire independent valuers to assess the market value of their assets, but for various reasons, can choose not to adjust or impair the book value.

Occasionally, such information can be gleaned from companies’ announcements. One of the best examples would be First Ship Lease Trust.

A Troubled History

First Ship Lease Trust is a Singapore-listed business trust that owns a fleet of ships that are chartered to lessees around the world. However, with the worldwide glut in shipping capacity since 2009, FSLT has faced one set of headwinds after another, most notably:

- May 2010 – Groda Shipping defaults on 2 product tankers leased from FSLT
- Feb 2012 – Berlian Laju defaults on lease for 3 chemical tankers
- Apr 2012 – FSLT forced to renegotiate charter rates with TORM, which had fallen into financial difficulties
- Jun 2012 – FSLT suspends distributions to unit holders as part of deal with lenders to relax loan covenants
- Jun 2013 – Geden Lines defaults on leases for 2 crude oil tankers

Due to its long list of troubles, FSLT trades at possibly one of the highest discounts to NAV among shares in Singapore. It has a reported NAV/share of US$0.480 but a share price of just around S$0.12, representing a discount of about 70%.

Some investors appear to have relied solely on this fact to invest in FSLT, but as will be explained, the NAV can be a very misleading indicator of intrinsic value.

A Clear Bargain, Not

In Jun 2012, FSLT announced that it has obtained from its lenders a one-year relaxation of covenants on its loans, whereby

- the minimum security value-to-loan (“VTL”) ratio was reduced from 125% to 100%, as well as
- the debt service coverage (“DSC”) ratio wasreduced from at least 1.1:1 to at least 1:1

These terms were subsequently extended in Jun 2013.

VTL is simply the ratio of the values of assets used to secure against a loan, to the value of secured loan outstanding. DSC can take several forms, but it is commonly defined as EBITDA divided by interest payments.{loadposition advert1}

The need for FSLT to obtain a relaxation of covenant suggest that the current VTL ratio has dipped below 125%.

With an outstanding secured loan of about US$420m, an assumed VTL ratio of 1.25 implies that FSLT’s market value of ship assets is US$525m. This compares with the US$713m of vessels that is reported on FSLT's balance sheet, i.e. the current market value of FSLT's ships is about US$188m (or US$0.287/share) *below the book value*.

The revalued NAV for FSLT is thus US$0.480 minus US$0.287 = US$0.193/share. This implies that FSLT's true NAV per share is (in the most optimistic case) more than 50% below its book value.

No Respite

Of course, 125% VTL is just an assumption and the fact that FSLT had to request for a relaxation of the covenant to as low as 100% suggest that FSLT's vessels are worth well less than 125% of loans outstanding.

While FSLT has been paying down its loans, its ships are also being depreciated over time. Even if the chartering market remains stable, FSLT has to repay principle faster than the rate of depreciation, just to maintain the VTL ratio.

The following table shows the RNAV/share of FSLT at various levels of VTL.

VTL
125%
120%
115%
110%

100%

Mkt value vessels (USD mil)

524.4

503.5

482.5

461.5

419.5

Impairment (USD mil)

188.1

209.1

230.1

251.0

293.0

Impairment/share (USD)

$0.29

$0.32

$	0.35

$	0.38

$	0.45

RNAV/share (USD)

$0.19

$0.16

$	0.13

$	0.10

$	0.03

RNAV/share (SGD@1.25SGD/USD)

$0.24

$0.20

$	0.16

$	0.12

$	0.04

In other words, FSLT is so highly leveraged that at a VTL of 100%, the value of FSLT's ships would be worth just 4 Singapore cents per share.

Conclusion

FSLT may be trading at a 70%+ discount to its NAV%, but its share price now is by no mean cheap.

With yet another lessee (Geden) defaulting on its lease with FSLT, the shipping market may have deteriorated to yet another level. FSLT's VTL ratio could be again under renewed pressure, sending its RNAV into negative territory, never mind what the book value says.

The case of FSLT is probably the best reminder to investors that NAV is only an indicator of value and that it should never be solely relied upon for investment decisions.

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