# First Ship Lease Trust and its Subsidiaries

## (Constituted in the Republic of Singapore pursuant to a Deed of Trust dated 19 March 2007)

Annual Report
Year ended 31 December 2012

# Report of the Trustee-Manager of First Ship Lease Trust

The directors of FSL Trust Management Pte. Ltd., the Trustee-Manager of First Ship Lease Trust (the "Trust") and its subsidiaries (together referred to as the "Group"), are pleased to submit this annual report to the unitholders of the Trust, together with the audited financial statements for the financial year ended 31 December 2012.

## Directors

The directors of the Trustee-Manager in office at the date of this report are as follows:

Wong Meng Meng (Chairman)
Phang Thim Fatt
Michael John Montesano III
Philip Clausius
Cheong Chee Tham

## Directors' interests

According to the register kept by the Trustee-Manager for the purposes of Section 76 of the Singapore Business Trusts Act (the "Act"), particulars of interests of directors who held office at the end of the financial year in units of the Trust are as follows:

| Name of directors | Holdings at beginning of the year | | Holdings at end of the year | |
|---|---|---|---|---|
| **The Trust** | **Direct** | **Deemed** | **Direct** | **Deemed** |
| Units | | | | |
| Philip Clausius | 715,000 | – | 715,000 | – |
| Cheong Chee Tham | 148,500 | 44,000 | 148,500 | 44,000 |
| Michael John Montesano III | 13,200 | – | 13,200 | – |

Except as disclosed above, no director who held office at the end of the financial year had interests in units, debentures, warrants or unit options of the Trust, or of related corporations, either at the beginning or at the end of the financial year.

Except as disclosed above, neither at the end of, nor at any time during the financial year was the Trustee-Manager a party to any arrangement whose objects are, or one of whose objects is, to enable the directors of the Trustee-Manager to acquire benefits by means of the acquisition of units, debentures or unit options of the Trust.

Except as disclosed in note 24 to the financial statements, since the end of the last financial year, no director has received or become entitled to receive a benefit by reason of a contract made by the Trust or a related corporation with the director, or with a firm of which he is a member or with a company in which he has a substantial financial interest.

There were no changes in any of the above mentioned interests in the Trust between the end of the financial year and 21 January 2013.

## Unit options

During the financial year, there were:

(i) no options granted by the Trustee-Manager to any person to take up unissued units in the Trust; and

(ii) no units issued by virtue of any exercise of option to take up unissued units of the Trust.

As at the end of the financial year, there were no unissued units of the Trust under option.

## Internal controls

Based on the internal controls established and maintained by the Trustee-Manager, work performed by the external auditors, a review performed by an independent external advisory team, and reviews performed by management and the Board, the Board and the Audit Committee are of the opinion that the Trustee-Manager's internal controls, addressing financial, operational and compliance risks were adequate as at 31 December 2012. No system can provide absolute assurance against material errors, human errors, fraud or other irregularities and the internal controls of the Trustee-Manager are designed to provide reasonable but not absolute assurance in this regard.

## Audit committee

The members of the Audit Committee during the financial year and as at the date of this report comprise three independent and non-executive directors:

Phang Thim Fatt (Chairman)
Wong Meng Meng
Michael John Montesano III

The Audit Committee carried out its functions in accordance with Regulation 13(6) of the Singapore Business Trusts Regulations and the SGX Listing Manual.

In performing its functions, the Audit Committee reviewed the overall scope of external audit and the assistance given by the Trustee-Manager's officers to the auditors. It met with the Trust's external auditors to discuss the scope and results of their quarterly reviews and annual audit. In addition, the Audit Committee reviewed the financial statements of the Group and the Trust before their submission to the Board of Directors of the Trustee-Manager.

The Audit Committee has recommended to the Board of Directors, the nomination of Messrs KPMG LLP for re-appointment as auditors of the Trust at the forthcoming Annual General Meeting of the unitholders.

## Auditors

The auditors, KPMG LLP, have indicated their willingness to accept re-appointment.

For and on behalf of the Board of Directors of the Trustee-Manager

**Wong Meng Meng**
*Chairman*

**Philip Clausius**
*Director*

28 February 2013

# Statement by the Trustee-Manager

## Statement and certification

In our opinion:

(a) the financial statements set out on pages FS1 to FS42 are drawn up so as to give a true and fair view of the state of affairs of the Group and of the Trust as at 31 December 2012 and the results, changes in unitholders' funds and cash flows of the Group for the year ended on that date in accordance with the provisions of the Singapore Business Trusts Act and International Financial Reporting Standards; and

(b) at the date of this statement, there are reasonable grounds to believe that the Trust will be able to pay its debts as and when they fall due.

With respect to the income statement of the Group for the year ended 31 December 2012:

- fees or charges paid or payable out of the trust property to the Trustee-Manager are in accordance with the Deed of Trust dated 19 March 2007 as amended and supplemented from time to time;

- interested person transactions are not detrimental to the interests of all the unitholders as a whole based on the circumstances at the time of the transaction; and

- the Board is not aware of any violation of duties of the Trustee-Manager which would have a materially adverse effect on the business of the Trust or on the interests of all the unitholders as a whole.

The Board of Directors has, on the date of this statement, authorised the above statements and these financial statements for issue.

For and on behalf of the Board of Directors of the Trustee-Manager

**Wong Meng Meng**
*Chairman*

**Philip Clausius**
*Director*

28 February 2013

## Statement by the Chief Executive Officer

In accordance with Section 86 of the Singapore Business Trusts Act, I certify that I am not aware of any violation of duties of the Trustee-Manager which would have a materially adverse effect on the business of the Trust or on the interests of all the unitholders of the Trust as a whole.

**Philip Clausius**
*Chief Executive Officer*

28 February 2013

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# Independent auditors' report

Unitholders of First Ship Lease Trust

## Report on the financial statements

We have audited the accompanying financial statements of First Ship Lease Trust (the "Trust") (constituted in the Republic of Singapore pursuant to a Deed of Trust dated 19 March 2007) and its subsidiaries (the "Group"), which comprise the statements of financial position of the Group and the Trust as at 31 December 2012, the income statement, statement of comprehensive income, statement of changes in unitholders' funds and statement of cash flows of the Group for the year then ended, and a summary of significant accounting policies and other explanatory information, as set out on pages FS1 to FS42.

*Trustee-Manager's responsibility for the financial statements*

The Trustee-Manager is responsible for the preparation of financial statements that give a true and fair view in accordance with the provisions of the Singapore Business Trusts Act (the "Act") and International Financial Reporting Standards.

The Trustee-Manager has acknowledged that its responsibility includes devising and maintaining a system of internal accounting controls sufficient to provide a reasonable assurance that assets are safeguarded against loss from unauthorised use or disposition; and transactions are properly authorised and that they are recorded as necessary to permit the preparation of true and fair profit and loss accounts and balance sheets and to maintain accountability of assets.

*Auditors' responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Singapore Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Trust's preparation of financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Trustee-Manager, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the consolidated financial statements of the Group and the statement of financial position of the Trust are properly drawn up in accordance with the provisions of the Act and International Financial Reporting Standards to give a true and fair view of the state of affairs of the Group and of the Trust as at 31 December 2012 and the results, changes in unitholders' funds and cash flows of the Group for the year ended on that date.

*Emphasis of matter*

Without qualifying our opinion, we draw attention to Note 2.2 to the financial statements, which indicates that lenders of the amortising term loan facility with a carrying amount of US$430,218,000 as at 31 December 2012, have granted the Trust temporary relaxation of two loan covenants (relating to Security Value-to-Loan ratio and Debt Service Coverage ratio) for 12 months. The relaxation will expire on 30 June 2013, which falls within 6 months of the reporting date. Covenants under the original loan agreement will be reinstated from 1 July 2013 and the Trust may breach the original Security Value-to-Loan ratio and the Debt Service Coverage ratio covenants. Should the Trust breach either of the two loan covenants after the expiry of the relaxation period, lenders shall have the ability to exercise their remedies under the loan agreement. Management believes the estimated cash flows from the portfolio of vessels will be sufficient to meet the scheduled principal repayments and interest payments, and it intends to resolve such potential breach of these two loan covenants with the lenders prior to 30 June 2013.

The above circumstance indicates the existence of a material uncertainty that may affect the Group's ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this material uncertainty.

**Report on other legal and regulatory requirements**

In our opinion, the accounting and other records required by the Act to be kept by the Trustee-Manager and by those subsidiaries incorporated in Singapore of which we are the auditors, have been properly kept in accordance with the provisions of the Act.

KPMG LLP

**KPMG LLP**
*Public Accountants and*
*Certified Public Accountants*

**Singapore**
28 February 2013

**Statements of financial position**
**As at 31 December 2012**

| | | Group | | Trust | |
|---|---|---|---|---|---|
| | **Note** | **2012 US$'000** | **2011 US$'000** | **2012 US$'000** | **2011 US$'000** |
| **Assets** | | | | | |
| Vessels | 4 | 727,517 | 784,696 | – | – |
| Subsidiaries | 5 | – | – | 523,253 | 601,828 |
| Available-for-sale financial assets | 6 | 5,637 | – | – | – |
| Derivative assets | 7 | 47 | 426 | 47 | 426 |
| **Non-current assets** | | 733,201 | 785,122 | 523,300 | 602,254 |
| Derivative assets | 7 | 185 | 314 | 185 | 314 |
| Inventories | 8 | 519 | 998 | – | – |
| Trade and other receivables | 9 | 3,542 | 3,677 | 85,838 | 83,030 |
| Cash and cash equivalents | 10 | 37,488 | 32,304 | 29,604 | 28,877 |
| **Current assets** | | 41,734 | 37,293 | 115,627 | 112,221 |
| **Total assets** | | 774,935 | 822,415 | 638,927 | 714,475 |
| **Equity attributable to unitholders of the Trust** | | | | | |
| Units in issue | 11 | 525,412 | 525,412 | 525,412 | 525,412 |
| Reserves | 12 | (208,180) | (200,433) | (329,918) | (304,168) |
| **Total equity** | | 317,232 | 324,979 | 195,494 | 221,244 |
| **Liabilities** | | | | | |
| Financial liabilities | 13 | 390,710 | 437,561 | 390,710 | 437,561 |
| Deferred income | 14 | 6,455 | – | – | – |
| **Non-current liabilities** | | 397,165 | 437,561 | 390,710 | 437,561 |
| Trade and other payables | 15 | 7,037 | 7,326 | 684 | 3,122 |
| Financial liabilities | 13 | 52,039 | 52,548 | 52,039 | 52,548 |
| Deferred income | 14 | 1,444 | – | – | – |
| Current tax payable | | 18 | 1 | – | – |
| **Current liabilities** | | 60,538 | 59,875 | 52,723 | 55,670 |
| **Total liabilities** | | 457,703 | 497,436 | 443,433 | 493,231 |
| **Total equity and liabilities** | | 774,935 | 822,415 | 638,927 | 714,475 |

The accompanying notes form an integral part of these financial statements.

**Consolidated income statement**
**Year ended 31 December 2012**

| | Note | 2012 US$'000 | 2011 US$'000 |
|---|---|---|---|
| Revenue | 16 | 106,107 | 110,714 |
| Depreciation expense on vessels | | (57,196) | (59,688) |
| Impairment loss on vessels | 4 | – | (22,117) |
| Voyage expenses | | (10,545) | (13,569) |
| Vessel operating expenses | | (10,439) | (4,706) |
| Management fees | | (3,365) | (3,652) |
| Trustee fees | | (160) | (169) |
| Other trust expenses | | (5,122) | (3,409) |
| **Results from operating activities** | | 19,280 | 3,404 |
| Other income | | – | 5,000 |
| Finance income | 17 | 124 | 79 |
| Finance expenses | 17 | (27,782) | (25,549) |
| **Net finance expenses** | | (27,658) | (25,470) |
| **Loss before tax** | 18 | (8,378) | (17,066) |
| Income tax expense | 19 | (9) | – |
| **Loss for the year** | | (8,387) | (17,066) |
| **Income available for distribution** | 20 | 654 | 18,293 |
| **Distribution per unit (US cents)** | | 0.10 | 2.95 |
| **Earnings per unit (US cents)** | | | |
| Basic | 21 | (1.28) | (2.72) |
| Diluted | 21 | (1.28) | (2.72) |

The accompanying notes form an integral part of these financial statements.

**Consolidated statement of comprehensive income**
**Year ended 31 December 2012**

| | 2012<br>US$'000 | 2011<br>US$'000 |
|---|---|---|
| Loss for the year | (8,387) | (17,066) |
| **Other comprehensive income** | | |
| Translation differences relating to financial statements of foreign operations | 368 | (1,023) |
| Exchange differences on monetary items forming part of net investment in foreign operations | 155 | (977) |
| Effective portion of changes in fair value of cash flow hedges | (4,728) | (5,169) |
| Net change in fair value of cash flow hedges reclassified to income statement | 8,642 | 14,953 |
| Net change in fair value of available-for-sale financial assets | (2,488) | – |
| Tax on other comprehensive income | – | – |
| Other comprehensive income for the year, net of tax | 1,949 | 7,784 |
| **Total comprehensive income for the year** | (6,438) | (9,282) |

The accompanying notes form an integral part of these financial statements.

**Consolidated statement of changes in unitholders' funds**
**Year ended 31 December 2012**

| | Note | Units in issue US$'000 | Hedging reserve US$'000 | Foreign currency translation reserve US$'000 | Fair value reserve US$'000 | Accumulated losses US$'000 | Total equity US$'000 |
|---|---|---|---|---|---|---|---|
| **Group** | | | | | | | |
| At 1 January 2011 | | 510,273 | (25,997) | (943) | – | (140,885) | 342,448 |
| **Total comprehensive income for the year** | | | | | | | |
| **Loss for the year** | | – | – | – | – | (17,066) | (17,066) |
| **Other comprehensive income** | | | | | | | |
| Translation differences relating to financial statements of foreign operations | | – | – | (1,023) | – | – | (1,023) |
| Exchange differences on monetary items forming part of net investment in foreign operations | | – | – | (977) | – | – | (977) |
| Effective portion of changes in fair value of cash flow hedges | | – | (5,169) | – | – | – | (5,169) |
| Net change in fair value of cash flow hedges reclassified to income statement | | – | 14,953 | – | – | – | 14,953 |
| **Total other comprehensive income** | | – | 9,784 | (2,000) | – | – | 7,784 |
| **Total comprehensive income for the year** | | – | 9,784 | (2,000) | – | (17,066) | (9,282) |
| **Transactions with unitholders, recognised directly in equity** | | | | | | | |
| **Contributions by and distributions to unitholders** | | | | | | | |
| Units issued pursuant to equity placement | | 15,139 | – | – | – | – | 15,139 |
| Distributions to unitholders | 20 | – | – | – | – | (23,326) | (23,326) |
| **Total transactions with unitholders** | | 15,139 | – | – | – | (23,326) | (8,187) |
| **At 31 December 2011** | | 525,412 | (16,213) | (2,943) | – | (181,277) | 324,979 |

The accompanying notes form an integral part of these financial statements.

**Consolidated statement of changes in unitholders' funds (continued)**
**Year ended 31 December 2012**

| | Note | Units in issue US$'000 | Hedging reserve US$'000 | Foreign currency translation reserve US$'000 | Fair value reserve US$'000 | Accumulated losses US$'000 | Total equity US$'000 |
|---|---|---|---|---|---|---|---|
| **Group** | | | | | | | |
| At 1 January 2012 | | 525,412 | (16,213) | (2,943) | – | (181,277) | 324,979 |
| **Total comprehensive income for the year** | | | | | | | |
| **Loss for the year** | | – | – | – | – | (8,387) | (8,387) |
| **Other comprehensive income** | | | | | | | |
| Translation differences relating to financial statements of foreign operations | | – | – | 368 | – | – | 368 |
| Exchange differences on monetary items forming part of net investment in foreign operations | | – | – | 155 | – | – | 155 |
| Effective portion of changes in fair value of cash flow hedges | | – | (4,728) | – | – | – | (4,728) |
| Net change in fair value of cash flow hedges reclassified to income statement | | – | 8,642 | – | – | – | 8,642 |
| Net change in fair value of available-for-sale financial assets | | – | – | – | (2,488) | – | (2,488) |
| **Total other comprehensive income** | | – | 3,914 | 523 | (2,488) | – | 1,949 |
| **Total comprehensive income for the year** | | – | 3,914 | 523 | (2,488) | (8,387) | (6,438) |
| **Transactions with unitholders, recognised directly in equity** | | | | | | | |
| Distributions to unitholders | 20 | – | – | – | – | (1,309) | (1,309) |
| **Total transactions with unitholders** | | – | – | – | – | (1,309) | (1,309) |
| **At 31 December 2012** | | 525,412 | (12,299) | (2,420) | (2,488) | (190,973) | 317,232 |

The accompanying notes form an integral part of these financial statements.

**Consolidated statement of cash flows**
**Year ended 31 December 2012**

| | Note | 2012 US$'000 | 2011 US$'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Loss before tax | | (8,378) | (17,066) |
| Adjustments for: | | | |
| Depreciation expense on vessels | | 57,196 | 59,688 |
| Impairment loss on vessels | | – | 22,117 |
| Amortisation of debt transaction costs | | 1,369 | 2,615 |
| Amortisation of initial direct costs | | 633 | 554 |
| Amortisation of deferred income | | (225) | – |
| Interest income | | (124) | (79) |
| Interest expense | | 26,218 | 23,756 |
| Unrealised foreign exchange gain | | (126) | (831) |
| | | 76,563 | 90,754 |
| Changes in trade and other receivables | | 223 | 77 |
| Changes in inventories | | 479 | (260) |
| Changes in trade and other payables | | (25) | 452 |
| Lease income received in advance | | 1,416 | (1,196) |
| Release of pledge | | – | 2,800 |
| Cash generated from operations | | 78,656 | 92,627 |
| Income taxes refund/(paid) | | 8 | (8) |
| **Net cash from operating activities** | | 78,664 | 92,619 |
| | | | |
| **Cash flows from investing activities** | | | |
| Acquisition of vessels | | – | (93,183) |
| Costs incurred for dry-docking | | – | (18) |
| Interest received | | 100 | 87 |
| **Net cash from/(used in) investing activities** | | 100 | (93,114) |
| | | | |
| **Cash flows from financing activities** | | | |
| Proceeds from issuance of units (net of transaction costs) | | – | 15,139 |
| Distribution to unitholders | | (1,309) | (23,326) |
| Repayment of secured bank loans | | (44,000) | (506,264) |
| Net proceeds from secured bank loans | | – | 518,780 |
| Interest paid | | (28,271) | (24,576) |
| Security deposit | | (10,000) | – |
| **Net cash used in financing activities** | | (83,580) | (20,247) |
| | | | |
| **Net decrease in cash and cash equivalents** | | (4,816) | (20,742) |
| Cash and cash equivalents at 1 January | | 32,304 | 53,046 |
| **Cash and cash equivalents at 31 December** | 10 | 27,488 | 32,304 |

The accompanying notes form an integral part of these financial statements.

# Notes to the financial statements

These notes form an integral part of the financial statements.

The financial statements were authorised for issue by the Trustee-Manager on 28 February 2013.

## 1 Domicile and activities

First Ship Lease Trust (the "Trust") is a Singapore-domiciled business trust constituted pursuant to a Deed of Trust dated 19 March 2007 as amended and supplemented from time to time (the "Trust Deed") with FSL Trust Management Pte. Ltd. (the "Trustee-Manager"). The Trustee-Manager's registered office is 9 Temasek Boulevard, #19-03, Suntec Tower Two, Singapore 038989. The Trust Deed is governed by the laws of the Republic of Singapore. The Trustee-Manager is under a duty to take into custody and hold the assets of the Trust in trust for the unitholders as a whole.

The Trust was formally admitted to the Official List of the Singapore Exchange Securities Trading Limited on 27 March 2007.

The Trust is a provider of leasing services on a bareboat charter basis to the international shipping industry. It has a modern, high quality and diverse portfolio of 25 vessels consisting of 11 product tankers, seven containerships, three chemical tankers, two dry bulk carriers and two crude oil tankers as at 31 December 2012. As at the authorisation date of the financial statements, 22 vessels are employed on leases (20 vessels on long-term bareboat charters and two vessels on time charters) and have a dollar-weighted average remaining lease period of approximately five years (excluding extension periods and early buy-out options). The remaining three chemical tankers are employed in a chemical tanker pool. The combined portfolio of vessels has a dollar-weighted average age of approximately seven and a half years.

The consolidated financial statements relate to the Trust and its subsidiaries (together referred to as the "Group" and individually as "Group entities").

The Trust Deed provides the following fees payable to the Trustee-Manager:

*Management fees*

The Trustee-Manager is entitled to receive a management fee of 4.0% of the cash lease income in the relevant calendar year.

Any change in the structure of the management fee must be approved by an extraordinary resolution of a meeting of unitholders duly convened and held in accordance with the provisions of the Trust Deed.

The management fee payable to the Trustee-Manager is payable in the form of cash and/or units (as the Trustee-Manager may elect, such election to be irrevocable). Where the management fee is paid in cash, the amount is paid monthly, in arrears. Where the management fee is paid in the form of units, the amount is paid quarterly, in arrears.

*Incentive fees*

The Trustee-Manager is entitled to receive an incentive fee, payable quarterly and calculated as at 31 March, 30 June, 30 September and 31 December each year for the three-month period ending on each of the said dates. The incentive fee is determined on the basis of comparing the net distribution amount per unit against a benchmark quarterly distribution per unit in accordance with the formula stipulated in the Trust Deed.

The incentive fee payable to the Trustee-Manager is payable in the form of cash or, at the option of Trustee-Manager, by way of the issue of new units as soon as practicable after the end of the relevant quarter.

Any change in the structure of the incentive fees must be approved by an extraordinary resolution of a meeting of unitholders duly convened and held in accordance with the provisions of the Trust Deed.

*Trustee fees*

The Trustee-Manager is entitled to receive a trustee fee of 0.02% per annum of the value of the Trust Property (being all the assets of the Trust, as stipulated in the Trust Deed). The trustee fee is payable out of the Trust Property of the Trust in cash on a quarterly basis. Each quarterly payment shall be determined based on the value of the Trust Property as at the last day of the immediately preceding quarter and as reflected in the quarterly financial information of the Group for that quarter. The Trustee-Manager is also entitled to reimbursement of expenses incurred in the performance of its duties under the Trust Deed.

Any change in the structure of the trustee fee must be approved by an extraordinary resolution of a meeting of unitholders duly convened and held in accordance with the provisions of the Trust Deed.

*Other fees*

The Trustee-Manager is also entitled to the following:

- An acquisition fee amounting to 1.0% (or such lower percentage as may be determined by the Trustee-Manager in its absolute discretion) of the acquisition price of vessels acquired directly or indirectly by the Trust, pro-rated if applicable, to the proportion of the Trust’s interest. The acquisition fee is payable in the form of cash and/or units (as the Trustee-Manager may elect, such election to be irrevocable and made before the payment of the acquisition fee). No acquisition fee is payable on the acquisition of the initial portfolio of vessels.

- A disposal fee amounting to 0.5% (or such lower percentage as may be determined by the Trustee-Manager in its absolute discretion) of the sale price of vessels disposed, pro-rated if applicable, to the proportion of the Trust’s interest. The disposal fee is payable in cash.

Any increase in the acquisition fee or disposal fee above the permitted limit or any change in the structure of such fees shall be approved by an extraordinary resolution of a meeting of unitholders duly convened and held in accordance with the provisions of the Trust Deed.

# 2 Basis of preparation

## 2.1 Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

## 2.2 Basis of measurement

The financial statements have been prepared on the historical cost basis except for financial derivatives and certain financial assets and financial liabilities which are stated at fair value and/or amortised cost as set out in the accounting policies under note 3 of the financial statements.

The lenders of the amortising term loan facility with a carrying amount of US$430,218,000 as at 31 December 2012, have granted the Trust temporary relaxation of two loan covenants (relating to Security Value-to-Loan ratio and Debt Service Coverage ratio) for 12 months. The relaxation will expire on 30 June 2013, which falls within 6 months of the reporting date. Covenants under the original loan agreement will be reinstated from 1 July 2013 and the Trust may breach the original Security Value-to-Loan ratio and the Debt Service Coverage ratio covenants. Should the Trust breach either of the two loan covenants after the expiry of the relaxation period, lenders shall have the ability to exercise their remedies under the loan agreement. Management believes the estimated cash flows from the portfolio of vessels will be sufficient to meet the scheduled principal repayments and interest payments, and it intends to resolve such potential breach of these two loan covenants with the lenders prior to 30 June 2013.

The above circumstance indicates the existence of a material uncertainty that may affect the Group's ability to continue as a going concern. The accompanying financial statements do not include any adjustments that might result from the outcome of this material uncertainty.

## 2.3 Functional and presentation currency

The financial statements are presented in United States ("US") dollars which is the Trust's functional currency. All financial information presented in US dollars has been rounded to the nearest thousand, unless otherwise stated.

## 2.4 Use of estimates and judgements

The preparation of financial statements in conformity with IFRS requires the Trustee-Manager to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the financial statements is included in the following notes:

- Note 3.6 – classification of leases;
- Note 4 – impairment assessment and recoverable amounts of vessels; and depreciation, useful lives and residual values of vessels; and
- Note 22 – valuation of financial instruments.

## 3 Significant accounting policies

The accounting policies used by the Group have been applied consistently to all periods presented in these financial statements, and have been applied consistently by Group entities.

With effect from 1 January 2012, the Group has adopted all the applicable new and revised IFRS that are mandatory for application from that date.

The adoption of these new and revised IFRS had no significant impact to these financial statements.

### 3.1 Consolidation

***Subsidiaries***

Subsidiaries are entities controlled by the Group. Control exists when the Group has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries have been changed where necessary to align them with the policies adopted by the Group.

***Transactions eliminated on consolidation***

Intra-group balances and transactions, and any unrealised income or expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealised losses are eliminated only to the extent that there is no evidence of impairment.

***Accounting for subsidiaries by the Trust***

Investments in subsidiaries are stated in the Trust's statement of financial position at cost less accumulated impairment losses.

## 3.2 Foreign currencies

***Foreign currency transactions***

Transactions in foreign currencies are translated to the respective functional currencies of the Group entities at the exchange rate at the date of the transaction. The functional currencies of the Group entities are the US dollar and the Euro. Monetary assets and liabilities denominated in foreign currencies at the end of the reporting period are retranslated to the functional currency at the exchange rate at that date. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognised in profit or loss, except for differences arising on the retranslation of monetary items that in substance form part of the Group's net investment in a foreign operation (see below).

***Foreign operations***

The assets and liabilities of foreign operations are translated to US dollars at exchange rates at the end of the reporting date. The income and expenses of foreign operations are translated to US dollars at exchange rates prevailing at the dates of the transactions.

Foreign currency differences are recognised in other comprehensive income, and presented within equity in the foreign currency translation reserve. When a foreign operation is disposed of, in part or in full, the relevant amount in the foreign exchange translation reserve is transferred to the income statement.

***Net investment in a foreign operation***

Exchange differences arising from monetary items that in substance form part of the Trust's net investment in a foreign operation are recognised in other comprehensive income, and are presented within equity in the foreign currency translation reserve in the consolidated financial statements. When the foreign operation is disposed of, the cumulative amount in the foreign currency translation reserve is transferred to the income statement as an adjustment to the profit or loss arising on disposal.

## 3.3 Vessels

Vessels are stated at cost less accumulated depreciation and impairment losses.

Cost includes expenditure that is directly attributable to the acquisition of the vessel as well as initial direct costs incurred in negotiating and arranging the operating lease of the vessel.

The cost of replacing part of an item of vessel is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably.

Except as described below, depreciation on vessels leased on a bareboat charter basis under operating lease agreements is recognised in the income statement on a straight-line basis down to the estimated residual value at the end of the base lease term, which ranges from nine to twelve years. The estimated residual value is based on regression analysis of the median historical values for standard vessels obtained from third party sources, and for non-standard vessels obtained from specialised brokers.

Vessels deployed on spot arrangement, time charter, pool arrangement or bareboat charter with rentals based on market rates, are depreciated on a straight-line basis at rates which are calculated to write-down their cost to their estimated residual values at the end of the economic useful life of 25 years. The residual value of such vessel is estimated based on the average scrap steel price per light deadweight tonne in recent years.

Depreciation methods, useful lives and residual values are reviewed, and adjusted as appropriate, at each reporting date.

Dry-docking costs are capitalised and depreciated on a straight-line basis over the period to the next scheduled dry-docking, which is generally five years.

## 3.4 Inventories

Inventories comprise bunkers and consumable stores. Inventories are stated at the lower of cost and net realisable value. Cost is derived on a weighted average basis. Net realisable value is the estimated selling price in the ordinary course of business less applicable variable selling expenses. When inventories are consumed, the carrying amount of these inventories is recognised as an expense in the year in which the consumption occurs.

## 3.5 Financial instruments

***Non-derivative financial instruments***

A financial instrument is recognised if the Group becomes a party to the contractual provisions of the instrument. Financial assets are derecognised if the Group's contractual rights to the cash flows from the financial assets expire or if the Group transfers the financial asset to another party without retaining control or transfers substantially all the risks and rewards of the asset. Regular purchases and sales of financial assets are accounted for at trade date, i.e. the date that the Group commits itself to purchase or sell the asset. Financial liabilities are derecognised if the Group's obligations specified in the contract expire or are discharged or cancelled.

***Non-derivative financial assets***

The Group classifies non-derivative financial assets into the following categories: loans and receivables and available-for-sale financial assets.

***Loans and receivables***

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest method, less any allowance for impairment losses.

Loans and receivables comprise trade and other receivables, and cash and cash equivalents.

Cash and cash equivalents comprise cash balances and bank deposits.

***Available-for-sale financial assets***

Available-for-sale financial assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses, are recognised in other comprehensive income and presented in the fair value reserve in equity. When an investment is derecognised, the gain or loss accumulated in equity is reclassified to income statement.

Available-for-sale financial assets comprise equity securities.

***Non-derivative financial liabilities***

The Group classifies non-derivative financial liabilities into other financial liabilities category. Such financial liabilities are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest method.

Other financial liabilities comprise bank loans, and trade and other payables.

***Derivative financial instruments and hedging activities***

The Group holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss.

Derivatives are recognised initially at fair value; attributable transaction costs are recognised in the income statement when incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

***Cash flow hedges***

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in other comprehensive income and transferred to hedging reserve in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in the income statement.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases, the amount recognised in equity is transferred to the income statement in the same period that the hedged item affects profit or loss.

***Impairment of financial assets***

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

***Impairment of financial assets: loans and receivables***

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Significant loans and receivables are tested for impairment on an individual basis. The remaining loans and receivables are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in the income statement.

An impairment loss in respect of financial assets measured at amortised cost is reversed if the subsequent increase in fair value can be related objectively to an event occurring after the impairment loss was recognised. The reversal is recognised in the income statement.

***Impairment of financial assets: available-for-sale financial assets***

Impairment losses on available-for-sale financial assets are recognised by reclassifying the losses accumulated in the fair value reserve in equity to income statement. The cumulative loss that is reclassified from equity to income statement is the difference between the acquisition cost and the current fair value, less any impairment loss recognised previously in income statement. Any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognised in other comprehensive income.

***Units in issue***

Units issued are classified as equity.

Unit issue costs represent expenses incurred in connection with the issue of units. All such expenses are deducted directly from unitholders' funds, net of any tax effects.

## 3.6 Leases

***When entities within the Group are lessors of an operating lease***

Bareboat/time charter

The Group owns vessels and leases them to lessees under fixed and floating rate bareboat/time charter arrangements. These charters are classified as operating leases. In determining lease classification at inception, the Group evaluated the terms and conditions of the charter arrangement. As the present values of minimum lease payments do not amount to substantially the fair values of the vessels, and the purchase options, where applicable, are not expected to be sufficiently lower than the fair values at the date the options become exercisable, the Group judged that substantially all the risks and rewards of the vessels remain with the Group.

Lease income is recognised in the income statement on a straight-line basis over the lease term. Initial direct costs incurred by the Group in negotiating and arranging an operating lease added to the carrying amount of the leased asset are recognised as an expense in the income statement over the lease term on the same basis as the lease income.

## 3.7 Impairment – non-financial assets

The carrying amounts of the Group's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amounts are estimated.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. A cash-generating unit is the smallest identifiable asset group that generates cash flows that largely are independent from other assets and groups. Impairment losses are recognised in the income statement. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the assets in the unit (group of units) on a pro rata basis.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or cash-generating unit.

An impairment loss in respect of non-financial assets recognised in prior periods is assessed at each reporting date for any indications that the loss has decreased or no longer exists.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

## 3.8 Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability.

## 3.9 Revenue recognition

Lease income receivable under operating leases is recognised in the income statement over the period of the respective lease terms.

Deferred income, arising from the shares in TORM A/S ("TORM") received by the Group as part of an agreement to permanently amend the terms on its two TORM charter contracts, is recognised in the income statement as 'bareboat charter lease income' over the remaining lease term on the TORM charter contracts.

For vessels deployed in the spot market, freight income is recognised based on percentage of completion method calculated on a discharge-to-discharge basis over the voyage period.

For vessels deployed on pool arrangement, the pool measures revenue based on the contractual rates and the duration of each voyage for each vessel, and revenue is recognised upon delivery of service in accordance with the terms and conditions of the charter parties on a time charter equivalent basis. Total pool revenue is derived by aggregating the revenues earned by each vessel participating in the pool. Each vessel owner's share of the total pool revenue is primarily dependent on the i) number of days the vessel has been available for the pool in relation to the total available pool earning days during the period, and ii) pool points assigned to each vessel in the pool. Pool points are determined based on the size and performance of the vessel. The pool revenue is net of pool commission, bunkers costs and related voyage expenses.

## 3.10 Finance income and finance expense

Finance income comprises interest income on funds invested, net foreign currency gains and gains on hedging instruments that are recognised in the income statement. Interest income is recognised as it accrues, using the effective interest method.

Finance expense comprises interest expense on borrowings, net foreign currency losses, impairment losses recognised on financial assets, and losses on hedging instruments that are recognised in the income statement.

All borrowing costs are recognised in the income statement using the effective interest method, except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to be prepared for its intended use or sale.

## 3.11 Income tax expense

Income tax expense comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in other comprehensive income or in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that it is probable that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted at the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

The lease income derived by the Group's entities from the respective bareboat charter and time charter agreements qualifies for tax exemption under the Maritime Sector Incentive ("MSI") scheme (previously known as the Maritime Finance Incentive scheme), with effect from 19 March 2007. This tax exemption on the qualifying income will be granted for the remaining useful life of any vessel that is acquired by the Trust during the initial period of 10 years from the effective date. The distributions made out of the tax exempt income less allowable expenses will also be exempt from Singapore income tax in the hands of the unitholders. The freight income and pool income derived by the Group is also exempted from tax under Section 13A of the Singapore Income Tax Act, Chapter 134.

The Group is subject to tax on its non-tax exempt income such as interest income at the prevailing corporate tax rate, after adjusting for allowable expenses.

## 3.12 New standards and interpretations not adopted

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these financial statements. Those new standards, amendments to standards and interpretations that require significant re-assessment of current assumptions and relevant to the financial statements of the Group, are set out below:

- IFRS 10 *Consolidated Financial Statements*, which changes the definition of control such that an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power with the investee. IFRS 10 introduces a single control model with a series of indicators to assess control. IFRS 10 also adds additional context, explanation and application guidance based on the principle of control.

- IFRS 12 *Disclosure of Interests in Other Entities*, which sets out the disclosures required to be made in respect of all forms of an entity's interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities.

- IFRS 13 *Fair Value Measurement*, which replaces the existing guidance on fair value measurement in different IFRS with a single definition of fair value. The standard also establishes a framework for measuring fair values and sets out the disclosure requirements for fair value measurements.

The adoption of the above standards is not expected to have any material impact on the Group's financial statements.

# 4 Vessels

| Group | Vessels US$'000 | Initial direct costs US$'000 | Total US$'000 |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2011 | 981,132 | 6,124 | 987,256 |
| Additions | 92,018 | 1,183 | 93,201 |
| Translation differences on consolidation | (2,705) | – | (2,705) |
| At 31 December 2011 | 1,070,445 | 7,307 | 1,077,752 |
| Translation differences on consolidation | 1,464 | – | 1,464 |
| At 31 December 2012 | 1,071,909 | 7,307 | 1,079,216 |
| **Accumulated depreciation/amortisation** | | | |
| At 1 January 2011 | 210,297 | 1,936 | 212,233 |
| Depreciation/amortisation charge for the year | 59,688 | 554 | 60,242 |
| Impairment losses | 22,117 | – | 22,117 |
| Translation differences on consolidation | (1,536) | – | (1,536) |
| At 31 December 2011 | 290,566 | 2,490 | 293,056 |
| Depreciation/amortisation charge for the year | 57,196 | 633 | 57,829 |
| Translation differences on consolidation | 814 | – | 814 |
| At 31 December 2012 | 348,576 | 3,123 | 351,699 |
| **Carrying amount** | | | |
| At 1 January 2011 | 770,835 | 4,188 | 775,023 |
| At 31 December 2011 | 779,879 | 4,817 | 784,696 |
| At 31 December 2012 | 723,333 | 4,184 | 727,517 |

All of the Group's vessels, with a net carrying value of US$723,333,000 (2011: US$779,879,000), are mortgaged to financial institutions (see note 13).

***Depreciation, useful lives and residual values of vessels***

Vessels leased on a bareboat charter basis under operating lease arrangements

Except for bareboat charters with rentals based on market rates, these vessels are depreciated on a straight-line basis at rates which are calculated to write-down their cost to their estimated residual values at the end of the base lease term, excluding any early buy-out options or extended lease periods. At the reporting date, the Group considered the base lease term to be the period which the vessels are expected to be available for use by the lessees. Therefore, should there be any notification received from the lessees to exercise the early buy-out option or to extend the lease period beyond the base lease term, the depreciation expense of the Group's vessels in the future periods may therefore be revised.

The residual value is reviewed at each reporting date, with any change in estimate accounted for as a change in estimate prospectively. The residual value of such vessel is estimated based on regression analysis of the median historical values for standard vessels obtained from third party sources, and for non-standard vessels obtained from specialised brokers. Factors such as asset price, quality and fungibility are also taken into consideration to determine the acceptable level of residual value. Any significant changes in the residual value of the Group's vessels in future periods can affect the depreciation expense.

Vessels deployed on time charter, pool arrangement and bareboat charters with rentals based on market rates

These vessels are depreciated on a straight-line basis at rates which are calculated to write-down their cost to their estimated residual values at the end of the economic useful life of 25 years.

The residual value is reviewed at each reporting date, with any change in estimate accounted for as a change in estimate prospectively. The residual value of such vessel is estimated based on the average scrap steel price per light deadweight tonne in recent years.

Changes in estimates

i) Vessels deployed on pool arrangement

Following the lease payment default by the lessees of three chemical tankers, *FSL New York*, *FSL London* and *FSL Tokyo* (previously known as *Pertiwi*, *Pujawati* and *Prita Dewi*, respectively) in February 2012, the recoverable amount of these vessels as at 31 December 2011 was re-assessed and an impairment loss of US$22,117,000 was recognised in 2011 as the payment default was assessed to be an adjusting post-balance sheet event for the year ended 31 December 2011. These vessels were re-delivered to the Trust and are currently deployed in 'Nordic Tankers 19,000 Stainless Steel Pool'. With the change in charter arrangement, the expected useful life of each of the three vessels has been revised from 12 to 25 years and the basis of estimate for residual value has also changed. The changes in the expected useful life and residual value of these three vessels constitute a change in estimates and the effects of the change have been applied prospectively from 1 January 2012.

The effects of these changes on depreciation expense in the current year and future years are as follows:

| | 2012<br>US$'000 | 2013 to 2014<br>US$'000 | 2015<br>US$'000 |
|---|---|---|---|
| Decrease in depreciation expense | (3,906) | (7,812) | (3,906) |

ii) Vessels leased on bareboat charters with rentals based on market rates

In April 2012, the various stakeholders of TORM (including the Trust) agreed upon a restructuring plan, which was subsequently signed on 2 October 2012. Under the restructuring agreement, the various early buyout, purchase and lease extension options were cancelled and the contracted bareboat charter rates are realigned to rates that TORM achieves in the tanker market. In view of these revised terms, the expected useful life of each of the two vessels has been revised from seven to 25 years and the basis of estimate for residual value has also changed. The changes in the expected useful life and residual value of these two vessels constitute a change in estimates and the effects of the change have been applied prospectively from 1 April 2012.

The effects of these changes on depreciation expense in the current year and future years are as follows:

| | 2012<br>US$'000 | 2013 to 2014<br>US$'000 | 2015<br>US$'000 |
|---|---|---|---|
| Decrease in depreciation expense | (799) | (2,132) | (1,066) |

***Impairment assessment of vessels***

Impairment loss is recognised when events and circumstances indicate that the vessel may be impaired and the carrying amount of the vessel exceeds the recoverable amount. The recoverable amount for each vessel is determined based on the higher of fair value less costs to sell and value-in-use calculation.

The fair value is determined based on valuation report from independent shipbrokers. The valuation of vessels was prepared assuming a sale between a willing seller and a willing buyer on a charter-free basis.

The recoverable amount of the Group's vessels is determined based on value-in-use calculation.

<u>Vessels leased on a bareboat charter basis under operating lease arrangements</u>

Except for bareboat charters with rentals based on market rates, the value-in-use calculation uses cash flow projections based on the contractual cash flows over the period of the base lease term and projected residual value, discounted at rates which reflect the specific risks relating to each vessel.

The Group does not consider the 18 vessels leased on a bareboat charter basis under operating lease arrangements (2011: 20 vessels) to be impaired.

<u>Vessels deployed on time charter, pool arrangement and bareboat charters with rentals based on market rates</u>

The value-in-use calculation uses projected cash flows over the remaining useful life of each vessel. The pre-tax discount rate of 7.76% (2011: 7.76%) takes into account the time value of money and the risks specific to the vessels' estimated cash flows. The projected cash inflows are based on inflation-adjusted daily rates from observable historical trends and forecasted rates by independent third parties, under a one-year time charter arrangement for vessels of similar specifications. The projected cash outflows take into account these vessels' projected operating expenses. The terminal value of each vessel is determined based on the average scrap steel price per light deadweight tonne in recent years.

## 5 Subsidiaries

| | Trust | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| Equity investments, at cost | 121,981 | 119,359 |
| Amounts due from subsidiaries (non-trade) | 401,272 | 482,469 |
| | 523,253 | 601,828 |

Details of the subsidiaries are as follows:

| **Name of subsidiaries** | **Country of Incorporation** | **Effective equity held by the Group** | |
|---|---|---|---|
| | | **2012** | **2011** |
| | | **%** | **%** |
| FSL-1, Inc. | Marshall Islands | 100 | 100 |
| FSL-2, Inc. | Marshall Islands | 100 | 100 |
| FSL-3, Inc. | Marshall Islands | 100 | 100 |
| FSL-4, Inc. | Marshall Islands | 100 | 100 |
| FSL-5, Inc. | Marshall Islands | 100 | 100 |
| FSL-6, Inc. | Marshall Islands | 100 | 100 |
| FSL-7, Inc. | Marshall Islands | 100 | 100 |
| FSL-8, Inc. | Marshall Islands | 100 | 100 |
| FSL-9 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-10 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-11 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-12 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-13 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-14, Inc. | Marshall Islands | 100 | 100 |
| FSL-15, Inc. | Marshall Islands | 100 | 100 |
| FSL-16, Inc. | Marshall Islands | 100 | 100 |
| FSL-18 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-19 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-20, Inc. | Marshall Islands | 100 | 100 |
| FSL-21, Inc. | Marshall Islands | 100 | 100 |
| FSL-22, Inc. | Marshall Islands | 100 | 100 |
| FSL-23 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-24 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-25 Pte. Ltd. | Singapore | 100 | 100 |
| FSL-26 Pte. Ltd. | Singapore | 100 | 100 |
| FSL Netherlands B.V. | Netherlands | 100 | – |

KPMG LLP, Singapore are the auditors for all of the Singapore-incorporated subsidiaries. No statutory audit is required for subsidiaries incorporated in Marshall Islands and in Netherlands under the laws of incorporation.

The amounts due from subsidiaries are unsecured and interest-free. As the amounts are, in substance, part of the Trust's net investments in the subsidiaries, they are included as interests in subsidiaries and stated at cost less impairment losses.

All of the Singapore-flagged vessel-owning subsidiaries are subject to externally imposed capital requirements as required under Regulation 5 of the Merchant Shipping (Registry of Ships) Regulations. These subsidiaries have complied with the requirements during the financial year.

## 6 Available-for-sale financial assets

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| **Non-current** | | |
| Available-for-sale financial assets: Equity securities | 5,637 | – |

Available-for-sale financial assets relate to the shares in TORM received by the Group as part of an agreement to permanently amend the terms on its two charter contracts. The Group's shareholding in the enlarged share capital of TORM is approximately 2.5%.

## 7 Derivative assets

| | Group and Trust | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| **Non-current** | | |
| Financial derivatives | 47 | 426 |
| **Current** | | |
| Financial derivatives | 185 | 314 |

The derivative financial assets relate to the cumulative fair value change of hedged instruments designated as cash flow hedges. The following are the expected contractual undiscounted cash inflows of derivatives:

| | **Carrying amount** | **Cash flows** | | |
|---|---|---|---|---|
| | | **Contractual cash flows** | **Within 1 year** | **Within 1 to 5 years** |
| **Group and Trust** | **US$'000** | **US$'000** | **US$'000** | **US$'000** |
| **2012** | | | | |
| **Derivative financial assets** | | | | |
| Cross currency swap contracts used for hedging | | | | |
| - inflows | 232 | 233 | 185 | 48 |

| | Carrying amount | Cash flows | | |
|---|---|---|---|---|
| | | Contractual cash flows | Within 1 year | Within 1 to 5 years |
| **Group and Trust** | **US$'000** | **US$'000** | **US$'000** | **US$'000** |
| **2011** | | | | |
| **Derivative financial assets** | | | | |
| Cross currency swap contracts used for hedging | | | | |
| - inflows | 740 | 746 | 314 | 432 |

## 8 Inventories

| | Group | | Trust | |
|---|---|---|---|---|
| | 2012 US$'000 | 2011 US$'000 | 2012 US$'000 | 2011 US$'000 |
| Bunkers | – | 716 | – | – |
| Consumable stores | 519 | 282 | – | – |
| | 519 | 998 | – | – |

## 9 Trade and other receivables

| | Group | | Trust | |
|---|---|---|---|---|
| | 2012 US$'000 | 2011 US$'000 | 2012 US$'000 | 2011 US$'000 |
| Other receivables | 1,863 | 374 | 44 | 352 |
| Amounts due from subsidiaries (non-trade) | – | – | 85,624 | 82,513 |
| Trade receivables | 956 | 2,951 | – | – |
| Loans and receivables | 2,819 | 3,325 | 85,668 | 82,865 |
| Prepayments | 723 | 352 | 170 | 165 |
| | 3,542 | 3,677 | 85,838 | 83,030 |

The amounts due from subsidiaries are unsecured, interest-free and repayable on demand. There is no allowance for doubtful debts arising from the outstanding balances.

The ageing of trade receivables at the reporting date was:

| | Group | |
|---|---|---|
| | 2012 US$'000 | 2011 US$'000 |
| Past due 1 – 30 days | 956 | 2,796 |
| Past due 31 – 60 days | – | 18 |
| Past due 61 – 90 days | – | 93 |
| More than 90 days | – | 44 |
| | 956 | 2,951 |

No impairment allowance is necessary for trade receivables, including the past due receivables as there are no indications from customers on their inability to pay their outstanding balances.

## 10 Cash and cash equivalents

| | Group | | Trust | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| | **US$'000** | **US$'000** | **US$'000** | **US$'000** |
| Restricted cash | 10,000 | – | 10,000 | – |
| Fixed deposits with financial institutions | 21,765 | 25,410 | 18,996 | 25,410 |
| Cash at bank | 5,723 | 6,894 | 608 | 3,467 |
| Cash and cash equivalents in the Statement of Financial Position | 37,488 | 32,304 | 29,604 | 28,877 |
| Less: Restricted cash | (10,000) | – | (10,000) | – |
| Cash and cash equivalents in the Consolidated Statement of Cash Flows | 27,488 | 32,304 | 19,604 | 28,877 |

In connection with the temporary relaxation of two loan covenants under the term loan facility, a deposit of US$10,000,000 was placed with the security agent of the term loan facility (see note 13).

The weighted average effective interest rate relating to fixed deposits at the reporting date for the Group and Trust is 0.31% (2011: 0.22%) per annum. Interest rates reprice at intervals within 3 months.

All the cash and cash equivalents are primarily denominated in the functional currencies of the Group entities.

## 11 Units in issue

| | Group and Trust | |
|---|---|---|
| | **2012** | **2011** |
| | **Number of units** | **Number of units** |
| **Fully paid units:** | **'000** | **'000** |
| At 1 January | 654,665 | 598,665 |
| Issue of units pursuant to equity placement | – | 56,000 |
| At 31 December | 654,665 | 654,665 |

In 2009 and 2011, the Trust carried out equity placement exercises. The proceeds from the equity placements have been deployed for acquisition of two vessels, *TORM Margrethe* and *TORM Marie*, in 2011. The unit issue costs, comprising professional, advisory and other costs relating to the issuance of units in the Trust, were deducted directly against the unitholders' funds.

Each unit in the Trust represents an undivided interest in the Trust. The rights and interests of unitholders are contained in the Trust Deed and include the right to:

- receive income and other distributions attributable to the units held;
- participate in the termination of the Trust by receiving a share of all net cash proceeds derived from the realisation of the assets of the Trust less any liabilities, in accordance with their proportionate interests in the Trust;
- exercise one vote per unit at all unitholders' meetings; and
- receive audited accounts and the annual report of the Trust.

The restrictions of a unitholder include the following:

- a unitholder has no right to request the Trustee-Manager to transfer to him any assets (or part thereof) or of any estate or interest in any asset (or part thereof) of the Trust;
- a unitholder cannot give any directions to the Trustee-Manager (whether at a meeting of unitholders or otherwise) if it would require the Trustee-Manager to do or omit doing anything which may result in:
    - the Trust ceasing to comply with applicable laws and regulations; or
    - the exercise of any discretion expressly conferred to the Trustee-Manager by the Trust Deed.
- a unitholder's right is limited to the right to require due administration of the Trust in accordance with the provisions of the Trust Deed; and
- a unitholder has no right to request the Trustee-Manager to redeem his units while the units are listed on Singapore Exchange Securities Trading Limited.

A unitholder's liability is limited to the amount paid or payable for any units in the Trust. The provisions of the Trust Deed provide that no unitholders will be personally liable to indemnify the Trustee-Manager or any creditor of the Trustee-Manager in the event the liabilities of the Trust exceed its assets.

***Capital management***

The Trustee-Manager defines "capital" to include funds raised through the issuance of units, revenue reserves and proceeds raised from debt facilities. The Trustee-Manager's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the Trust. The Trustee-Manager monitors the distribution per unit, which is the annualised distribution to unitholders divided by total number of units.

The cash flows from the operating activities of the Trust are sufficient to fund the anticipated debt service, quarterly distributions to unitholders, payments to Trustee-Manager and working capital requirements. To the extent that financing for additional vessels is required, additional equity or debt securities may be issued or additional secured borrowings may be incurred.

There were no changes in the Trust's approach to capital management during the year.

The Trust is not subject to externally or regulatory imposed capital requirements.

## 12 Reserves

| | Group | | Trust | |
|---|---|---|---|---|
| | **2012** **US$'000** | **2011** **US$'000** | **2012** **US$'000** | **2011** **US$'000** |
| Hedging reserve | (12,299) | (16,213) | (12,299) | (16,213) |
| Foreign currency translation reserve | (2,420) | (2,943) | – | – |
| Fair value reserve | (2,488) | – | – | – |
| Accumulated losses | (190,973) | (181,277) | (317,619) | (287,955) |
| | (208,180) | (200,433) | (329,918) | (304,168) |

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments until they are derecognised or impaired.

The foreign currency translation reserve comprises:

(a) foreign exchange differences arising from the translation of the financial statements of foreign operations whose functional currencies are different from the functional currency of the Trust; and

(b) foreign exchange differences on monetary items which form part of the Group's net investment in foreign operations.

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale financial assets until the investments are derecognised or impaired.

The accumulated losses were arrived after deduction of distributions to unitholders. Under the Singapore Business Trusts Act, the distribution to unitholders is allowed even when the cumulative distributions were in excess of the cumulative accounting profits recorded.

## 13 Financial liabilities

| | Group and Trust | |
|---|---|---|
| | **2012** **US$'000** | **2011** **US$'000** |
| **Non-current** | | |
| Secured bank loans | 386,218 | 428,780 |
| Financial derivatives | 4,492 | 8,781 |
| | 390,710 | 437,561 |
| **Current** | | |
| Secured bank loans | 44,000 | 44,000 |
| Financial derivatives | 8,039 | 8,548 |
| | 52,039 | 52,548 |

The Trustee-Manager, on behalf of the Trust, secured a 6-year amortising term loan facility with an outstanding loan balance of US$435,558,000 as at 31 December 2012.

Under the term loan facility, the Trust will make quarterly loan repayments of US$11,000,000 and a lump sum repayment on maturity date.

The term loan facility is secured on the following:

(i) a first priority mortgage over the Group's vessels in the portfolio;

(ii) a first priority assignment of the Group's rights, title, interest in the insurances to and for each vessel, including insurance for hull and machinery, protection and indemnity and war risks;

(iii) a first priority assignment of the Group's rights, title and interest in and to the charter agreements and the charter income of each vessel; and

(iv) a pledge over the Group's shares in TORM.

In June 2012, the Trustee-Manager secured a temporary relaxation of two loan covenants from the lenders for 12 months until 30 June 2013 ("Relaxation Period"):

(i) the minimum security value-to-loan ("VTL") ratio is reduced from 125% to 100%; and

(ii) debt service coverage ratio is reduced from at least 1.1:1 to at least 1:1.

During the Relaxation Period, the Trust is restricted from paying any distributions to unitholders. In addition, a US$10,000,000 security deposit is placed with the security agent, and a levy of 2% per annum is imposed on the shortfall amount, which is the difference between the outstanding loan balance and the theoretical loan balance assuming VTL ratio is 125%.

### *Terms and debt repayment schedule*

The interest margin on the term loan facility is as follows:

| **31 December 2012** | | **31 December 2011** | |
|---|---|---|---|
| **VTL ratio** | **Margin over US$ 3-month LIBOR** | **VTL ratio** | **Margin over US$ 3-month LIBOR** |
| >100% to 140% | 3.0% | >125% to 140% | 3.0% |
| >140% to 180% | 2.8% | >140% to 180% | 2.8% |
| >180% | 2.6% | >180% | 2.6% |

As at 31 December 2012, the applicable margin over US$ 3-month LIBOR was 3.0% (2011: 3.0%). The VTL ratio will be assessed semi-annually.

The terms and conditions of the term loan facility are as follows:

| Group and Trust | Nominal interest rate | Year of maturity | Face value US$'000 | Carrying amount US$'000 |
|---|---|---|---|---|
| **2012** | | | | |
| US$ floating rate loans | US$ 3-month LIBOR + applicable margin | 2017 | 435,558* | 430,218 |

* Before the deduction of unamortised debt transaction costs of US$5,340,000.

| Group and Trust | Nominal interest rate | Year of maturity | Face value US$'000 | Carrying amount US$'000 |
|---|---|---|---|---|
| **2011** | | | | |
| US$ floating rate loans | US$ 3-month LIBOR + applicable margin | 2017 | 479,558^ | 472,780 |

^ Before the deduction of unamortised debt transaction costs of US$6,778,000.

The following are the expected contractual undiscounted cash outflows, including interest payments and excluding the impact of netting agreements:

| Group and Trust | Carrying amount US$'000 | Cash flows: Contractual cash flows US$'000 | Within 1 year US$'000 | Within 1 to 5 years US$'000 | After 5 years US$'000 |
|---|---|---|---|---|---|
| **2012** | | | | | |
| **Non-derivative financial liabilities** | | | | | |
| US$ floating rate loans^ | 430,440 | (499,728) | (58,966) | (440,762) | – |
| **2011** | | | | | |
| **Non-derivative financial liabilities** | | | | | |
| US$ floating rate loans^ | 473,348 | (574,838) | (61,928) | (239,516) | (273,394) |

^ Inclusive of accrued interest as at the reporting date.

The derivative financial liabilities relate to the cumulative fair value change of hedged instruments designated as cash flow hedges. The following are the expected contractual undiscounted cash outflows of derivatives:

| | Carrying amount | Cash flows | | |
|---|---|---|---|---|
| **Group and Trust** | **US$'000** | **Contractual cash flows US$'000** | **Within 1 year US$'000** | **Within 1 to 5 years US$'000** |
| **2012** | | | | |
| **Derivative financial liabilities** | | | | |
| Interest rate swaps used for hedging | | | | |
| - outflows | 12,531 | 12,801 | 8,277 | 4,524 |
| **2011** | | | | |
| **Derivative financial liabilities** | | | | |
| Interest rate swaps used for hedging | | | | |
| - outflows | 17,329 | 19,025 | 10,131 | 8,894 |

## 14 Deferred income

| | Group 2012 US$'000 | Group 2011 US$'000 |
|---|---|---|
| **Non-current** | | |
| Deferred income | 6,455 | – |
| **Current** | | |
| Deferred income | 1,444 | – |

Deferred income is recognised on the Statement of Financial Position upon the receipt of shares in TORM by the Group and is amortised to the Income Statement over the remaining lease term on the TORM charter contracts.

## 15 Trade and other payables

| | Group | | Trust | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | US$'000 | US$'000 | US$'000 | US$'000 |
| Trade payables | 181 | 208 | 34 | 83 |
| Accrued financing expenses | 444 | 2,121 | 444 | 2,121 |
| Accrued operating expenses | 2,600 | 2,325 | 197 | 918 |
| Lease income received in advance | 2,903 | 1,486 | – | – |
| Other payables | 909 | 1,186 | 9 | – |
| | 7,037 | 7,326 | 684 | 3,122 |

The following are the expected contractual undiscounted cash outflows, excluding the impact of netting agreements:

| | Carrying amount | Cash flows | |
|---|---|---|---|
| | | Contractual cash flows | Within 1 year |
| **Group** | **US$'000** | **US$'000** | **US$'000** |
| **2012** | | | |
| **Non-derivative financial liabilities** | | | |
| Trade and other payables | 3,690 | (3,690) | (3,690) |
| **2011** | | | |
| **Non-derivative financial liabilities** | | | |
| Trade and other payables | 3,719 | (3,719) | (3,719) |
| **Trust** | | | |
| **2012** | | | |
| **Non-derivative financial liabilities** | | | |
| Trade and other payables | 240 | (240) | (240) |
| **2011** | | | |
| **Non-derivative financial liabilities** | | | |
| Trade and other payables | 1,001 | (1,001) | (1,001) |

## 16 Revenue

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| Bareboat charter lease income | 76,347 | 89,124 |
| Freight income | 18,996 | 21,590 |
| Time charter income | 4,834 | – |
| Pool income | 5,930 | – |
| | 106,107 | 110,714 |

Bareboat charter lease income relates to lease income derived from operating leases. Included in bareboat charter lease income, US$225,000 (2011: US$ Nil) relates to recognition of the deferred income in the income statement for the year (see note 14).

Freight income relates to income derived from (i) two product tankers, *FSL Hamburg* and *FSL Singapore*, before the commencement of time charter arrangements with Petròleo Brasileiro S.A. ("Petrobras") and (ii) three chemical tankers, *FSL New York*, *FSL London* and *FSL Tokyo*, before they entered the pool.

Time charter income relates to income derived from two vessels, *FSL Singapore* and *FSL Hamburg*, deployed on time charter with Petrobras from 16 May 2012 and 23 August 2012, respectively.

Pool income relates to income derived from three chemical tankers, *FSL New York*, *FSL London* and *FSL Tokyo*, deployed on pool arrangement from third quarter of 2012.

## 17 Finance income and expenses

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| **Recognised in the income statement** | | |
| Interest income from cash and cash equivalents | 124 | 79 |
| Finance income | 124 | 79 |
| | | |
| Interest expense: | | |
| - bank loans | 26,218 | 23,756 |
| - amortisation of debt transaction costs | 1,597 | 2,615 |
| - commitment and bank agency fees | 59 | 258 |
| Net foreign exchange gain | (92) | (1,080) |
| Finance expenses | 27,782 | 25,549 |
| | | |
| Net finance expenses recognised in income statement | (27,658) | (25,470) |

## 18 Loss before tax

The following items have been included in arriving at loss before tax:

| | Group 2012 US$'000 | Group 2011 US$'000 |
|---|---|---|
| Other income^ | – | (5,000) |
| Audit fees paid/payable to auditors of the Trust | 110 | 107 |
| Non-audit fees paid/payable to: | | |
| - auditors of the Trust* | 142 | 127 |
| - other auditors | 60 | 20 |
| Amortisation of initial direct costs | 633 | 554 |

^ Pertained to the receipt of settlement sum from Daxin Petroleum Pte. Ltd. ("Daxin") pursuant to the amicable out-of-court settlement on a without-admission-of-liability basis between the Trust and Daxin in November 2011.

* Inclusive of review fees on quarterly results.

## 19 Income tax expense

| | Group 2012 US$'000 | Group 2011 US$'000 |
|---|---|---|
| **Current tax expense** | | |
| Current year | 18 | – |
| Over-provision in prior year | (9) | – |
| | 9 | – |

***Reconciliation of effective tax rate***

| | 2012 US$'000 | 2011 US$'000 |
|---|---|---|
| Loss before income tax | (8,378) | (17,066) |
| | | |
| Tax calculated using Singapore tax rate of 17% | (1,424) | (2,901) |
| Effect of tax rate in foreign jurisdiction | 7 | – |
| Income not subject to tax | (18,011) | (19,868) |
| Expenses not deductible for tax purposes | 19,446 | 22,769 |
| Over-provision in prior year | (9) | – |
| | 9 | – |

## 20 Income available for distribution

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| Income available for distribution to unitholders at the beginning of the year | 655 | 5,688 |
| | | |
| Loss for the year | (8,387) | (17,066) |
| Net adjustments (Note A) | 9,041 | 35,359 |
| Income available for distribution | 654 | 18,293 |
| | | |
| Distribution to unitholders: | | |
| For the period from 1 October 2010 to 31 December 2010 | | |
| - Distribution of US0.95 cents per unit (tax-exempt income) | – | (5,688) |
| For the period from 1 January 2011 to 31 March 2011 | | |
| - Distribution of US0.95 cents per unit (tax-exempt income) | – | (5,687) |
| For the period from 1 April 2011 to 30 June 2011 | | |
| - Distribution of US0.95 cents per unit (tax-exempt income) | – | (5,732) |
| For the period from 1 July 2011 to 30 September 2011 | | |
| - Distribution of US0.95 cents per unit (tax-exempt income) | – | (6,219) |
| For the period from 1 October 2011 to 31 December 2011 | | |
| - Distribution of US0.10 cents per unit (tax-exempt income) | (655) | – |
| For the period from 1 January 2012 to 31 March 2012 | | |
| - Distribution of US0.10 cents per unit (tax-exempt income) | (654) | – |
| | (1,309) | (23,326) |
| Income available for distribution to unitholders at the end of the year | – | 655 |

Arising from the temporary relaxation of two loan covenants under the term loan facility (see note 13), the Trust is restricted from paying any distributions to unitholders for 12 months until 30 June 2013.

**Note A**

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| Net adjustments comprise: | | |
| | | |
| Non-cash adjustments: | | |
| - Depreciation expense on vessels | 56,893 | 59,385 |
| - Amortisation of debt transaction costs | – | 841 |
| - Amortisation of initial direct costs | 72 | 73 |
| - Amortisation of deferred income | (225) | – |
| - Unrealised foreign exchange gain | (126) | (831) |
| - Impairment loss on vessels | – | 22,117 |
| - Others | (375) | – |
| | 56,239 | 81,585 |
| Repayment of secured bank loans | (44,000) | (26,707) |
| Amount not available for distribution | (3,198) | (19,519) |
| Net adjustments | 9,041 | 35,359 |

## 21 Earnings per unit

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| Basic and diluted earnings per unit is based on: | | |
| Loss for the year | (8,387) | (17,066) |
| | **Number of units** | |
| | **'000** | **'000** |
| Issued units at beginning of the year | 654,665 | 598,665 |
| Effect of units issued | – | 29,458 |
| Weighted average number of units at the end of the year | 654,665 | 628,123 |

## 22 Financial risk management

***Overview***

Risk management is integral to the whole business of the Group. The Group is exposed to credit, liquidity and market risks. The Group uses derivative financial instruments to hedge its interest rate and foreign currency risk exposures. The Group does not hold or issue derivative financial instruments for trading purposes.

Management uses natural hedges or closely monitors the Group's business risk exposures in connection with its financial assets and financial liabilities and adopts the appropriate measures including the use of other financial instruments when considered necessary to reduce any potential financial risk exposures or losses.

***Credit risk***

As part of the Trustee-Manager's due diligence activities and prior to the completion of a lease transaction, each new lessee is analysed individually for creditworthiness. The Trustee-Manager then incorporates the results from its due diligence activities into a risk-adjusted pricing model. This model incorporates a credit loss component which takes into account the likelihood of default, the level of recoverability following a default and the credit exposure at the time of default.

Upon the completion of a lease transaction, the Trustee-Manager conducts on-going credit reviews annually or semi-annually to monitor each lessee's financial performance and compliance with financial covenants (if any). In addition, the payment conduct of a lessee is monitored on a monthly basis.

The Group's credit risk is concentrated in lessees in the shipping industry; and the Group's maximum exposure to credit risk in the event that counterparties fail to perform their obligations as of 31 December 2012 in relation to each class of recognised financial assets is the carrying amount of those assets as indicated in the Statements of Financial Position.

The Group does not expect to incur material credit losses on its financial assets. Cash and cash equivalents are placed with financial institutions which are regulated.

***Liquidity risk***

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as and when they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group ensures that it has sufficient cash on demand to meet expected operational expenses for a period of 30 days, including the servicing of financial obligations. When applicable, the Group also ensures that it has sufficient cash for quarterly distributions to its unitholders. As at the reporting date, there were no outstanding commitments for any acquisition of vessels.

As at 31 December 2012, the Group's current liabilities exceeded its current assets by US$18,804,000 (2011: US$22,582,000). However, in view of estimated cash flows from operations over the next 12 months, the Trustee-Manager expects the Group to pay its liabilities as and when they fall due.

***Market risk***

Market risk is the risk that changes in market prices, such as interest rates, foreign exchange rates and equity prices, will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters.

***Interest rate risk***

The Group adopts a policy of ensuring that 100% of its exposure to changes in interest rates on bank loans is hedged using a combination of natural hedges and/or interest rate swaps. The Trustee-Manager, on behalf of the Trust, reviews any unhedged exposures periodically and will consider hedging them after taking into consideration the prevailing interest rate environment.

As at 31 December 2012, the Group has interest rate swaps with a total notional contract amount of US$224,040,000 (2011: US$364,943,000), whereby it pays fixed interest rates ranging from 1.06% per annum to 5.24% per annum and receives a variable rate equal to US$ 3-month LIBOR. The Trust classifies these interest rate swaps as hedging instruments under the cash flow hedge model.

The net cumulative fair value change of these interest rate swaps as at 31 December 2012 is US$12,531,000 (2011: US$17,329,000). This amount is recognised as financial derivatives in "financial liabilities".

*Sensitivity analysis*

With respect to the interest rate swaps (designated as hedging instruments under cash flow hedge model), variable rate bank loans and certain floating rate lease agreements, a change of 50 bp in interest rate at the reporting date would increase (decrease) other comprehensive income and profit or loss by the amounts shown below. This analysis assumes that all other variables remain constant.

| Group and Trust | Other comprehensive income 50 bp increase US$'000 | 50 bp decrease US$'000 | Profit or loss 50 bp increase US$'000 | 50 bp decrease US$'000 |
|---|---|---|---|---|
| **31 December 2012** | | | | |
| Variable rate bank loans | – | – | (2,351) | 2,351 |
| Interest rate swaps | 3,433 | (2,999) | 1,002 | (1,002) |
| | 3,433 | (2,999) | (1,349) | 1,349 |
| Floating rate lease income | – | – | 631 | (631) |
| | 3,433 | (2,999) | (718) | 718 |
| **31 December 2011** | | | | |
| Variable rate bank loans | – | – | (2,370) | 2,370 |
| Interest rate swaps | 2,523 | (2,449) | 1,887 | (1,887) |
| | 2,523 | (2,449) | (483) | 483 |
| Floating rate lease income | – | – | 654 | (654) |
| | 2,523 | (2,449) | 171 | (171) |

The Group has entered into two floating rate lease arrangements ("host contracts") which are pegged to the US$ 3-month LIBOR ("embedded derivatives"). These arrangements provide an economic hedge against the interest rate risk exposure arising from the respective loans relating to these leases.

The Trustee-Manager considers the economic characteristics and risks of these embedded derivatives to be closely related to the economic characteristics and risks of the host contracts. Accordingly, in respect of these embedded derivatives, no separate accounting from the host contracts is required as the embedded derivatives are essentially contingent rentals based on variable interest rates.

***Foreign currency risk***

The Group is exposed to foreign currency risk on certain lease income denominated in a currency other than the functional currency of the Trust. The currency giving rise to this risk is the Euro.

As at 31 December 2012, the Group hedged 100% of its forecasted lease income denominated in the Euro. The Group uses cross currency swap contracts with a total notional contract amount of US$16,387,000 (2011: US$15,392,000), to hedge the foreign currency risk associated with its forecasted Euro revenue. The net cumulative fair value gain for these cross currency swap contracts as at 31 December 2012 is US$232,000 (2011: US$740,000). This amount is recognised as financial derivatives in "derivative assets".

In respect of other monetary assets and liabilities held in currencies other than the US dollar, the Group ensures that the net exposure is kept to an acceptable level by buying or selling foreign currencies at spot rates, where necessary, to address short term imbalances.

The Group's and the Trust's exposures to foreign currencies are as follows:

| | 31 December 2012 | | 31 December 2011 | |
|---|---|---|---|---|
| | Euro US$'000 | Singapore dollar US$'000 | Euro US$'000 | Singapore dollar US$'000 |
| **Group** | | | | |
| Cross currency swap contracts* (notional amounts) | 16,387 | – | 15,392 | – |
| Other receivables | 38 | 19 | – | 357 |
| Cash and cash equivalents | 764 | 63 | 516 | 560 |
| Trade and other payables | (49) | (54) | (17) | (66) |
| **Trust** | | | | |
| Cross currency swap contracts* (notional amounts) | 16,387 | – | 15,392 | – |
| Other receivables | – | 16 | – | 344 |
| Cash and cash equivalents | 200 | 63 | 9 | 360 |
| Trade payables | – | (33) | – | (51) |

* Designated as hedging instruments under cash flow hedge model.

*Sensitivity analysis*

A 10% strengthening of US dollar against the following currencies at the reporting date would increase (decrease) other comprehensive income and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

| | Group | | Trust | |
|---|---|---|---|---|
| | Other comprehensive income US$'000 | Profit or loss US$'000 | Other comprehensive income US$'000 | Profit or loss US$'000 |
| **31 December 2012** | | | | |
| Euro | 1,695 | (83) | 1,695 | (22) |
| Singapore dollar | – | (3) | – | (5) |
| **31 December 2011** | | | | |
| Euro | 1,452 | (56) | 1,452 | (1) |
| Singapore dollar | – | (95) | – | (73) |

A 10% weakening of US dollar against the following currencies at the reporting date would increase (decrease) other comprehensive income and profit or loss by the amounts shown below. This analysis assumes that all other variables, in particular interest rates, remain constant.

| | Group | | Trust | |
|---|---|---|---|---|
| | **Other comprehensive income US$'000** | **Profit or loss US$'000** | **Other comprehensive income US$'000** | **Profit or loss US$'000** |
| **31 December 2012** | | | | |
| Euro | (1,523) | 83 | (1,523) | 22 |
| Singapore dollar | – | 3 | – | 5 |
| **31 December 2011** | | | | |
| Euro | (1,452) | 56 | (1,452) | 1 |
| Singapore dollar | – | 95 | – | 73 |

***Equity price risk***

The Group is exposed to equity price risk on its available-for-sale equity securities.

*Sensitivity analysis*

A 5% increase (decrease) in the share price of TORM shares at the reporting date would increase (decrease) the Group's other comprehensive income by US$282,000 (2011: US$ Nil). This analysis assumes that all other variables remain constant.

***Estimation of fair values***

The following summarises the significant methods and assumptions used in estimating the fair values of financial instruments of the Group and the Trust.

*Derivatives*

The fair value of derivative instruments is calculated by reference to current forward exchange rates and interest rates for contracts with similar maturity profiles, and discounting the estimated future cash flows based on the terms and maturity of each contract and using market interest rates for a similar instrument at the measurement date.

*Non-derivative financial liabilities*

The Group believes that the carrying amount of the variable rate bank loans, which are repriced on a quarterly basis, closely reflects the corresponding fair values.

*Available-for-sale equity securities*

The fair value of available-for-sale equity securities is calculated by reference to quoted share price listed on a stock exchange.

*Other financial assets and liabilities*

The carrying amounts of financial assets and liabilities with a maturity of less than one year (including trade and other receivables, cash and cash equivalents and trade and other payables) approximate their fair values because of the short period to maturity.

***Interest rates used in determining fair values***

The interest rates used to discount estimated cash flows, where applicable, are based on US$ yield curve and Euro yield curve at the reporting date for interest rate swaps and cross currency swap contracts respectively, and were as follows:

| | 2012<br>% | 2011<br>% |
|---|---|---|
| Derivatives | 0.18 to 0.74 | 0.06 to 0.80 |

**Carrying amount of financial assets and liabilities**

The following table summarises the carrying amount of financial assets and liabilities recorded at the end of the reporting period by IAS 39 categories:

| | Group | | | Trust | |
|---|---|---|---|---|---|
| | Loan and receivables US$'000 | Available-for-sale US$'000 | Financial liabilities at amortised cost US$'000 | Loan and receivables US$'000 | Financial liabilities at amortised cost US$'000 |
| **2012** | | | | | |
| Trade and other receivables | 2,819 | – | – | 85,668 | – |
| Cash and cash equivalents | 37,488 | – | – | 29,604 | – |
| Available-for-sale financial assets: Equity securities | – | 5,637 | – | – | – |
| Trade and other payables | – | – | 7,037 | – | 684 |
| Secured bank loans | – | – | 430,218 | – | 430,218 |
| | 40,307 | 5,637 | 437,255 | 115,272 | 430,902 |

| | Group | | Trust | |
|---|---|---|---|---|
| | Loan and receivables US$'000 | Financial liabilities at amortised cost US$'000 | Loan and receivables US$'000 | Financial liabilities at amortised cost US$'000 |
| **2011** | | | | |
| Trade and other receivables | 3,325 | – | 82,865 | – |
| Cash and cash equivalents | 32,304 | – | 28,877 | – |
| Trade and other payables | – | 7,326 | – | 3,122 |
| Secured bank loans | – | 472,780 | – | 472,780 |
| | 35,629 | 480,106 | 111,742 | 475,902 |

**Fair value hierarchy**

The table below analyses financial instruments carried at fair value by valuation method. The different levels have been defined as follows:

- Level 1 : quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 : inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 : inputs for the asset or liability that are not based on observable market data (unobservable inputs).

| | Level 1<br>US$'000 | Level 2<br>US$'000 | Level 3<br>US$'000 | Total<br>US$'000 |
|---|---|---|---|---|
| **Group** | | | | |
| **31 December 2012** | | | | |
| **Assets** | | | | |
| Available-for-sale financial assets: | | | | |
| Equity securities | 5,637 | – | – | 5,637 |
| Derivative assets | – | 232 | – | 232 |
| | 5,637 | 232 | – | 5,869 |
| **Liabilities** | | | | |
| Derivative liabilities | – | 12,531 | – | 12,531 |
| **Trust** | | | | |
| **31 December 2012** | | | | |
| **Assets** | | | | |
| Derivative assets | – | 232 | – | 232 |
| **Liabilities** | | | | |
| Derivative liabilities | – | 12,531 | – | 12,531 |
| **Group and Trust** | | | | |
| **31 December 2011** | | | | |
| **Assets** | | | | |
| Derivative assets | – | 740 | – | 740 |
| **Liabilities** | | | | |
| Derivative liabilities | – | 17,329 | – | 17,329 |

## 23 Commitments

The non-cancellable operating lease rentals receivable are as follows:

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| Within 1 year | 75,852 | 83,616 |
| After 1 year but within 5 years | 216,275 | 298,495 |
| After 5 years | 59,170 | 109,652 |
| | 351,297 | 491,763 |

Operating lease-Bareboat charter

Except for two lease agreements in which their base rental contains an adjustment which is pegged to US$ 3-month LIBOR, the rental rates of lease arrangements are fixed over the base lease term. The base lease terms under these non-cancellable leases range from nine to twelve years (2011: seven to twelve years). In nine lease agreements (2011: 11 lease agreements) held by the Group, the lessees have the options to extend the lease period beyond the base lease period up to ten years. The lessees have the option to purchase the related vessels in 16 lease agreements.

Operating lease-Time charter

There are two time charter lease arrangements (2011: Nil) and the rental rates are fixed over the base lease term of three years.

The figures disclosed above exclude two lease agreements with rentals based on market rates as it is impracticable to determine the committed rentals.

## 24 Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control or joint-control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common significant influence. Related parties may be individuals or other entities. The Trustee-Manager is a subsidiary of a substantial unitholder of the Trust.

Other than disclosed elsewhere in the financial statements, significant transactions with related parties are as follows:

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| Transactions with the Trustee-Manager: | | |
| Management fees | 3,365 | 3,652 |
| Trustee fees | 160 | 169 |
| Transactions with other related parties: | | |
| Directors' fees paid to non-executive directors | 201 | 201 |
| Lease rentals received from Schoeller Holdings Ltd* | 6,051 | 6,555 |
| Inspection fees paid to Columbia Shipmanagement Ltd* | 120 | 171 |
| Commission paid to Columbia Shipmanagement Ltd* | 80 | 108 |
| Shipmanagement fee paid to Columbia Shipmanagement (Singapore) Pte. Ltd.* | 545 | – |
| Commission paid to United Product Tankers* | 223 | 247 |

No separate consideration is paid to the Trustee-Manager (other than the fees disclosed above) for services rendered by the executive directors.

* Related parties of a unitholder who holds 24% of the Trust's issued units as at 31 December 2012.

## 25 Segment information

No operating segment information has been prepared as the Group has only one reportable segment. With respect to the presentation of geographical information, the Group deals with several lessees and the vessels are deployed to various parts of the world at the discretion and direction of these lessees. Accordingly, the Trustee-Manager does not consider it meaningful to allocate revenues and non-current assets to specific geographical areas.

**Major customers**

Each of the following customers accounted for more than 10% of the Group's total revenue in 2012 and/or 2011:

| | Group | |
|---|---|---|
| | **2012** | **2011** |
| | **US$'000** | **US$'000** |
| Yang Ming Marine | 20,055 | 20,055 |
| Berlian Laju Tanker^ | – | 14,153 |
| James Fisher | 11,731 | 11,716 |
| Evergreen Marine | 11,696 | 11,695 |
| Geden Lines | 11,985 | 11,669 |
| | 55,467 | 69,288 |

^ Contributed less than 10% of the Group's total revenue in 2012.