Global Ship Lease, Inc. (NYSE:GSL) Research Summary

Global Ship Lease, Inc. (NYSE:GSL) is a marine shipping company. It is headquartered in London and technically incorporated in the Marshall Islands, but reports its financial statements in US Dollars (as is the industry standard in the marine shipping sector) and trades on the New York Stock Exchange. It currently has a market capitalization of $92.45mm (putting it in the "micro-cap" range[1]) and revenues in the trailing twelve months (TTM/LTM) of $267.50mm. It is reported to have 7 employees.

Qualitative Analysis

A qualitative analysis of GSL's financial position yield promising insights. One of the most significant observation is the significant amount of GSL's revenue that is guaranteed by contracts for the next few years. Their management reports contracted revenue of $659mm and 2.3 years TEU[2]-weighted forward cover. This provides a baseline of stability for the next few years and has helped to insulate them from the general decreases in demand across most sectors caused by COVID-19.

GSL also reports high capacity of "reefer" (refrigerated or temperature-controlled) cargo ships, one of the fastest growing segments in containerized trade. Reefer cargo is higher-paying for lease contractors like GSL and is vital in the supply chain for foodstuffs. GSL's ownership of high-reefer ships, a relatively recent phenomenon, positions them well to capitalize on this trend in the coming years.

Perhaps the most encouraging note is GSL's increased revenue and earnings (operating profit, EBITDA, and net income) in 2020 Q2 relative to 2019 Q2. Given that the second quarter of 2020 saw many industries and companies ravaged by the novel Coronavirus and its economic effects (and that many segments of the global economy were quickly growing and accelerating in 2019), this is particularly impressive and is a positive sign about the resilience of GSL's revenue and profitability. This is likely a product of significant capital expenditures by GSL in 2019. The company also recorded new charters or extensions for eleven of its ships in Q2.

A further examination of the company's leverage is also reassuring. Only $4.7mm of the company's debt (0.6% of the $756mm in total debt on its balance sheet) matures before late 2022, and 57% of the company's debt is floating-rate, allowing them to benefit from interest rates at historic lows. The company is continually pursuing de-levering, having amortized $20.5mm of debt and issuing no long term debt in Q2 (especially impressive in the current economic environment), and is in discussions regarding refinancing of $267.6mm of 2022 notes outstanding.

Countless metrics could substantiate the obvious observation that shipping volumes declined sharply earlier this year as a result of COVID-19. Nearly as many metrics suggest significant growth in shipping volumes since their minimum in 2020 and a path towards a steady recovery. The worst seems to be behind the shipping industry, and GSL is positioned well for a healthy recovery.

The company has a board of eight directors, an effective size. None of the chief executives sits on the board of directors. Ian J. Webber, the Chief Executive Officer, has held his role since August 2008, as has Thomas A. Lister, the Chief Commercial Officer, held his. Many members of the board (and, of course, the executives) have extensive experience in the shipping sector, and a handful joined after the 2018 merger with Poseidon Containers.

[1] This is not a formally defined designation, but typically refers to companies with market capitalization of $300mm or less. The term is used in this sense hereafter.
[2] Twenty-foot equivalent units

Only one director (Michael S. Gross[3]) serves on the board of directors of any other company, a positive sign, as it suggests that GSL has a significant share of its directors' managerial focus. The company reported $3mm of stock-based compensation (SBC) in the LTM ending Q2 of 2020, but we did not find information on the exact allocation of this compensation to specific executives, directors, or other employees. Nonetheless, any SBC is a positive sign about the company's management, as it aligns the interests of management and shareholders.

Comparable Companies Analysis

We performed comparable companies analysis comparing GSL with 20 other micro-cap marine shipping companies. For a variety of metrics and ratios, we calculated minima, maxima, arithmetic means, medians, and arithmetic means weighted by volume and by market capitalization. The majority of GSL's peers did not report meaningful P/E multiples, making it even more of a positive sign that GSL reports consistent positive net income. GSL did have a P/E multiple below the arithmetic mean and the market-cap-weighted mean.

GSL had price-to-sales[4], price-to-book value, price-to-cash, and price-to-free cash flow ratios below both the medians and the means of the comparable companies. For the first three out of these four metrics, it also reported ratios below both weighted averages of its peers. Its P/FCF multiple was below the market-cap-weighted average but above the volume-weighted average. Analysis of EV/EBITDA ratios is described below and similar figures were calculated; GSL had very satisfying ratios.

Relative to its peers, GSL further demonstrated pleasing EPS growth this year and compounded growth over the past 5 years of 120.8% and 15.4%, respectively, as well as compounded sales growth over the past 5 years of $13.50%. Its peers on average showed declines in EPS this year, mixed EPS growth over the past 5 years, and positive but modest (relative to GSL) sales growth over the past five years. Overall, GSL appears both successful and undervalued relative to its peers.

For each price ratio referenced above, we calculated the per-share value of interest (earnings, sales, etc.), and multiplied this value by each of the statistics calculated from the peer companies to find implied share prices based on a number of metrics.

The results are below:

[3] As a matter of curiosity: Mr. Gross was also a co-founder of Apollo Management, a leading private equity firm, and a graduate of the Kellogg School of Management at Northwestern University.

[4] It is not lost on us that the numerator and denominator of this multiple represent different investor groups; it is included in spite of its technical flaws because it is a common and useful valuation shorthand.

Ticker	P/E	P/S	P/B	P/C	P/FCF
GSL	4.94	0.35	0.24	1.25	1.01
Per share value of inter	$ 1.12	$ 15.83	$ 23.08	$ 4.43	$ 5.49
Implied range min	$ 0.93	$ 0.95	$ 1.62	$ 2.39	$ 5.49
Implied range max	$ 103.52	$ 45.11	$ 36.93	$ 132.78	$ 25.07
Implied, avg.	$ 27.18	$ 10.95	$ 8.78	$ 20.61	$ 15.37
Implied, median	$ 2.13	$ 8.31	$ 6.58	$ 9.00	$ 15.00
implied, cap weighted	$ 7.79	$ 10.55	$ 7.35	$ 11.92	$ 6.59
Implied, vol weighted	$ 0.31	$ 1.72	$ 0.63	$ 15.52	$ 0.38
Current share price:	$ 5.54				
Implied range min	-83%	-83%	-71%	-57%	-1%
Implied range max	1769%	714%	567%	2297%	352%
Implied, avg.	391%	98%	59%	272%	177%
Implied, median	-62%	50%	19%	62%	171%
implied, cap weighted	41%	90%	33%	115%	19%
Implied, vol weighted	-94%	-69%	-89%	180%	-93%

The majority of these metrics demonstrate significant upside.

Discounted Cash Flow Analysis

Free Cash Flow Projections

We assumed a forecast period of 5 years, through 2024. We projected 2020 figures separately from 2021-24 figures.

For 2020 revenue, EBITDA, and depreciation, we used four times the average of the 2020 Q1 and Q2 figures. This builds in the current available 2020 data, accounting for both COVID-19 and recovery from the virus beginning in the second two quarters of 2020. The revenue and EBITDA from the first two quarters of 2020 have been very promising so far, owing likely in large part to increased capital expenditures in 2019.

For 2020 capital expenditures and change in operating working capital, we used 2020 Q1 plus thrice the 2020 Q2 figure. Since these figures are more dependent on decisions by management, this calculation builds in the assumption that management will make decisions in the third and fourth quarters more closely resembling those in Q2 than in Q1 (since much of Q1 was before the onset of COVID-19).

For the following years, we projected capital expenditures, depreciation, and COWC using the historical average proportions of revenue over the period 2015-19. Each year's revenue from 2021-24 was calculated as follows (assuming a projection of revenue for year *n*):

1. For each historical year 2015-19, we found the figure (increase in revenue)/(previous year's CapEx).
2. We took the minimum of these historical figures, in the interest of conservatism, excluding decreases in revenue.
3. We then multiplied this figure by the previous year's CapEx (year *n-1*).
4. The resulting figure---the projected increase in revenue as a conservative function of the previous year's CapEx---was then added to the previous year's revenue (revenue from year *n-1*).

These projections account for the asset-intensive nature of GSL's business as well as the decisions behind discretionary investment activity like capital expenditures.

The tax rate used was the average total tax rate paid by the company over 2015-19. Likely due to the company's official incorporation in the Marshall Islands, the company pays a relatively low tax rate of 6.9% on average.

Cost of Capital Assumptions

Cost of Equity

The risk-free rate was the 1-year average rate on 10-year Treasury bonds, from 7/17/19-20.

To find the appropriate unlevered beta, we performed two calculations, and chose the most conservative (highest beta) of the two:

1. Damodaran's average unlevered beta for European Shipbuilding & Marine companies (0.90), with a sample size of 62 companies.
2. The median unlevered beta of a sample of 12 peer companies (micro-cap marine shipping companies) of 0.49. We assumed tax rates in line with GSL's for all companies not based in the US, and tax rates of 20% for American companies. We used current levered beta, market capitalizations, and reported debt-to-equity (D/E) ratios to find the unlevered beta for each.

This was then re-levered at the company's current capital structure.

The equity risk premium (ERP) was Damodaran's for the United Kingdom as of July 2020. This is based on an assumption of a base ERP for mature economies of 5.23%, based on the returns on the S&P 500. We used the most conservative of the two methods he used to estimate country risk:

1. A default spread based on the Moody's credit rating of the country's 10-year government bonds
2. A default spread based on the current interest rates on credit default swaps (CDSs) on the country's 10-year government bonds, less the current interest rates on the corresponding US Treasury bond CDSs

These spreads were scaled up by a factor of 1.25x and added to the base ERP, resulting in ERPs of 5.96% and 5.43%, respectively. The former was used.

Cost of Debt

We used the LTM interest expense divided by the company's total debt.

Cost of Preferred

We used the coupon rate on the company's preferred stock. Its current number of preferred shares outstanding is noted on its balance sheet, so this was multiplied by the issue price of $25 to arrive at the total amount of preferred stock.

The company's current capital structure was used to find the weighted average cost of capital (WACC) based on the above.

Terminal Value Calculations

Gordon Growth Method

We assumed a terminal growth rate of 1.3%. This is as close as possible to the US Federal Reserve's target inflation rate (2%) while remaining below the growth rate of the GDP of the UK (1.4%) by a desired margin of at least ten basis points.

Exit Multiple Method

We examined 20 peer companies, all micro-cap marine shipping companies. For each, we recorded the 2019 EV/EBITDA multiple and the current EV/EBITDA multiple, where data were available and meaningful. For each set of multiples, we calculated the following:

1. Arithmetic mean
2. Median
3. Arithmetic mean weighted by average trading volume
4. Arithmetic mean weighted by market capitalization

This gave us eight figures, ranging from 10.17x to 35.45x. Then, in the interest of conservatism, we chose the smallest of these figures (the simple median of 2019 multiples). As a curiosity, for each set of multiples (2019 or current), we calculated the standard deviation, quartiles, and interquartile range.

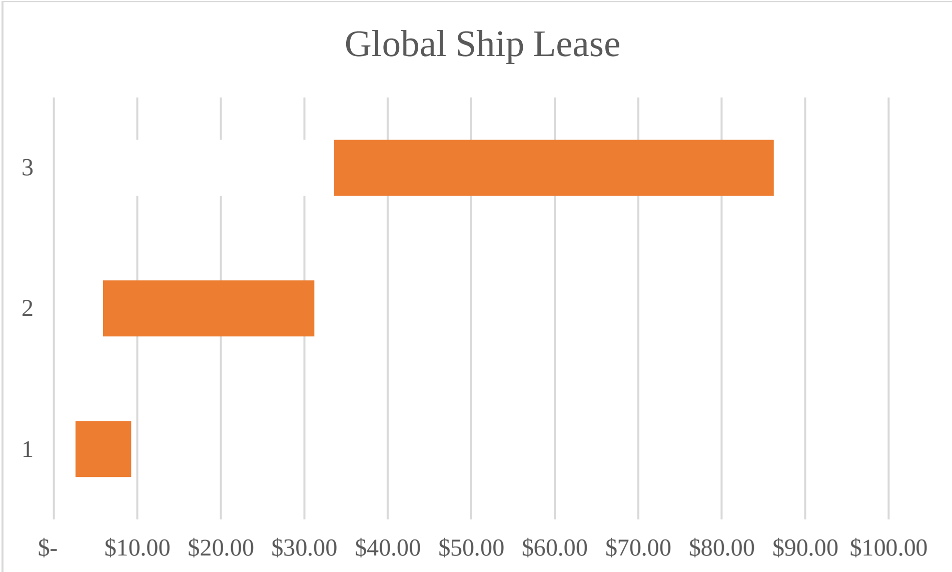
For both methods, we subtracted current net debt and preferred.

Sensitization and Results

We used GSL's current shares outstanding of 17.74mm. The perpetuity growth method returned a share price of $8.92 and the exit multiple method produced a share price of $37.40. At a current share price of $5.60, these present upsides of 59% and 568%, respectively, with a median and median upside of $23.20 and 314%, respectively. We obviously do not expect so significant an upside to be fully realized.

We sensitized the results along the usual variables (WACC and terminal growth rate for the PGM, and WACC and exit multiple for the EMM). These produced ranges of $5.88-25.33 and $33.59-52.66, respectively. The sensitivity tables included margins of approximately +/- 100 basis points for WACC, -50 to +210 basis points for the terminal FCF growth rate, and -1.2 to +2.3 for the exit multiple.

The 52-week range of GSL's share price is $2.61-6.64.



Football field for Global Ship Lease, Inc. The rows represent the EMM, PGM, and 52-week range, respectively.

Catalysts

The stock has satisfactory opportunity for share price growth. 62.07% of shares are held by institutions, promising the investment required for its share price to appreciate substantially. At the same time, with an average volume of 35,901 shares and a share count of 17.74mm shares, approximately 0.2% of the company's shares change hands daily, offering substantial inefficiencies on which to capitalize.

Conclusion

Due to its strong financial position and our projection of significant upside, we recommend a long position on Global Ship Lease, Inc.

---*Wasim Rahaman*