



10. april 2014

Chairman's report presented at the annual general meeting of Danish Ship Finance A/S 2014

In this, my last report as chairman, I would like to take stock of the year 2013 and the topics that we're currently dealing with on the Board of Directors.

After my report, our chief executive officer, Erik I. Lassen, will review the annual report for 2013.

The shipping market

I will start my review by making a few comments about the shipping market.

For the first time in quite a while, there were signs of optimism in some of the sectors that have been facing some very difficult challenges in recent years.

The year started out with low rates in the large dry bulk, tanker and container segments. Towards the end of the year, there was a shift in the dry bulk and tanker segments, whereas the container market continued to be squeezed by the large supply of new tonnage.

Rates rose in the dry bulk and tanker segments, driving up ship prices, although dry bulk rates have dropped slightly since then. Going into the second quarter of 2014, we see that prices of dry bulk vessels since the end of 2012 have gone up by about 45%, while tanker prices have risen by just under 25%.

These rather decent increases would indicate that the market now basically takes a more positive view of earnings prospects.

The record order books of the pre-crisis years have generally been reduced, and the market is better balanced today than during the early years of the crisis. Some risks persist, however, due to many new orders and a fleet which is younger now than it was a few years back; this means that many segments do not have much old tonnage to scrap.

Unfortunately, some segments have experienced a growing order book, although we believe that the need for new vessels has already been met. This need can be difficult to assess, however. Some of

these investments were made by investors outside the shipping community, many of whom may be considered as speculative and short-term investors – something that could cause some concern.

Rate increases were announced on a number of occasions in the container market in 2013, but the large supply of vessels combined with a small increase in demand resulted in a subsequent erosion of the announced rate increases. Many large container vessels still on the order books, so many shipping companies will face a challenge in securing high capacity utilisation and low unit costs in the coming years.

Overall, we do not think that the shipping industry has fully emerged from the crisis, but we hope that the recent signs of improvement, especially in the dry bulk and tanker segments, may be steps in the right direction. Let's not forget that quite a few segments are performing quite decently, including offshore vessels, car carriers and gas tankers.

Rounding off this topic, let me emphasise that we should always remember that shipping is a volatile industry and that the market can quickly turn sour again. This could occur if there is a return to the excessive contracting activity as seen during the years ahead of the financial crisis. Contracting activity was relatively strong in many segments in 2013, so let's hope that the future demand may absorb the many new vessels.

Competitive situation

Over the last couple of years, the financial crisis and the crisis in the shipping industry have dramatically changed the competitive environment for ship financing.

Quite a few of the established lenders have announced that they are withdrawing from ship financing operations, while others are giving low priority to the area.

However, a core of lenders are still in the market, and like Danish Ship Finance they have remained focused on the shipping industry.

New lenders have also set up shop with the intention to build – or rebuild – a presence in ship financing. We also note that the Asian export credit institutions are supporting local shipyard production by offering ship financing on conditions that are often difficult to match for commercial institutions.

During the early years of the crisis, the changed competitive environment resulted in dramatically improved credit margins and conditions compared with the terms and conditions prevailing before mid-2008. Over the course of the past year, competition has intensified and credit margins have shrunk somewhat, especially for the most creditworthy shipowners.

Overall, however, Danish Ship Finance still has good opportunities for doing business with reputable shipowners. On the other hand, we probably need to accept that we will not be able to maintain recent years' strong increase in earnings from lending operations.

Lending and funding

Our total lending fell by about 10% in 2013, but this does not in any way indicate that Danish Ship Finance has lost competitive strength.

We are still able to issue bonds and source funding for our loans on competitive terms and conditions. In recent years, we have stepped up our direct engagements with bankers and investors, and combined with our long track record in the bond market, a prudent lending profile and low risk for the bondholders this has helped us keep our funding competitive.

Retaining competitive funding has been challenging because Moody's, the credit rating agency, maintains its negative view of the shipping industry and therefore still assigns a rating of Baa2 with a negative outlook to Danish Ship Finance. On the Board of Directors, we fail to see the reasoning behind Moody's rating in view of our robust capital and cash position. Still, we need to be patient and hope that our stable financial performance will at some point convince Moody's that it is possible to conduct stable lending business even when offering loans to a volatile industry.

The Board's position is underlined by the fact that our loans remain well secured by the underlying mortgages despite the sharp drop in ship prices witnessed during the past five years. By the end of 2013, 92% of loans after impairment charges was secured within 60% of the market value of the mortgaged vessels, while 99% was within 80%. Add to this the fact that we are focused on lending to reputable shipowners expected to be capable of withstanding crises.

The fact that lending has nevertheless dropped is ascribable to a decline in lending to our largest customer. As we have communicated for a number of years, the exposure with our largest customer has typically accounted for up to 40% of our total lending. We would expect this percentage to fall in the years ahead,

and that will open up for new opportunities which we intend to exploit in the same prudent manner that we have pursued to date. Despite declining lending, we will not compromise our credit quality, and we will therefore seek to expand our customer base by adding a number of the world's most eminent shipowners. While we have achieved a good market coverage, there are still a number of solid and reputable shipping companies with which we hope and look forward to establishing long-standing relationships.

Earnings and capital structure

In a moment, Erik I. Lassen will review the annual report for 2013 in greater detail.

First, however, I would like to draw your attention to the earnings trends that we have witnessed in recent years. Danish Ship Finance has in fact created strong shareholder value when we look at developments in earnings from lending operations. Earnings from lending operations before impairment charges have more than doubled in recent years, and we are pleased with that performance. The coming years will show whether we are able to maintain it.

The low level of interest rates is the reason why we have not recorded a similar increase in our profit. Our equity and an amount equal to our impairment provisions are invested primarily in short-

term Danish mortgage bonds, which currently only yield a low rate of return, so we have to wait for the general level of interest rates to rise.

With respect to our impairment charges, it is difficult to make a solid promise, but we believe that there is no need for further impairment charges in the current situation. We hope that a gradual easing of the shipping crisis will result in a reduction of the size of the allowance account, and such a reduction may also be driven by a successful solution to some of the few large loan cases.

The combination of a decline in lending and a lower DKK/USD exchange rate lifted the year-end solvency ratio to 17%. It is worth noting that our tier 1 capital ratio was also 17%. This means that Danish Ship Finance already now meets the intensified solvency requirements to be implemented in 2019.

In the upcoming period, the Board of Directors will of course monitor the capital structure. The company must retain a solid buffer to the statutory requirements and a buffer reflecting the volatile shipping environment in which new crises can quickly emerge. On the other hand, we should also ensure that the company does not hold excessive capital that might restrict business opportunities that may arise in the very short term. The Board will discuss this topic in the course of the year.

Management remuneration

The Danish Financial Business Act stipulates that the chairman of the board must describe at the general meeting the remuneration of the management in the preceding financial year and the expected remuneration in the current and upcoming financial year.

With respect to the remuneration for 2013, I refer to note 7 of the annual report.

The salary increase at 1 January 2014 represents 3% for the Management Board, and in 2015 we expect an adjustment of management board remuneration in line with market conditions.

Referring to a subsequent item on the agenda, I would also like to note that we have made minor adjustments to the severance conditions for both members of our Management Board.

Conclusion

In closing my report, I wish to emphasise that the Board of Directors is pleased with the developments in Danish Ship Finance, which has operated under difficult market conditions and external impacts. We believe that our business model has proven to be sustainable after having been subjected to quite severe stress testing in recent years.

I would also like to take the opportunity to thank the Management Board and the employees for a job well done in a rapidly changing market.