DANMARKS SKIBSKREDIT

24 March 2011

Chairman's report presented at the annual general meeting of Danish Ship Finance A/S 2011

As all shareholders should have received the annual report for 2010, I will only briefly touch upon the issues already described therein.

After I finish my report, Erik I. Lassen, our chief executive officer, will provide a review of the financial statements.

Before I give a detailed account of each area, let me start by saying that Danish Ship Finance' lending strategy and business model have proven to be very resistant to the turbulence triggered by the financial and economic crises of the past few years.

The company reported a decent financial performance in 2010 with a profit of DKK 493 million after tax, which resulted in a year-end solvency ratio of more than 15 per cent. Both figures are considered satisfactory.

1. Shipping markets and lending

Many people outside our line of business have a tendency to regard shipping as an industry in which all segments develop along more or less the same lines.

In 2010, however, it was evident once again that earnings and ship prices in each segment are influenced by individual demand and supply factors.

Accordingly, one segment may perform quite well, whilst another is struggling.

An example of these differences is the container segment, which had a very difficult year in 2009, only to report record-high earnings in 2010. Obviously, the developments were triggered by an increase in demand for container transport, but it was also the result of innovative thinking on the supply side in the form of lower service speeds, or what is known as slow-steaming. Slow-steaming drastically reduced supply and surprisingly quickly created a balance between supply and demand, which was quite remarkable given the fact that many new vessels were supplied from the shipyards.

Other segments are marked by unusually large order books, which especially gives rise to concern in respect of the largest dry bulk segment – the capesize vessels. This segment ended the year with very low rates and a market sentiment that was radically different from that of the container segment.

Between these two extremes, the segments performed from reasonably well to less than satisfactory. Rates were lifted by the increase in freight volumes – particularly in segments in which the order book and supply of new ships were better realigned to the size of the fleet in operation and the possibility of scrapping old and obsolete ships.

The reason that I mention these developments is that they are current examples of how difficult it is to predict shipping trends.

It is also in light of that recognition that, more than ten years ago, Danish Ship Finance defined its lending strategy using the principle of "credit quality rather than short-term return".

We retained this strategy during the economic boom, and this is the principal reason why we have so far only suffered moderate losses.

In 2010, we recorded a drop in the number of loans with "objective evidence of impairment" from 17% to 8% of total lending. The reduction was attributable especially to a small general increase in ship prices during the year, and combined with instalments, and in some cases supplementary collateral from the shipowner, the reduction meant that many shipowners once again complied with the minimum requirements to the value of the mortgaged vessels relative to the outstanding debt.

We are also pleased that, despite the decline in ship prices since the peak in 2008, 88% of the loan amounts is secured through mortgages within 60% of the current market value. 98% of the loan amounts is secured within 80% of the market value. This is satisfactory. Please see note 36 to the annual report for more details on this.

We are currently terminating a single loan, which will unfortunately produce a loss, but once the loan has been terminated, interest will be paid on all loans, and 99% of all loans will be repaid as scheduled. We are quite pleased with these figures only a little more than two years after the crisis began in earnest.

However, we are aware that the outlook for many shipping segments is generally quite sombre.

First of all, in a number of segments there is a very large order book as a percentage of the fleet in operation and, secondly, the current shipyard capacity is historically high.

With respect to the shipyard capacity, we are concerned that the nations involved will go to great lengths to keep employment at high levels, despite the fact that many segments worldwide are not really in need of additional vessel tonnage in the years ahead.

As a result, we should prepare ourselves for potential borrower default problems. For example, we should expect a renewed increase in objective evidence of impairment of loans in 2011 due to breach of loan covenants. The reason is that ship prices have started to decline again, and for some of our loans this will most likely result in the LTV ratio exceeding the agreed maximum.

However, we believe that our total impairment charges of more than DKK 2 billion provide a strong buffer to accommodate a potential decline in the market.

Even though we expect a few difficult years for the shipping industry, we will not discontinue granting new loans. We will continue to focus on reputable shipowners who have weathered the storm so far and who are also expected to do so going forward. This applies especially to our existing customers, but we also have the capacity to add new and strong customers to our loan portfolio.

2. The financial markets

Following a very chaotic 2009, the financial markets gradually returned to normal in 2010.

However, it is probably too soon to declare that the crisis in the financial markets is over.

As Danish Ship Finance has pursued a strict balance principle, we do not have an ongoing need to renew our funding. We only need to issue bonds to the extent that we submit new loan offers. For loans disbursed and loan offers granted, we have already sourced the necessary funding throughout the term of the loan.

So even though a renewed financial crisis may cause a number of different challenges, we believe that none of these would be large enough to seriously put our business model to the test.

However, there will always be challenges, and in our case such challenges are primarily in the form of new proposed legislation based, among other things, on the recommendations of the Basel Committee. The new regulations contain many good steps, but it is important that the new rules do not cause unnecessary problems for the institutions that have performed well during the crisis, pursuing sound lending policies and focusing on liquidity.

In this connection, we feel compelled to express our concern that the legislators attach too much importance to the rating agencies when it comes to investment opportunities for institutions such as life insurance and pension companies. The current proposals stipulate that external ratings should be regarded as the one and only true picture of an issuer's creditworthiness and, by extension, the amount of capital that an operator such as a life insurance company must allocate for an investment. This will apply regardless of whether investors have another opinion and a different risk perception.

We find it difficult to imagine that the financial system could operate without the guidance provided by external ratings. Ratings provide a good guideline for an issuer's credit standing, but we would be concerned if this assessment is given more weight than for example the insight held by the national regulator about the financial issuer.

In this regard, we should remember that national regulators have in-depth knowledge about the underlying risks, whereas rating agencies do not have access to loan information about individual borrowers. Even though we are only a minor player on the big stage, we wish to recommend that Denmark should advocate capital weight models that do not rely on external rating agencies.

Our bonds currently carry a low standard risk weighting because we comply with the strict regulatory requirements for issuing gild-edged bonds. Therefore, we would feel most comfortable if the public authorities remain the body that ranks financial institutions. As mentioned above, the authorities have the best preconditions for assessing individual institutions as they have the best insight into every aspect of their operations.

3. Competitive situation

Major changes have taken place in terms of competition.

A number of large foreign lenders have discontinued their new lending operations to the shipping industry altogether or significantly reduced their activities compared with pre-crisis levels.

Even though other lenders have retained their lending activities, the overall supply of ship financing from traditional sources in the western world has been notably reduced.

The lower lending capacity has especially affected the segment of small shipowners without strong credit, as the remaining lenders have intensified their efforts towards the most creditworthy shipowners, which are considered to have the lowest credit risk.

This is the very segment that Danish Ship Finance has consistently focused on, and given the exit of some banks and the addition of others, we therefore still experience a healthy level of competition.

However, in spite of the competition we have not witnessed a return to the very low pre-crisis credit margins. Although credit margins have narrowed relative to the very high levels of 2009 and early 2010, the higher funding costs of the financial institutions have lifted the minimum credit margins by a good deal relative to pre-crisis levels.

In net figures, however, earnings from lending operations are higher than before the crisis began, but that is probably a good thing given the fact that credit margins had dropped too low relative to the underlying risk. Furthermore, we now see a more healthy difference between credit margins paid by very creditworthy customers and customers who are not so creditworthy.

In terms of financing for newbuildings, we see a growing trend that, in various ways, shipowner nations are seeking to support local shipyard production by offering favourable financing especially to the more creditworthy shipowners. In the far majority of cases, export subsidy financing is granted to shipowners who would be able to obtain financing on normal commercial terms and conditions. This development is to the detriment of commercial lenders, and we would prefer that all transactions were made on market terms. However, we need to relate to the political reality.

In the coming years, we will retain our focus on our existing clients, especially Danish shipowners, with whom we have special affiliation. We will also have the capacity for and a need to provide loans to foreign shipowners, and in this regard, we are quite confident about the future despite competition from commercial lenders and export credit institutions and other forms of state-funded loans.

4. Employees

It has not been a tradition for us to mention what is perhaps the most important resource of a financial enterprise; our employees.

All board members are aware that all departments of Danish Ship Finance have a good mix of experienced employees, who have “been there, done that” and who know our customers and the market, and younger employees who bring new talent and skills. The combination of strong market knowledge of shipping and finance and a competent administrative staff able to continuously realign company matters to the rapid inflow of new rules and regulations is a key component of our business model.

As an example of new legislative measures I would like to bring attention to the so-called executive order on section 71, which stipulates a large number of formal requirements to the management of a financial institution. The executive order on section 71 has also imposed large implementation requirements on Danish Ship Finance, even though in practice we already complied with significant parts of the requirements.

Together with the rest of the Board, I would like to tell you how pleased we are with the performance of our employees, and as Danish Ship Finance will be celebrating its 50-year anniversary this year, we have decided to reward their great efforts over the years by granting a jubilee benefit.

5. Management remuneration

The Danish Financial Business Act introduces a requirement 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 in 2010, I refer to note 7 of the annual report you have received.

The basic salary of the Management Board for 2011 has been adjusted extraordinarily for both board members. The extraordinary adjustment, equal to just over one month's salary, is connected to the fact that the Management Board has waived a contractual right to bonus, applicable from 2011. This change was made as a result of the new rules on incentive pay in the financial sector, which make it difficult to apply a simple bonus model. Against this background, it has been agreed to make a permanent adjustment to make up for the waived bonus.

In 2012, the remuneration of the Management Board is expected to be adjusted according to market practice.

6. Concluding remarks

Concluding my report, I would like to repeat that Danish Ship Finance will be celebrating its 50-year anniversary this year, and allow me to conclude that we a dealing with a very healthy 50-year-old!

We made it through 2010 reasonably well, and we have embarked on 2011 with a sound customer portfolio, robust liquidity and a comfortable solvency ratio.