Danish Ship Finance A/S – Annual General Meeting 2019

2018 was a good year for Danish Ship Finance overall. On the lending side, the loan book grew by a healthy 6%, ending the year at DKK 39.6 billion, and a number of new strong clients were added to the portfolio. On the funding side, we were able to issue bonds of more than DKK 9 billion at narrow spreads to Danish AAA bonds. We issued the longest maturity bond since prior to the financial crisis, cementing our strong position in the Danish bond market. The net result after tax saw a decline compared to 2017, mainly due to a lower result on investments and lower income from lending.

The organisation also saw some significant changes over the year. Our Executive Board was enlarged from two to three members. Erik I. Lassen continued as CEO and Michael Frisch joined as Chief Commercial Officer, heading up the customer related activities. Lars Jebjerg replaced Per Schnack as CFO. I take this opportunity to thank Per Schnack for his dedicated contribution to the development of Danish Ship Finance over the last decades.

By the third quarter, the management team embarked on a strategic review with the aim of revisiting the company's overall vision and strategic direction. The outcome was an action-oriented strategic plan that will unfold over the next couple of years. Many of the results are expected to start to show already this year.

The strategy review confirmed that we should continue to do what we do best; provide secured corporate lending to reputable ship owners across market cycles. Prudent financial and credit policies will continue to govern our work. With this as the backdrop, we formulated a new vision that encompasses our overall objective of being the obvious choice in ship finance for our clients, employees, owners, investors and the society we operate in. The strategic plan is divided into three key themes; Operational excellence, Strengthening the core and Diversification, which each hold a range of initiatives aimed at sustaining and strengthening our competitive position and ensuring that we stay relevant for clients.

We continue to work actively with the regulatory changes coming our way. We have had a special focus on maintaining ships as eligible assets in the European covered bond framework. At this time, we have no doubts that ships will continue as eligible assets for the issuance of CRR compliant covered bonds.

Issues concerning sustainability and ESG are rapidly gaining traction in the shipping industry and in financial services. This is a subject that we take very seriously, and in 2018, we devoted more resources to cover this area, making sure we take the right steps in this respect.

Shipping markets

The shipping market continues to strengthen at a slow but steady pace. Variation between the major ship segments exists, but average freight rates increased by over 10% over the year, underlining that the supply-demand balance is improving in many segments. However, the shipping industry still have some way to go before fully recovering from the downturn that started a decade ago, in the aftermath of the financial crisis.

The Dry Bulk market continued its positive development in 2018, which supported freight rates and ship prices, especially in the first three quarters of the year. Strong Chinese demand continued to be the primary demand driver, which still constitutes a concern in the medium term due to an expected rebalancing of the Chinese growth model. In the first quarter of 2019, we have seen this positive trend reversing and the outlook for Dry Bulk is now less clear.

The Container markets still show signs of overcapacity and earnings remained low in 2018. Box rates and time charter rates did however follow an upward trajectory from mid-2018 onwards on the back of higher demand and limited supply growth. Many tonnage providers continue to have difficulties finding sustainable long-term employment for their vessels.

The Tanker markets started the year burdened by overcapacity with low freight rates and ship prices. The markets did however start to improve by mid-year and onwards. Chemical Tankers did not experience the same improvement and the segment continued to be negatively affected by excess Product Tanker vessels seeking employment in the chemical trades.

Demand for Offshore-related tonnage is still low even though oil prices have increased to levels above the average break-even rate for offshore exploration. Investments are still centred around onshore exploration in the US and to a much lesser extent around offshore. Many vessels are therefore still in lay-up and ship prices remain under pressure.

The LNG market enjoyed improved market fundamentals as demand was strengthened by new infrastructure projects coming online, boosting growth in travelling distances. This in turn put a stop to scrapping and the fleet grew by 11% over the year. In order to absorb new vessels being delivered, the market is very dependent on demand to remain strong and new LNG infrastructure projects to be completed.

The LPG market struggled with overcapacity in 2018 and freight rates and ship prices hovered around all-time lows in some segment sizes. A seasonal uptick towards the end of the year did support market fundamentals somewhat.

The global orderbook has declined markedly, from 19% of the fleet in 2012 to 10% in 2019, which combined with a more balanced age distribution of the fleet make the industry better positioned for the future. Generally, we do not expect freight rates to return to pre-crisis levels and we therefore find it positive that many ship owners have started to explore new and more digital ways of streamlining their operations and preparing their business models for the future.

Lending

As I started out mentioning, the loan book grew in 2018, especially during the second half of the year as new loan offers were disbursed, and the book ended the year DKK 2.2 billion higher than 2017. In 2018 loan offers of more than DKK 10 billion were made, a volume which exceeds the ordinary annual loan repayments. This underpins the expected upward trend in the size of the loan portfolio.

Growth in gross lending was not achieved at the expense of credit quality. On the contrary, new lending was of higher credit quality than the average of the existing loan book and at stable margins. Hence, we are well underway in the process of gradually rebuilding the loan book to a level of around the DKK 45 billion size, which is our current medium-term target, and which is expected to drive a steady increase in income from lending going forward.

The competitive situation

The competitive landscape continues to be characterized by some of the larger established players lowering their exposure to the market, leaving room for new players, primarily from Asia, to grow their market share. This has put some pressure on margins. As we get closer to the implementation date for Basel IV, we expect that margins could start to increase. If implemented as currently proposed, Basel IV will increase the capital requirement for IRB institutions, which ultimately could lead to more attractive margin levels in ship finance as the majority of our competitors are applying risk weights to shipping loans in accordance with the IRB methodology.

Bond issuance

2018 was another strong year in a funding perspective and we issued another DKK 9.1 billion at attractive rates. We even managed to issue bonds at long maturities not seen since before the financial crisis.

In addition, we are proud to announce that we in March 2019 strengthened our funding position even further by issuing Euro denominated covered bonds. This has been a strategic priority that we have worked on for quite some time. We are happy to report on the positive reception and acknowledgment that we have received from European bond investors that until now largely have been unfamiliar with the qualities of our rather unique business model.

That said, we remain very much committed to the Danish bond market, which will continue to be our primary funding market.

Remuneration of Executive Board

According to the Danish Financial Business Act, the Chairman of the Board shall address the management’s remuneration in the past financial year as well as expectations for the current and coming financial year.

I will allow myself to refer to note 8 of the recently published Annual Report for details on management remuneration in 2018.

The 2018 remuneration of the Board of Directors and Executive Board is specified in the remuneration policy, which can be found on the company website. It states that the remuneration increased in 2018, primarily reflecting costs related to offboarding and onboarding members of the Executive Board.

According to the legislation, it is also my duty to express expectations for any adjustments in the remuneration for the next year. We expect to adjust the Executive Board’s remuneration in line with prevailing market conditions.

I will now present the 2018 results and the main items of the balance sheet.

Financial performance

Net profits for the year fell to DKK 262 million from DKK 334 million in 2017. The main reason was lower income from investments due to the low interest rate environment and the late ramp up in the loan book, which kept income from lending lower in large parts of the year.

Investment income fell in 2018 to DKK 66 million, ending the year at a 0.5% return. This was markedly below the 2017 result of DKK 323 million, but still ahead of benchmark. This was primarily caused by market value adjustments as the interest rate cycle started to turn in 2018.

Net interest and fee income totaled DKK 672 million in 2018 down from DKK 696 million in 2017.

Loan impairment charges for the year were only DKK 35 million in 2018, compared to DKK 163 million in 2017, primarily reflecting a stabilization of the credit quality of the loan book. However, the crisis of the Offshore segment continues to pose challenges for some of our clients, and net write-offs debited to the allowance account reached DKK 252 million in 2018, up from DKK 98 million in 2017.

Costs increased to DKK 158 million from DKK 141 million in 2017, which reflected a strong focus on implementing a range of strategic initiatives as well as the changes in the Executive Board.

Balance sheet

Despite the late ramp up in the loan book, net lending ended the year at DKK 36.7 billion, up from DKK 34.5 billion at year-end 2017.

The balance sheet increased to DKK 62.3 billion, up from DKK 58.2 billion at year-end 2017.

The company continues to have very robust liquidity and capital positions.

Closing remarks

Looking back at 2018, we are satisfied with the achieved result given the difficult market conditions. The development witnessed in the loan book bodes well for future growth and underlines that our business model continues to be relevant even though the competitive landscapes changes around us. Looking ahead, we expect the results of the initiatives started in 2018 to begin to show in 2019 and we will continue to have a strong focus on executing our strategic plan.

Last, but not least, I would like to express the Board of Directors' gratitude for the great efforts made by the company's dedicated employees, which have ensured that we can look back on 2018 with satisfaction and with high expectations for an even better 2019.