



8 April 2013

## **Chairman's report at the annual general meeting 2013 of Danish Ship Finance A/S**

My report today will cover issues of material importance to the operations of Danish Ship Finance in 2012 as well as some of the topics that currently take up most of our attention.

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

### **Rating**

As in 2011, our rating was a key issue in 2012. We started the year on Moody's watchlist for a possible downgrade.

Being on the watchlist heralds strong winds, but in February the forecast was changed to a storm warning as we were put under review for a downgrade of up to five notches.

This event was covered by my predecessor's report in March of last year, so allow me just to say that our general management managed to contain the downgrade at three notches for a Baa2 rating, although the "negative outlook" label remains in force.

A rating expresses a rating agency's perception of the risk of an issuer in a very stressed environment defaulting on its payment obligations and the resulting risk of a loss for the investors. Considering Danish Ship Finance's very substantial capital and liquidity strength and strong resilience to unexpected credit losses, Moody's reaction seems somewhat excessive in terms of the risk of incurring credit losses.

Due to the rating uncertainty, we scaled back our bond issuing activities in the first half of 2012, but after the announcement of the new rating at the end of May, we returned to the bond markets.

We were pleased to see that investors were able to interpret the rating and price our bonds based on more objective criteria. In 2012, we issued bonds for more than DKK 11 billion and at price levels close to those at which our peers also issue their bonds. Don't forget that they have a higher rating.

We hope that our performance in time will convince Moody's how robust our business is.

It is probably too soon to expect an upgrade as we have still not seen the end of the current crisis which has affected some of the large shipping segments. But we hope to receive an upgrade at one point.

### **The shipping market**

In a few days' time, we will publish our Shipping Market Review, which provides a review of the major shipping segments. I refer to this publication but would like to reveal some of the conclusions here.

The key message of the report is probably that the order book measured as a percentage of the fleet in operation has dropped significantly from pre-crisis levels. In all segments, the order books are now at a more reasonable level.

In a few segments, however, the inflow of new vessels will remain too strong in the upcoming period, so the crisis in the shipping industry cannot be called off just yet, especially not in the dry bulk and tanker segments. It may take some time for rates to recover because too many vessels have been delivered in these segments in recent years, and it will take some time for demand growth to catch up with the excess supply of vessels.

However, the cyclical nature of shipping means that rates will recover. It's just a matter of time. And let's not forget that some shipping segments are in fact performing acceptably or even satisfactorily.

### **Lending**

The dry bulk and tanker market crisis in particular has triggered an increase in the volume of loans for which respite has been granted. There is nothing dramatic about that, although of course we would have preferred a different situation. The increase has been triggered by the crisis that has almost lasted for five years now, with only short-term recoveries along the way,

At the same time, we cannot rule out the possibility that the crisis will extend to such lengths that some shipowners may be put out of business, causing us to incur losses. We have prepared for such a contingency through our prudent approach to writing down loans, and our current accumulated impairment ratio of 5.8% of lending provides a substantial buffer.

In this context, I would like to remind you that, since the crisis broke out, we have only had accumulated losses corresponding to 0.3% of lending. This level corresponds to that experienced by Danish AAA-rated mortgage credit institutions and it is not much different from what we have experienced during our company's 50+ year history, which has also included several very difficult periods for one or more shipping segments.

Having said that, I would like to emphasise the importance of a substantial capital buffer considering the fact that the current crisis ranks among the deepest in recent economic history.

With respect to lending, I would like to point out that 89% of the loan amounts after impairment is secured within 60% of the currently very low market values. This is largely unchanged from 90% at the end of 2011 and a reasonable level considering that ship prices in our portfolio fell by 8% in 2012.

### **Competitive situation**

In 2012, a number of our principal competitors opted to scale down or discontinue their lending activities to the shipping industry. We believe that Danish Ship Finance can capitalise on this situation and that the most credit-worthy shipowners also stand to benefit.

The development has reduced the amount of capital available, and we can see that it is flowing towards lower-risk areas. We can hope that this will mean less funding available to the more speculative part of the shipping industry. That would help keep contracting for new tonnage at a more sustainable level.

While competition remains strong for high-end customers, the lower number of banks supports the movement towards a sensible balance between the interest rate paid by the shipowners and the risk undertaken by the lenders. There can be no doubt that credit margins had dropped to an unsustainably low level before the crisis broke out in 2008, and we believe and hope that the current level will generally prove sustainable.

### **Earnings and capital structure**

However, the strong underlying developments in earnings from lending operations and core earnings have not yet fully fed through to the bottom line. As in previous years, and as outlined in the income statement, it has been necessary to increase our impairment charges. Nevertheless, we are once more reporting a net profit as we have managed to do every year of this very difficult period for so many shipping companies and financial institutions.

The DKK 314 million profit for the year after tax implies a low return on total equity. However, the financial performance is not that bad from a shareholder's point of view. Remember that a large proportion of the company's capital base consists of tied-up capital, which, legally speaking, does not belong to the A shareholders. The shareholders can only claim part of the return on this capital.

If we look at the company's results relative to the capital the A shareholders have placed in our company, the return becomes a very decent double-digit percentage.

In this context, it may also be worth mentioning that, in accordance with the company's articles of association, DKK 47 million of the profit for the year is paid to Den Danske Maritime Fond. Since the conversion of Danish Ship Finance in 2005, Den Danske Maritime Fond has received a total of DKK 371 million including dividends for 2012. This amount has been used to help develop the Danish maritime sector.

Towards the end of the year, we opted to repay the hybrid tier 1 capital. The DKK 900 million raised in hybrid tier 1 capital obviously affected our earnings, but given the widespread uncertainty

back in 2009, we believe that it was a sensible decision to incur this cost as the hybrid capital has helped make the company's capital position even more robust throughout the crisis years.

After repayment of the state-funded loan, we maintain a solvency ratio of more than 15% and a low gearing. Combined with a decent allowance account, this bolsters our company for even a strong global economic downturn.

### **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 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 2013 represents 1% for the Management Board, and in 2014 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.

I would also like to take the opportunity to thank the Management Board and the employees for a job well done under difficult conditions. We should prepare ourselves for another year of many challenges in 2013.