Date: 29 March 2012

Chairman’s report presented at the annual general meeting of Danish Ship Finance A/S 2012

The annual report for 2011 has been sent to all our shareholders, and in my report I will try to elaborate on topics in the annual report that are currently of greatest interest to us.

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

I would like to start out by saying that the Board of Directors is pleased to note that we have so far successfully kept our losses at a low level compared with the rest of the industry, whilst also recording improved earnings from lending operations.

However, I will let Erik Lassen review the financial statements.

Rating

I normally start my report by describing either the financial markets or the shipping markets. This year, I will take a different route and start with our rating. Considering the importance ratings have gained in the capital markets today – and which is now being accelerated by the growing use of ratings in legislation – means that bond-issuing institutions like Danish Ship Finance become affected by the statements made by rating agencies.

At the end of November, Moody's placed our A2 rating on “review for possible downgrade”. The review process was expected to be completed during the first quarter of 2012, but in mid-February Moody's announced that more than 100 European financial institutions were on review for a downgrade. As we were on that list, a rating decision can now not be expected until in mid-May.

The reason I start out by touching upon this topic is that we have been told that Danish Ship Finance might face a downgrade of up to five notches. The Board of Directors finds this to be a very drastic statement, and one that differs strongly from our own perception of the situation and the risks that Danish Ship Finance is exposed to.

Given the performance demonstrated by our company during the financial crisis and the shipping crisis, we fail to comprehend how our company's issued bonds should come even close to being non-investment grade. We know that the general management constantly interacts with Moody's to provide them with the necessary comfort, and we truly hope that Moody's will change their mind and recognise our business model and strong performance.

What concerns us in this process is that Moody's focus seems to shift over time. We were downgraded from Aa3 to A2 with a negative outlook in 2009 primarily due to the outlook for large losses as a result of the global crisis and the crisis in the shipping industry.

As we all know, these losses were moderate and until now in line with the losses recorded by AAA/AA-rated Danish mortgage credit institutions. In other words, our losses were very far from Moody's estimates. What is most peculiar is that if you apply Moody's own, stringent stress test for banks offering shipping loans you would end up with a model result equal to a level of about Aaa-Aa.

Instead of acknowledging this fact and either confirm the rating or lift it, Moody's has now responded by giving us an outlook for a five-notch downgrade. This time, the following reasons have been provided:

- that we are lenders to a cyclical industry;
- that we have a high customer concentration;
- that we rely on issuance in the bond market; and
- that the lock-up period in the shareholder agreement concerning the sale of shares has expired.

The first three items do not in any way represent new information. On the contrary, these facts have characterised Danish Ship Finance's operations for decades, and they were known when we were assigned the Aa3 rating back in 1998.

We have demonstrated our ability to handle these matters and are therefore puzzled that these are now reasons for a possible downgrade.

With respect to the last item on the list, I can only confirm that it is correct that the lock-up period has expired; since Danish Ship Finance was converted into a limited liability company in 2005, it has been well-known that the shareholders from mid-2010 would be able to trade their shares.

In this connection, let me remind you that we retain a solvency ratio of more than 16% according to the standard method and lending which is only about five times our equity. For a financial institution, this is very low gearing.

We will maintain our dialogue with Moody's and hope for a satisfactory outcome. If these efforts prove unfruitful, we will consider the alternatives.

Shipping markets and lending

Turning to the shipping markets, I have to start out by saying that 2011 was a bad year for the large vessel segments – containers, tanker and dry bulk. These segments generally experienced low rates, primarily owing to the large number of new vessels delivered from the shipyards.

The other segments we provide loans for, e.g. offshore, LNG, LPG and Ro-Ro, had a relatively good year, emphasising the value of diversifying into several segments.

If we look at the segments where we have the most exposure, we foresee no problems with respect to our loans to the container shipping companies, a segment where one large client accounts for a large proportion of our loan portfolio. A few of our tanker and dry bulk clients are facing challenges, and we have had to grant respite in a few loan cases. However, this does not change the fact that, under the circumstances, we maintain a decent loan portfolio also in these areas, because we have focused on identifying the most reputable and robust shipowners. This is a strategy that pays off in difficult times although, admittedly, it was hard to watch most of our competitors increase their lending and earnings at great speed when times were good.

Moody's states that we are lenders to a cyclical industry. We couldn't agree more. Shipping is a cyclical industry, and ship prices have declined by as much as 45% since the start of the crisis in 2008. However, as I will now show you, this does not automatically mean that a lender holds a large portfolio of vessels with high loan-to-value ratios.

When the crisis began in 2008, 98% of our loans were secured within 60% of the market values prevailing at the time. Today, almost four years later, 90% of our loans are secured within 60% of current market values.

This is a slightly lower percentage than the 98% pre-crisis level, but remember that the 60% should be viewed relative to ship prices which are now roughly 45% lower than the pre-crisis levels. In other words, our mortgages are now even more secure than they were before the crisis. In addition, ship prices can only drop to a certain level, and we are nearing that level in many segments.

The most recent peak in average loan-to-value ratios was at 77% in 2009. Since then, the percentage has dropped to 64% at the end of 2011.

We believe that this reflects a sensible handling of the cyclicality.

The simple reason is that we regularly receive large loan instalments, which to some extent make up for the value decline, and in the vast majority of the loan cases we have the possibility of requiring supplementary collateral or a reduction of the loan.

Since the crisis set in, we have thus received additional collateral or redemptions in the order of DKK 12 billion. This is a substantial amount relative to total lending of almost DKK 50 billion.

We have subsequently released five of the 12 billion as the ratio between collateral and lending normalised because of repayments or rising ship prices.

However, the prudent loan-to-value ratios and the strengthened collateral in the vessels do not alter the fact that we have regularly increased our loan impairment ratio in order to prepare for a situation in which the payment ability of a number of shipping companies becomes adversely impacted by the declining rates and ship prices.

The Board of Directors believes that the current loan impairment charges were made on a prudent basis and are adequate to cover potential losses. In this context, I would like to mention that all of our customers made due interest payments at the end of the year and that we had granted respite with respect to repayment for only 3.9% of our loans. Appropriate loan impairment charges have been made for these loans, and I would also like to mention that we are relatively well covered by our mortgage in the vessels.

In other words, if things go wrong, we have reasonable loan-to-value ratios for nearly all our loans, minimising the risk of large losses.

We currently have an accumulated impairment ratio of 4.6% of total lending, while actual losses merely accounted for 0.1% per year since 2008. This is quite a wide margin for a financial enterprise in Denmark.

However, I cannot rule out the possibility that the impairment ratio will increase somewhat in 2012 as a result of our prudent policy in the area. This will depend on developments in the financial standing of shipowners.

Financial markets and funding

This year, I will not spend too much time on the financial markets. They have been affected by the debt crisis in southern Europe, and while interest rate levels fell in northern Europe, southern Europe experienced rising interest rates.

We have not at any time held bonds issued by any of the distressed countries, and consequently we have not shared the difficult deliberations undertaken by some European bond owners.

However, due to the short duration of our securities portfolio going into 2011, we did not benefit much from the declining interest rates. On the other hand, this means that right now we have only little exposure to the interest rate increases expected to occur at some point going forward.

Going into 2012, the debt crisis in Europe seems to have calmed down somewhat, among other things due to the ECB's three-year funding facility for banks. We hope that this marks the beginning of a normalisation of capital markets in Europe.

With respect to our own bond issuance activities, I would like to mention that we pursue the specific balance principle. The balance principle helps ensure a balance between lending and funding and thus prevents any refinancing risk in our books. This has helped us immensely during the financial turmoil.

We need to issue bonds to finance the loan offers we expect to make going forward. Even though the outcome of the rating process may possibly lead to an increase in our future funding costs, we expect that a large proportion of these additional costs can be offset by the general tendency to higher lending margins on long-term loans.

Competitive situation

Already at the beginning of 2011, it was clear that several of our competitors had started to scale down their lending to the shipping industry. This trend continued in 2011, and although a few new players have entered the market, the competitive environment currently seems favourable.

This situation makes Moody's statement somewhat annoying, because as long as our rating is subject to uncertainty, we have to be more cautious in our lending operations. We will continue to do business this spring, but we will also have to turn down good opportunities. It should be mentioned, however, that the number of transactions in the market and the number of attractive customers have also declined compared with pre-crisis levels.

Still, longer term we hope that we can turn the fact that we need to hold back somewhat in the months ahead into good fortune later on. The higher capital adequacy requirements for the financial sector are likely to push the gross margins even higher. In this regard, hopefully, we will not miss out on too much by postponing some of our lending operations. However, at the present time this is merely an expression of hope. As we all know, it is almost impossible to predict developments in the capital markets.

At a time when many lenders scaled down, we were pleased to see in 2011 that we had the capacity to add new clients to our portfolio. Once our rating situation has been resolved, we expect to add new and reputable clients to our portfolio once more.

Let us not forget that even though many shipping segments are suffering, not all the shipping companies have been impacted by the crisis. There are still many attractive and potential client leads out there in the market, and we will make a dedicated effort to attract them in the years ahead. We have defined a target of 100 clients during the next five years, which would increase our current portfolio by 25%.

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 remuneration for 2011, I would like to refer to note 7 to the annual report. I would also like to add that the increase in the base salary for the members of the Management Board was made because these members have waived their contractual possibility of receiving a bonus. As I explained last year, this is due to the rules on incentive remuneration in the financial sector, which make it difficult to apply a simple bonus model.

The 2012 salary increase represents 2.5% for the Management Board, and in 2013 we expect an adjustment of management board remuneration matching the market conditions.

Conclusion

Closing my report, I would like to say that the Board of Directors believes that Danish Ship Finance has done well in pursuing its strategy of focusing on the most reputable shipowners in good times as well as in bad. We will not change this strategy or our business model, regardless of what a rating agency might believe.