DANISH SHIP FINANCE

The Chairman's Report for the 2023 financial year

Looking back at 2023, I am very pleased that we could announce the 3rd best net profit in the 63 years that Danish Ship Finance has existed. With DKK 818 million after tax, we delivered a 23% increase from the already strong 2022 result.

At the end of 2022 we stated that we had the strongest loan book since the aftermath of the financial crisis 15 years ago. We believed that this would be a peak in loan book quality. However, 2023 saw further improvements with a reduction in the volume of legacy non-performing offshore loans. As of today, we have an even stronger loan book with no loans in an active work-out process and all loans are interest bearing.

The quality of the loan book is further underpinned by the fact that at year-end 2023 all loans were within a loan to value ratio of 60% and 92% were within 40% loan to value.

The strong ratios are partially a reflection of strong shipping markets and increased vessel values, in particular the Tanker and Gas segments. A similar development can be seen in some niche segments whereas one of the major segments, Dry Bulk, stayed flat. The value of container vessels dropped significantly in 2023, but we have prudently not been providing lending to container vessels in recent years, when the market increased to unusually high values. The spike in values were due to supply chain issues which reduced the availability of tonnage during COVID.

The drawback of strong shipping markets – from a lender's perspective - is that many shipowners have a reduced need for funding, and in some cases have chosen to bring down debt in the form of loan prepayments. The DKK 7.5 billion we received in prepayments in 2023 corresponds to almost 25% of the loan book at the start of the year. Prepayments have been the driver behind a decrease in our loan book of 9%. Notwithstanding the unusually high volume of prepayments, we have had a very active year, extending DKK 12 billion of new loan offers, adding new clients and extending our relationships with existing ones.

Despite the decline in the loan book and the associated lower earnings from lending, we delivered an even stronger net profit this year. The primary drivers behind the very satisfactory net profit were the successful conclusion of a number of workouts leading to large amounts previously written off being reversed. Also, the income from investments improved from a negative result in recent years as the interest rate environment finally normalised. We have kept interest rate risk low and consequently benefitted from the rate hikes, which were supplemented by a strong execution of trades within the portfolio. We believe that the investment income will again be a permanent source of base income as we do not see a reversal to an environment of negative interest rates.

We continue to push on the sustainability agenda and our experience is that the topic is top-of-mind with our clients. New technologies are emerging and will be ready to be deployed in the coming years. Most shipowners are prepared to – and have the means to – invest in green ships, but lack of supply of green fuels and a significant price gap to conventional fuels are for now holding back the ordering of green ships in more significant numbers.

Shipping markets

The overall freight rate index, the ClarkSea Index, was relatively stable during 2023, ending the year at USD 27,300 per day in December, which was within the top 30% observations since 2000. This development did however mask the fact that some segments experienced strong earnings while earnings in other segments were subdued. Tankers and Gas Carriers performed strongly during the year, as shifts in global oil and gas trade flows sent earnings skyrocketing. Conversely, freight rates in the Container and Dry Bulk segments initially tumbled due to weaker sentiment in the global economy. Contracting activity fell sharply in 2023, driven by lower appetite for new Container vessels, while few Tanker and Dry Bulk vessels were contracted.

World seaborne trade volumes regained some of the lost territory, and after having experienced a 0.4% decline in 2022, seaborne trade volumes are estimated to have increased by 3.0% in 2023. The recovery was uneven, with Tankers and Gas Carriers seeing strong demand growth and high freight rates, while fleet utilisation for Container and Dry Bulk vessels were weakening during much of 2023.

The climate agenda is front and center in the shipping industry and the path ahead is drawn up by the global regulatory framework that is governed by the International Maritime Organization (IMO). In 2023, the IMO reached a consensus to tighten GHG regulations, partly closing the gap to the objectives of the Paris Agreement. From 2024, the shipping industry will already start operating in accordance with new rules introduced by the IMO.

The IMO has introduced both technical and operational measures to ensure that the shipping industry reduces its climate footprint. The Energy Efficiency Design Index (EEDI) is a crucial step in ensuring that new ships are built to reduce the industry's climate impact, while the Carbon Intensity Indicator (CII) targets the operational efficiency of existing ships.

Lending

The development in the loan book was impacted by the fact that many shipowners have managed to generate substantial liquidity reserves over the past couple of years due to elevated earnings and subdued ordering of new vessels. A large share of these reserves has been spent on deleveraging balance sheets and prepaying debt. Hence, even though new loans equal to DKK 9.2 billion were disbursed and new accepted loan offers reached DKK 12.1 billion, our loan book decreased and ended the year at DKK 32 billion, collateralised by 596 vessels, down from DKK 35 billion at year-end 2022.

Although we had hoped to grow the loan book in 2023, we find our company to be in a good position to continue to attract new clients and grow the loan book.

Funding

On the funding side, we were active in both issuing new bonds and buying back existing shorter-dated bonds, following our established pre-funding strategy. We accessed the euro covered bond market in October with a highly successful and well oversubscribed three-year issuance. We were particularly pleased to welcome many new investors in this transaction.

By year-end 2023, issued bonds totalled DKK 44 billion at amortised cost with an average maturity of three years, of which 20% were denominated in EUR.

S&P once again confirmed the A-rating and Stable Outlook on our covered bonds.

Investments

We continued to manage the investment portfolio with low risk throughout the year, which kept the day-to-day volatility low. The portfolio return was boosted considerably by the reversion to higher short-term interest rates coupled with benign credit spreads. The investment portfolio generated an income of DKK 347 million before tax against a loss of DKK 87 million in 2022, corresponding to a return of 3.4% in 2023, compared to a return of -0.8% in 2022.

Financial performance

Once again, the net profit for the year of DKK 818 million was strongly supported by the hard work that has been put into resolving our legacy non-performing loans the past several years. Although reversals of loan impairment charges did not quite reach the very high level of 2022, we are more than pleased to report a reversal of DKK 506 million for 2023.

We are very comfortable with our current credit position, and although the total expected credit losses (ECL) allowance account has been brought down to a low level in a historical context of DKK 672 million at year-end 2023, from DKK 736 million at year-end 2022, we deem it to be more than sufficient to cover the remaining risk in the current portfolio.

The successful workouts lowered our non-performing loans exposure to DKK 0.9 billion and the non-performing loans ratio to 2.8% from 3.6% at year-end 2022.

The weighted average loan-to-value ratio after loan impairment charges equalled 40%, down from 43% at year-end 2022, and 100% of the loan book after loan impairment charges is covered within 60% of market values.

Costs amounted to DKK 201 million, up from DKK 187 million in 2022, primarily reflecting an extraordinary adjustment of variable compensation driven by the very strong 2023 result and certain advisory costs.

The 2023 result allowed us to pay the maximum dividend to the Danish Maritime Fund of DKK 83 million, through which we contribute to the growth and development of the Danish Maritime sector. Our total contributions since 2005, when the Danish Maritime Fund was established, now stand a DKK 962 million.

Balance sheet

Total assets increased to DKK 64.2 billion from 58.5 billion in 2022, primarily due to an increase in the bond portfolio.

The capital ratio increased to 23.6%, significantly in excess of the 13.3% regulatory requirement. This includes a Pillar II buffer for unrealised mark-to-market losses in our hold-to-maturity portfolio comprising of short-dated Danish AAA rated mortgage bonds.

Remuneration

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 the recently published Remuneration Report 2023, which is available on the company website for details.

The Remuneration Policy ensure that incentive bonuses in general are tied to the return for A-shareholders. The two members of the Executive Board were awarded the maximum bonus permissible under the remuneration policy, reflecting achievement of collective and individual performance targets and the financial return to class A shareholders for the financial year 2023.

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.

Board evaluation

The Board of Directors carried out its latest evaluation in December 2021. A new evaluation has been put on hold until the outcome of the ongoing sales process of Danish Ship Finance Holding is known. The aim of the latest evaluation was to ensure that the composition and special competencies of each member enable the Board to perform its duties and make sure that Danish Ship Finance create value for all stakeholders. The results showed good alignment and cooperation among members and with the Executive Board. The Board conducted an evaluation of their individual competencies in 2023, which showed that the Board continues to possess the required competencies for performing their duties.

Corporate culture

As the Chairman, I also have to mention our approach to ensuring a healthy corporate culture, originating from an amendment made to the Danish Financial Business Act. We continue to support the objective and actively work to constantly improve our corporate culture. The main focus is on communication and dialogue, employee well-being, preventing conflicts of interests, anti-money laundering and correct handling of insider information and GDPR.

During 2023, we held internal seminars focusing on, among other things, how to handle and report operational errors and each employee's obligations in handling internal knowledge, communication etc. In addition, all new employees receive a copy of the policy during onboarding and the Executive Board annually addresses the topics on at least one of the employee briefings following the Board meetings.

Closing remarks

2023 was an outstanding year from a shareholder perspective and a busy year for the organisation. In 2023, the composition of our earnings base normalised and once again our very solid platform benefits from two major income streams, one from lending and one from investments. With a strong brand and franchise and an exceptionally strong loan book, we are comfortable that our loan book over time will climb back towards previous levels, further strengthening the earnings base.

I expect over time that sustainability will take an even greater role in our activities, and we remain fully committed to our strategy of Financing the Transition.

As a final remark, I would like to thank all our employees for their dedication and hard work in 2023. I have full confidence that 2024 will also be a strong year bringing Danish Ship Finance forward.