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One year later

The effects of the Lehman bankruptcy on Malta's financial market

The first anniversary of the demise of the US investment bank Lehman Brothers which shocked the world on September 15, 2008 has been given lots of coverage by the international press. The global economic effect of this bankruptcy has been well documented but little has been said on the impact this had on the local financial market.

While the immediate impact on the local equity market may not have been sudden and evident possibly as investors and participants may have thought that our small equity market may be insulated from the effect of this bankruptcy, trading activity quickly shrunk, with investors seeking to understand any likely repercussions on publicly listed companies of the unfolding global events.

Investors who preferred to opt out of some equities experienced difficulties due to the shallowness of the market. With no buyers in sight and increasing levels of supply, within the space of a few weeks, the local equity market index began to trend downwards. The first visible effect of the Lehman bankruptcy surfaced when Bank of Valletta issued a company announcement on the evening of 15 September, 2008 informing the market that it held a position in senior bonds of Lehman Brothers as part of its overseas investment portfolio. For a number of weeks a section of the press speculated on the value of this loss, but it was only on October 31 that the total amount invested by BoV in Lehman bonds was made known.

This was the day when BoV issued its preliminary results for the financial year to September 30, 2008 and announced it had recognised a loss of €12.7 million from this holding. While this remained the only direct hit suffered by any of the companies listed on the Malta Stock Exchange (as no other bank or listed financial service company reported holding an investment in Lehman bonds), this event had a much more meaningful indirect effect on the market.

In the aftermath of the Lehman bankruptcy, most bonds of international banking and financial services organisations including the most renowned companies such as HSBC, UBS, Citigroup, Bank of America and others plummeted in value. With financial services companies in Malta and overseas having to value their portfolio on a "mark to market" basis in line with International Accounting Standards, the "unrealised losses" arising as a result of this event had a huge negative impact on investor sentiment. In fact BoV reported at the time of the publication of its September 2008 full-year results that while the Lehman failure cost it €12.7 million, the bank recognised impairments of a further €41 million as a result of the fall in value of its other bonds in its portfolio.

Meanwhile on April 30, 2009 a further €31.8 million write-down on its international investment portfolio was recognised by BoV in the first half of the 2009 financial year to March 31, 2009. Another company, Middlesea Insurance plc also suffered substantial write-downs on its investment portfolio during 2008 and in the first half of 2009. However, the steep losses by this insurance company in the last two financial periods is solely due to losses incurred by its Italian subsidiary which have nothing to do with the Lehman failure and overall conditions across the financial markets.

Apart from the Lehman impact on the financial services companies, the ensuing impact of the international recession on the tourism industry and other sectors hit many companies whose shares are listed on the Malta Stock Exchange. The extent of the negative impact is still emerging as evidenced by the many disappointing interim results being issued by most companies in recent weeks.

While international markets declined sharply until March this year and subsequently staged a strong recovery touching 11-month highs last week, the local equity market failed to mirror this turnaround during the last six months and has continued to suffer from very low activity and a general lack of interest by the investing public.

The focus away from the local equity market could be due to a number of factors including deteriorating profit levels and the resultant lowering of dividend payouts. Furthermore, the steep decline in interest rates on a global level to unprecedented lows and the shocking revelations among some of the world's most respected banks, especially in the UK, also impacted local investor behavior, instigating a stronger appetite for corporate bonds.

While on the one hand many savers were realising that the interest rate on their fixed-term bank deposits had shrunk to very low levels, other local investors who had retained some of their savings overseas preferred to repatriate their money and place this with the safer local banks who had adopted more conservative business practices over the years. The combined effect of all these factors prompted a strong demand for higher yielding bond investments.

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As a result of this strong demand, a number of companies launched bond issues on the local capital market. In the busiest six months for the local market since inception in 1992, a total of €200 million were raised through new bond issues by companies. The year kicked off with the €40 million issue by Midi plc followed by other issues from FimBank, BoV, Gasan, Tumas and IHI. A further three bond issues were launched very recently by Corinthia, Island Hotels Group and Melita Capital for a combined maximum value of €69 million but the total net new issuance amounts to €41 million since the balance represents bonds in the process of redemption.

A regular contributor to the press recently questioned the suitability of local bonds for Maltese investors. It would seem that investors' increased preference for bonds issued by Maltese companies results from the fact that such companies' business practices are more transparent and easier to follow as a result of their local domicile and consequent compulsory reporting obligations through appropriate company announcements. Furthermore, regrettably, too many Maltese investors got hurt with large losses on their overseas holdings such as the Lehman bonds amongst others over the past few years.

The columnist rightly brought up the question again on whether it would be the appropriate time for such local corporate issuers to have their bonds rated by a recognized rating agency. Although these agencies have somewhat lost a great deal of credibility following the recent international financial crises where they got caught retaining "investment grade" ratings to companies which eventually defaulted, a form of official rating for local companies would help prospective investors in their decision making process.

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