

Stock Market Review

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Lombard Bank: a steady financial performance in challenging times

Despite lagging the performance of the two major banks since the beginning of the year, Lombard's shares have, over a longer-term horizon, demonstrated a relative lack of volatility, Lombard's share price is down 19 per cent since the start of 2009 compared to positive performances by HSBC (+3.7 per cent) and BoV (+15 per cent).

This may be due to lower trading activity in Lombard shares compared to those of the two larger banks which in effect results from the substantially smaller shareholder base of Lombard compared to its larger competitors. Lombard's shareholders in fact total under 1,400 while those of HSBC and BoV are significantly higher at 10,143 and 17,434 respectively.

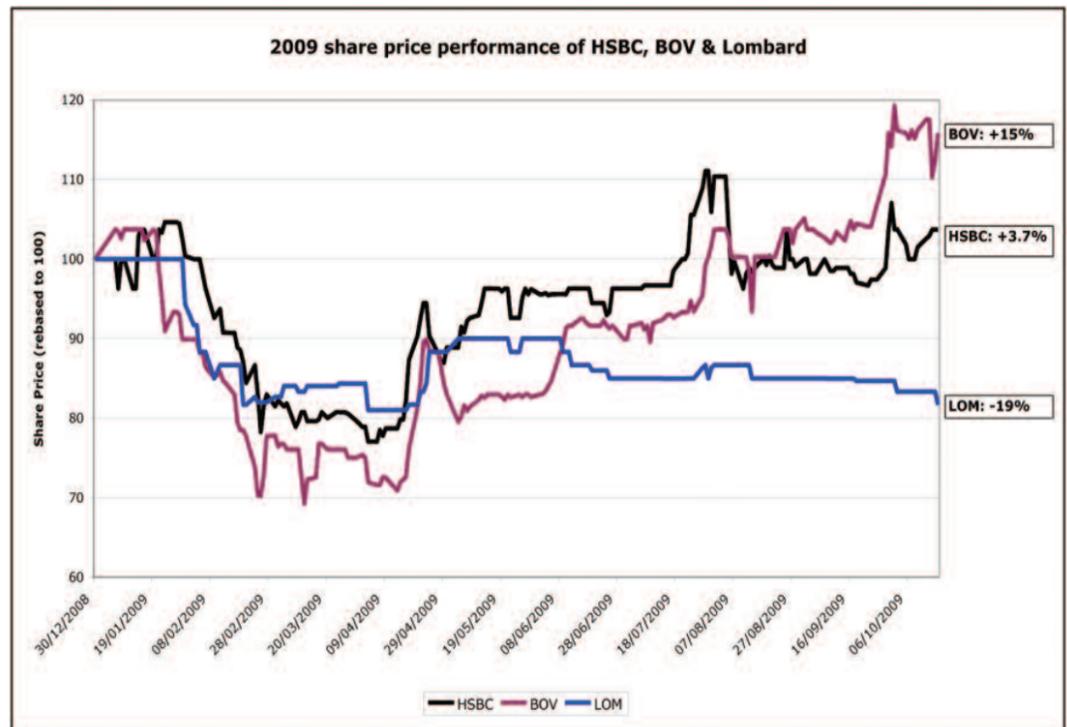
The reduced shareholder base tends to limit trading activity and, in turn, makes an equity less responsive to changes in investor sentiment. The share prices of BoV and HSBC have always been more volatile and are the main equities to lead the market into an upward or downward trend.

However, whereas the share prices of HSBC and BoV fell steadily during 2008, Lombard's remained fairly stable during the second half of 2008, presumably as a result of the buoyant 2007 full-year results and the 2008 interim figures reported by Lombard which included those of MaltaPost for the first time.

Furthermore, looking at the share price performance over a longer-term horizon since 2005, Lombard's equity has more than doubled whereas HSBC increased by 19 per cent and BoV's equity declined by 7.5 per cent. More importantly, while Lombard's current share price is down 30 per cent since reaching its all-time high in 2008, HSBC and BoV have slipped by 60 per cent since their peaks in the first half of 2006.

In the half-year report published by Lombard on August 27, Lombard reported that the profitability of the banking unit increased by 11.6 per cent while the Lombard Group accounts, taking into consideration the MaltaPost, figures show a 17 per cent decline in pre-tax profits to €6.4 million. The directors highlighted that this decline was solely as a result of the one-off transactions which boosted MaltaPost's profitability in 2008 and which were not repeated in the first six months of 2009.

These one-time items relate to MaltaPost's strong business activity generated from the euro



changeover as well as the general elections in March 2008. Moreover during the first half of 2009 due to the effect of e-substitution and the corresponding increase in parcel mail, the postal company suffered higher operating costs related to outbound mail.

Aside from the MaltaPost effect on the overall decline in the Lombard Group profitability, investors should be positively surprised that at bank level, Lombard grew its profits by 11.6 per cent. More importantly, while the two larger banking outfits saw their net interest income shrink as a result of the declining interest rate environment, Lombard's net interest income rose by two per cent to €6.7 million.

The Bank also benefited from a €40 million increase in deposits (+9 per cent) to €479.4 million as its loyal customers responded positively to the launch of the new deposit Xtra accounts. Lombard Bank remained highly dependent on net interest income and once again suffered a decline in fee and commission income which was in part due to lower fees earned from new loans (the bank's loan book remained stable since the start of the year at €325 million).

Instead of moving into other areas of financial services similar to the other larger banks to improve their fee and commission income, Lombard's strategy was that of acquiring a majority stake of the postal company and generating non-interest income from this subsidiary. With deposits increasing by €40 million and

loans remaining unchanged, Lombard's balance sheet reveals the prudent approach taken by top management to maintain high levels of liquidity.

Given the current economic circumstances, Lombard have taken a conservative approach to new corporate lending and the new deposits have been placed in short-term money market instruments in anticipation of attractive lending opportunities in safer economic times. The increase in deposits and unchanged level of overall loans led to a lower loan to deposit ratio of 67.9 per cent.

At the bank level, Lombard's management team, led by CEO Joseph Said, is reportedly seeking to selectively expand its operations through a gradual increase in the branch network and new products, particularly in business banking. Lombard opened another branch in Qormi (the seventh branch in Malta and Gozo) and, after acquiring a landmark property in Sliema in 2008, works on its restoration are expected to commence by the end of 2009.

With respect to business banking, Lombard aims to benefit from the opportunities and contacts of its largest shareholder Marfin Popular Bank of Cyprus who hold a 44.9 per cent shareholding in Lombard Bank. Lombard is also looking into cash-flow management products in response to client requests.

With respect to MaltaPost in which Lombard's shareholding increased to 65.2 per cent following the recent scrip dividend

which was taken up in new shares by Lombard's holding company Redbox Limited. A thorough business reorganisation at the postal company is being undertaken before entering into new areas of activity. This reorganisation also entails a nationwide branch upgrade of the MaltaPost outlets as well as staff training ahead of the widely anticipated entry of the postal company into financial services.

In some localities the encashment of government pension cheques against a small fee has commenced but it is believed that the intention is to offer savings products similar to those by post-banks in overseas markets. Moreover, with the strong growth in internet shopping, MaltaPost is benefiting from the increased parcel business which should open up avenues for the provision of courier services and other logistical support.

The sustained performance of Lombard's banking unit and the potential long-term benefits of the bank's strategic shareholding in MaltaPost seem to have been overlooked in recent months as evidenced by the low trading activity and the slower response to the upswing in the share prices of the larger local banks as well as banks overseas.

Once investor sentiment improves, Lombard's shares, together with the equities of some of the smaller companies which have been overlooked in recent months, should register increased activity.

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