

## Stock Market Review



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# HSBC expects profitability growth to resume this year

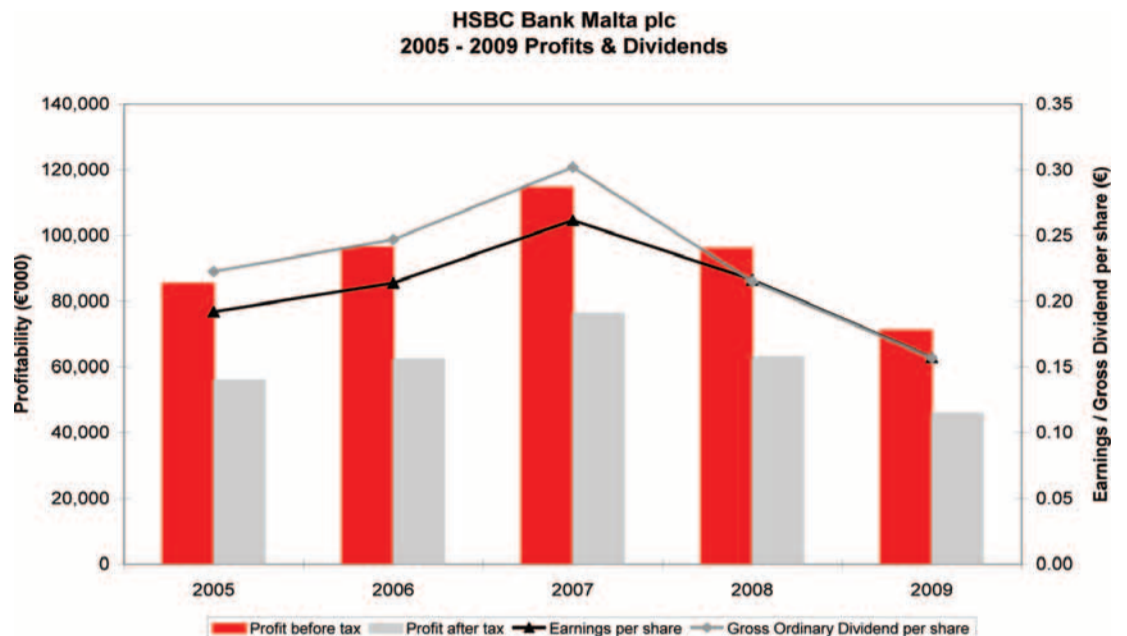
Shortly after the publication of HSBC Malta's 2009 full-year results on Monday afternoon, the bank convened a news conference providing further details of the financial performance and HSBC's outlook for the current financial year. Although pre-tax profits declined by 25.9 per cent to €71.2 million, HSBC Malta's CEO Alan Richards reiterated on several occasions that this performance was in line with the bank's expectations and revealed the resilience of the local group given the difficult economic environment during 2009.

The income statement of the HSBC Malta Group reveals that net interest income, the largest component of operating income, declined by €18.1 million or 14.7 per cent to €105 million. Despite a net increase in loans of €114.2 million, the significant decline in the European Central Bank euro refinancing rate (from 4.25 per cent in 2008 to one per cent in 2009) resulted in a steeper decline in interest receivable on loans compared to interest payable on deposits.

The time lag in the re-pricing of deposits compared to loans is a major negative factor affecting all banks during a period of interest rate declines, and HSBC Malta was no different in this respect. Meanwhile net fee and commission income increased slightly to €32.4 million on higher fees earned from new lending applications, card usage and retail brokerage activities. Profits from foreign exchange activities amounted to €7.2 million, representing a seven per cent decline from the previous year and significantly below the levels of circa €17 million which used to be earned by HSBC before Malta's adoption of the euro in 2008.

HSBC also experienced a decline in net gains in sale of financial assets as well as from the overall income earned from insurance activities. This dropped by almost 40 per cent to €13.8 million, but the CEO reported that the life assurance company had seen a strong recovery in its financial portfolio as the performance of global bond and equity markets rebounded in 2009 following the steep decline during the final quarter of 2008.

On the cost side, HSBC maintained a strict discipline on expenses. Overall administrative expenses dropped by €6.6 million or 7.3 per cent to €83.8 million. This decline was mainly due to a high level of voluntary retirement scheme payments in 2008 which were not repeated in 2009. General and



administrative expenses decreased by almost €700,000 from 2008 as HSBC sought to reduce costs as the downward pressure on revenues was evident during the year.

Loan impairments increased from €1.9 million in 2008 to €4.4 million during the financial year under review. Despite this increase, the CEO was quick to mention that this must be analysed in the light of the very low levels of impairments in recent years as well as the weaker economic environment in 2009, particularly during the final quarter of the year. Mr Richards claimed that compared to the overall size of the loan book, the level of provisions is extremely low at a mere 0.13 per cent. In fact, another indicator shows the ratio of non-performing loans as a percentage of overall loans remaining at a very healthy level at under three per cent.

With HSBC's overall income shrinking by €28.6 million, impairments rising by €2.5 million and a €7 million decline in costs, HSBC Malta's pre-tax profits decreased by over €24 million during 2009 to €71.2 million. HSBC Malta maintained an unchanged dividend policy in 2009, and the bank last Monday announced that it will be recommending a final gross dividend of €0.08 per share to all shareholders during the forthcoming Annual General Meeting scheduled to take place on April 8.

While this represents a 16.7 per cent decline from last year's final dividend, it is a slight increase from the interim dividend distributed in August 2009 and shows that HSBC Malta registered an improved profitability during the second half of its 2009 financial year. The final net dividend of €0.052 per share will be paid

on April 20 to those shareholders at close of trading next Monday. HSBC Malta reported growth in both its deposit base and lending book during 2009. Total deposits increased by €70 million to €4.09 billion as at December 31, 2009. HSBC's CEO said that this shows the trust of local depositors in the HSBC brand in the light of heightened competition from a number of new banks as well as increased opportunities for depositors from the various local bond issues presented during the year.

Few might realise the strong growth in deposits in recent years. HSBC reported a depositor base of just over €3 billion at the end of 2004. Within the space of five years, deposits at HSBC climbed by over €1.08 billion (over €200 million per annum), an extraordinary rate of growth in deposits which was similarly reflected in the overall depositor base of HSBC's major competitor. On the lending side, HSBC's CEO also explained that during this unprecedented financial crisis, HSBC continued to provide support to its local customers and over €660 million in new lending was approved in 2009.

Overall net total lending increased by €114.2 million to €3.2 billion, giving a loan-to-deposit ratio of 79 per cent. With overall shareholders' funds increasing by 8.5 per cent to €306.6 million, HSBC's CEO maintained that the 2009 performance represents a strong return on equity of 15 per cent and a capital adequacy ratio of 11.8 per cent.

Mr Richards remarked that the immediate outlook for the local economy remains challenging with only a slight improvement in GDP expected in 2010. Despite the possi-

bility of further loan impairments given the fragile economic environment and the CEO's expectation of continued downward pressure on net interest income, Mr Richards claims that HSBC Malta will return to profitability growth during the current financial year.

The HSBC newsletter *Munita* distributed to all shareholders last week also included some reassuring messages for shareholders. In his address HSBC Malta's Chairman Albert Mizzi explained "with the backing of the HSBC Group, our enduring commitment to liquidity, strong capital and a conservative approach to risk management, we are well positioned to build on our many strengths and support our customers in driving future growth." The chairman also stated that "HSBC is in excellent shape."

The immediate reaction to these results in the market was negative as the share price shed 7.24 per cent on Tuesday morning to its "limit down" price of €3.59. However only 500 shares traded on the day as buyers shied away, given the various shares on offer at the €3.59 level. The Malta Stock Exchange should have temporarily lifted the trade range to enable a more orderly functioning of the market on the day. HSBC's share price gained almost 20 per cent during the first seven weeks of 2010, hitting a high of €4.05 in mid-January. The decline after the full-year results announcement to €3.59 reduced the market capitalisation to just over €1 billion. HSBC Malta remains the largest company by market cap listed on the Malta Stock Exchange, followed by Bank of Valletta with a valuation of €680 million and International Hotel Investments currently valued at €434.8 million.

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