

## Stock Market Review



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# HSBC 2010 dividend payment set at 55 per cent

The financial statements of HSBC Bank Malta plc published last Friday afternoon reveal that the HSBC Malta Group returned to profitability growth after two years of declines from the record profits registered in 2007.

Pre-tax profits generated by HSBC Bank Malta plc during 2010 amounted to €83.1 million representing an increase of 16.7 per cent from the profits of €71.2 million in the previous year.

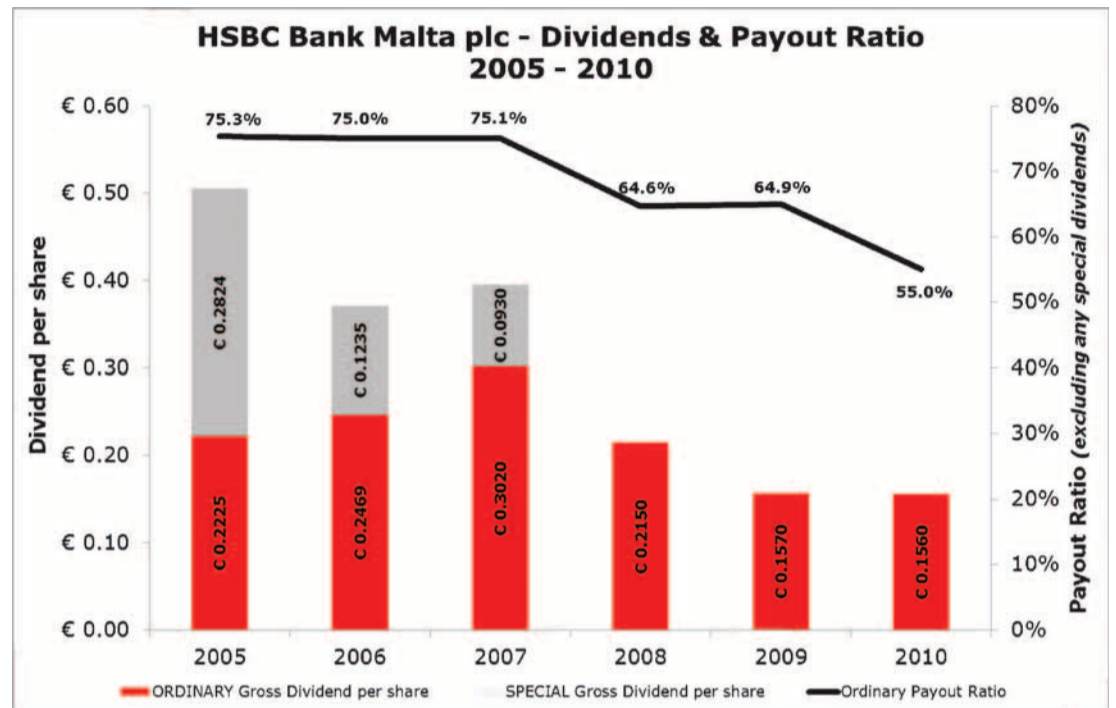
Like most financial institutions, HSBC's financial position had been negatively impacted by the sudden decrease in interest rates by the European Central Bank in 2008/9 in the aftermath of the international financial crisis. Lower interest rates normally have a negative effect on bank's profitability levels as they lead to a decline in the main source of income – net interest income. This was also felt by HSBC in Malta as net interest income decreased by €18 million in 2009 resulting in a drop in profitability.

However, as many term deposits have now re-priced in line with the current interest rate scenario, the net interest income generated by HSBC in 2010 has recovered strongly as interest paid to deposits declined to "only" €46 million. Net interest income grew by 17 per cent during 2010 to the same levels in 2008 with the interest margin climbing to an extraordinary level of 72.7 per cent – the highest level ever recorded by any bank in Malta.

Apart from improved income levels from the traditional interest income, HSBC Malta also saw a 5.9 per cent increase in revenue from fee and commission on higher usage of its debit and credit cards and income from brokerage and trust services.

Similarly, profits from the life insurance arm grew by 7.2 per cent to €12.6 million despite the volatile environment while income from foreign exchange services declined to €6.8 million. This is in sharp contrast to the foreign exchange revenue generated by Bank of Valletta plc which amounted to €18.4 million during their last financial year. According to HSBC's newly appointed chief financial officer Josephine Magri, this is in part due to different business models as well as higher volumes transacted by BoV due to the different areas of operations among their international client base.

In a press conference convened shortly after the board of HSBC approved the publication of the



2010 financial statements, CEO Alan Richards once again emphasised the bank's focus on disciplined cost management initiatives. Employee costs climbed three per cent to €50.7 million while general administrative expenses grew by 11.2 per cent to €30 million reflecting overall investments made by the Bank in information systems to improve customer delivery and segmentation as well as in its branch network. HSBC had announced an €8 million branch network upgrade some months ago over the next five years.

A closely watched item when banks issue their financial statements is the overall level of impairments or "bad debts" as they were described in the past. HSBC Malta recognised total net impairment allowances of €5.5 million in 2010 compared to €4.4 million the previous year. Although this is the highest level in a long number of years, an important indicator is the amount of non-performing loans compared to the overall level of loans. The ratio of three per cent for HSBC is still very healthy and compares favourably with the ratios of other local retail banks. The increased level of impairment allowances was anticipated by HSBC. The bank had indicated in recent months that impairments necessarily increase in times of an economic downturn.

HSBC also made good progress during 2010 from a balance sheet perspective. Despite the various bond issues and increased competitive pressures in the banking

sector, the overall level of deposits grew by 9.2 per cent (€376 million) in 2010 to €4.5 billion. However, in view of the weak demand for corporate lending especially during the first nine months of the year, much of the increased liquidity at the bank was placed in Malta Government Treasury Bills. HSBC reported that stronger demand for lending was evident during the final three months of 2010 (which also continued in the New Year) and the overall level of loans to customers at year-end of €3.3 billion reflects an increase of €77.4 million over the 12-month period.

Similar to trading patterns in previous years, HSBC's share price improved considerably ahead of the full-year results on very high volumes as over one million HSBC shares changed hands in the market during the first six weeks of the year. The publication of these financial statements was therefore widely anticipated by investors. However, the immediate reaction to the results earlier this week was negative as the share price declined by 4.4 per cent on Monday and a further 1.85 per cent the following day.

Although it is difficult to gauge whether the market expected HSBC Bank Malta plc to deliver a stronger financial performance, the decline is probably attributable to the revised dividend payout although the unfolding events in Libya may have also had a significant impact on investor sentiment. In fact, stockmarkets worldwide have all been affected. Ultimately, share-

holders may have expected the growth in profitability in 2010 to be reflected in a higher dividend payment.

The bank had given a strong indication of this revised policy in August at the time of the publication of the 2010 half-year results. In fact, the interim dividend had also reflected a lower payout ratio and in a media interview published on August 5, 2010, the CEO described the revised payout as a "short-term correction" in view of anticipated regulatory changes that will require banks to hold increased levels of capital going forward.

Despite the low interest rate environment and increased competitive forces in the banking sector, both local major banks reported encouraging financial results in recent months with pre-tax return on equity in excess of 20 per cent. Bank profitability levels fluctuate in line with the overall economic environment and the interest rate scenario and share prices normally follow a similar trend.

Following the sharp decline in interest rates in 2008 and 2009, there is growing pressure in the UK and also in the eurozone for central banks to start tightening monetary policy in view of inflationary pressures. Banks benefit from such interest rate hikes as loans are re-priced quicker than term deposits. The loan portfolios of the two major local banks have grown considerably in recent years with potential for increased profitability levels in better economic times for the benefit of all stakeholders.

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