Stock Market Review

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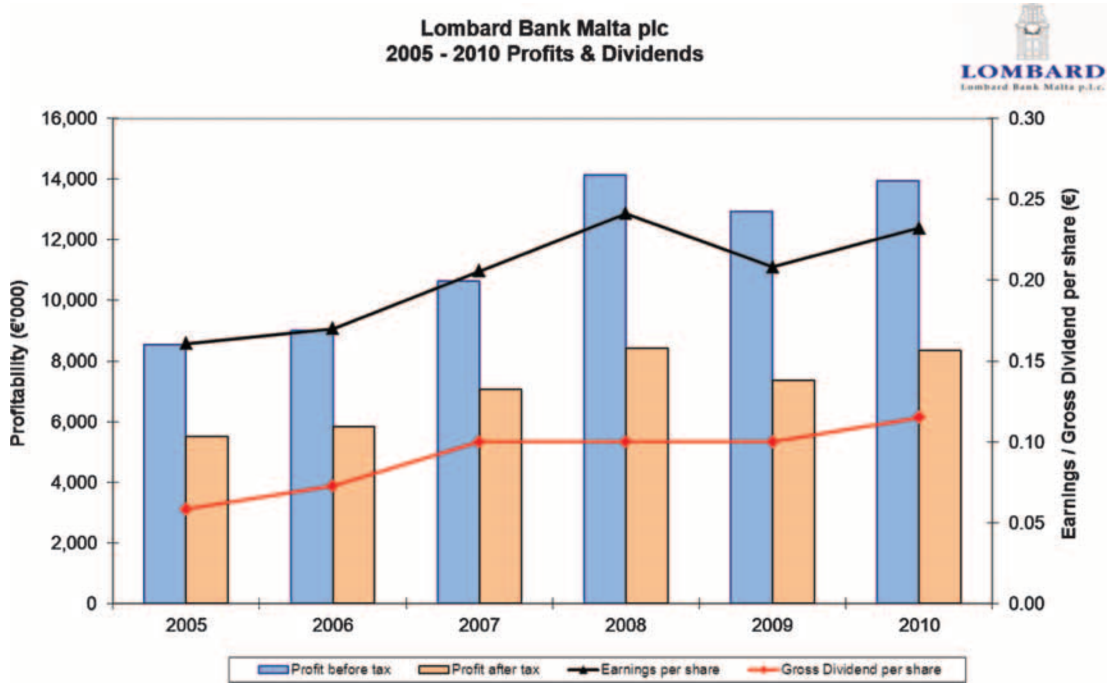
Lombard's profits just shy of 2008 record level

Lombard Bank Malta plc published its 2010 financial statements on March 10 revealing a 12.9 per cent increase in profit after tax to €8.3 million. The profitability level achieved during 2010 was just shy of the all-time record of €8.4 million registered in 2008 at a time when interest rates were significantly higher before the start of a sharp downturn in rates by the European Central Bank in late 2008 and 2009.

The higher profits registered during the last 12 months were mainly achieved due to the 10.1 per cent rise in net interest income to €16.1 million as deposits continued to re-price in line with the current low interest rate environment. The lower interest payments on deposits helped the net interest margin to climb to a record level of 61 per cent. Moreover the Lombard Group registered a four per cent rise in non-interest income as a result of (i) the continued strong revenue from postal sales amounting to €19.8 million (+2.1 per cent); (ii) higher foreign exchange earnings mainly through the postal subsidiary and (iii) a 6.7 per cent increase in net fee and commission income to €2.2 million resulting mainly from the various bond issues during 2010.

The Lombard Group achieved a record total operating income of €38.8 million. In contrast to the other larger retail banks, Lombard achieved a higher contribution from non-interest income as opposed to traditional interest income. This occurred following the acquisition of a majority stake in Maltapost plc as the high revenue generated from postal services of €19.8 million in 2010 is recognised as "non-interest income". The beneficial impact of the contributions to the profitability of the Lombard Group from the postal operator as from 2007 is clearly evident from the trend over the past three years.

Total expenses at the Lombard Group increased by 4.5 per cent during 2010 to €24.5 million. Nonetheless, the cost to income ratio at the group level improved to 63.2 per cent from 64.4 per cent in 2009. However, due to the different cost structures and characteristics of the postal subsidiary it is worth highlighting that the cost to income ratio at the bank level of 36.4 per cent compares very favourably to similar ratios in the industry, both locally as well as internationally.



The level of impairment allowances (bad debts) is always closely watched by analysts and there has been a clear increase in impairments over the past two years by the two large retail banks given the current economic environment. This fact was also referred to by the international credit rating agency Fitch Ratings when it recently assessed Bank of Valletta plc and indicated that "loan impairment charges are expected to remain higher than in past years".

While the Lombard Group provided for a high level of impairments totalling €645,000 at the interim stage, this was reduced to only €186,000 by the year-end. A further analysis of the computation of the level of impairments would be necessary but this information will only be available once Lombard publishes its Annual Report in the coming weeks. Total assets as at 31 December, 2010 increased by 4.6 per cent to €567.8 million, mainly due to the rise in loans and advances to banks. Customer loans edged 1.8 per cent higher to €333.7 million as "the bank remained selective in its lending activity".

In previous announcements Lombard directors had been indicating a higher level of prudence in new lending opportunities given the economic situation. An analysis of the sectoral allocation of the loan book and the exposure to the property and real estate sectors would be appropriate once the full set of financial statements are sent to shareholders ahead of the annual general meeting to be held on April 28, 2011.

Despite the increased competitive pressures within the banking industry mainly from newer banks tapping retail deposits, Lombard's deposit base continued to grow. Total customer deposits amounted to €472.7 million as at December 31, 2010, an increase of 5.9 per cent over the previous year. Lombard's advances to deposits ratio of 71 per cent compares well with the two larger retail banks in Malta. Shareholders' funds as at December 31, 2010 of €76 million (+11.5 per cent) translate into a net asset value per share of €2.107.

In last week's announcement, the directors of Lombard Bank also recommended the payment of a final gross dividend of €0.115 per share to all shareholders as at the close of trading on March 24. This represents a 15 per cent increase in the dividend over the previous year and the highest dividend ever distributed by the Bank. However this year, shareholders will not be given a choice to take their dividend either in shares or in cash. It will be paid in cash to all shareholders. The scrip dividend option had become a key feature of Lombard's shareholder benefit programme since they had first offered this option way back in 1998.

It was only skipped in 2000 when Lombard had made a rights issue in order to strengthen its capital base. The suspension of the scrip dividend option may be due to the strong equity built-up in recent years as evidenced by the capital adequacy ratio (Tier I + Tier II) of 17.9 per cent. Although capital requirements are expected to become more stringent in the coming years, the group's strong equity base could also enable Lombard's Directors to gradually resort to a more aggressive dividend payout policy which at 32.2 per cent remains below the level of most dividend-paying companies.

In their short commentary included in last week's announcement, Lombard directors stated that the 2010 financial statements "continue to highlight the strong business fundamentals of the Lombard Bank Group". Moreover they indicated optimism that the group is "well placed to continue to attain sound business growth". While a rising interest rate environment normally contributes positively to bank profits, the market also expects the postal subsidiary to contribute further to profitability growth going forward.

This is evident from the continuing rise in Maltapost's share price which is outperforming most other local equities supported by a high dividend yield clearly indicating that investors expect the company to continue to grow its business and profits. Lombard's ultimate objective for Maltapost is to replicate the postal banking initiatives undertaken by similar international postal operators overseas. Shareholders of Lombard Bank as well as of Maltapost continue to look forward to this development materialising. It should continue to reinforce the acquisition conducted by Lombard Bank in 2006/7.

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