

Stock Market Review



Edward Rizzo

Mr Rizzo is director of Rizzo, Farrugia & Co. (Stockbrokers) Ltd.

Impairments and sovereign debt crisis impact BoV's performance

The financial statements published by Bank of Valletta plc last Friday covering the six month period to March 31, 2011 reveal a profit after tax of €30.3 million, representing a slight 3.8 per cent improvement over the comparative period last year. The two line items that expose the financial statements of BoV to major fluctuations from one period to the next are the "impairments on the loan book" and the "recovery/mark-downs from the bond portfolio".

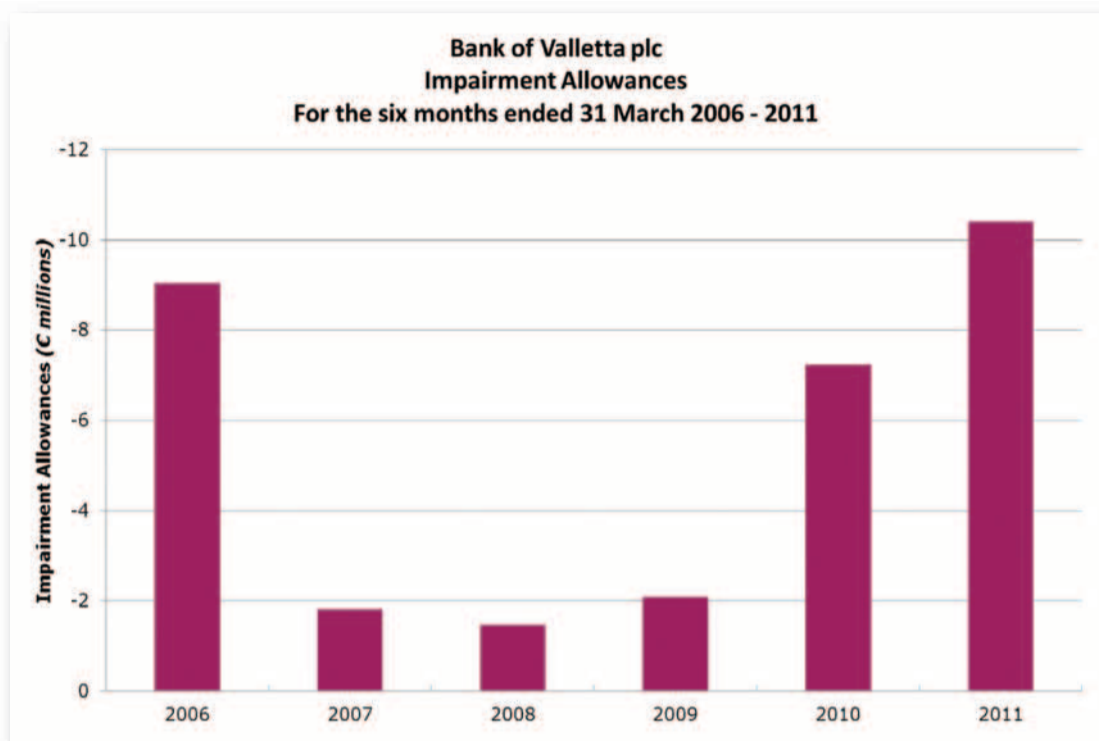
Unfortunately, impairments and mark-downs both negatively impacted BoV's financial performance during the past six months. On the other hand, net interest income continued to improve (+9.5 per cent to €67.8 million) while net fee and commission income dropped 5.2 per cent to €21 million. Moreover, the bank continued to register strong growth in foreign exchange income while costs were also well controlled.

A further positive development during the six month period to March 31, 2011 was the improved return from the bank's equity interests in the insurance sector. The share of profits from the bank's investments in Middlesea Insurance plc and MSV Life plc amounted to €3.8 million. This is a welcome development following the losses incurred in recent years.

The impairments recognised by BOV during the first half of their 2010/11 financial year increased by 43.7 per cent (€3.2 million) to €10.4 million. As had been revealed in the 2010 Annual Report, the overall impairment charge by BoV on its loan book has been increasing due to a more cautious outlook on certain sectors of the local economy since some uncertainties still remain following the global economic recession.

Moreover, during the period to March 31, 2011, the charge also includes "a precautionary additional allowance" following the political upheaval in Libya. BoV reported that it has certain indirect exposures to companies and individuals operating in North Africa and the bank felt it necessary to take a higher provision in view of the increased downside risks due to unfolding developments in Libya.

Meanwhile, the performance of the bank's foreign bond portfolio was again impacted by the continuing sovereign debt crisis



that has been affecting the eurozone since April 2010. During the past six months BoV suffered a total write-down of €5.6 million. This had a substantial impact on BoV's performance when one compares this to the positive recovery of €5.9 million taken in the six months to March 2010.

The international bond markets continue to be affected by the eurozone sovereign debt crisis following the request made by Portugal to also seek financial assistance from the EU and the IMF. Moreover, the focus is now also on the Greek Government's ability to honour its debt obligations. BoV reported in its recent interim report that its exposure to bonds issued by Greece, Portugal and Ireland is "very limited".

Turning to the decline in the net fee and commission income (-5.2 per cent to €21 million), BoV revealed that demand for new loans has slowed down in recent months while investment-related activities were also subdued due to weaker investor sentiment as well as lower issuance of bonds in the capital market. BoV explained that the slowdown in the local capital market was partly due to the publication of new regulations by the Listing Authority at the MFSA.

The balance sheet of the BoV Group as at March 31, 2011 also reflects the cautionary stance in the local economy. Loans were only marginally higher at €3.5 billion as demand for new loans remains subdued. During the

meeting with the financial community convened last Friday afternoon, BoV chairman Roderick Chalmers spoke about the effect of the political developments in Libya on the local economy. Mr Chalmers commented that the demand for credit by the business community slowed down following the Libyan debacle reflecting the aversion to risk and increased caution being adopted.

Likewise, customer deposits were also marginally unchanged at €5.2 billion. However, it is worth noting that while deposits from domestic retail customers continued to grow despite increased competitive pressures, there was a slowdown in deposits from institutions at the reporting date of March 31, 2011 reflecting the volatility normally experienced by such deposits.

BoV's share price has come under pressure in recent months and has declined by 10.4 per cent since the start of 2011. Sentiment towards BoV was dented by ongoing developments with the La Valette Property Fund but also from the unexpected downgrade of the Bank's credit rating by Fitch.

BoV's directors also made reference to the Fitch rating in last week's interim report. They stated that this was "unexpected and disappointing" and also declared that Fitch "were at pains to point out that the modification was more a reflection of Fitch having adopted a more cautious view on the position of banks

operating in small economies rather than because of any material change in BoV's situation".

Last Friday BoV declared an unchanged interim dividend of €0.0625 gross per share payable to all shareholders as at close of trading next Monday 9 May. As in previous years, BoV remarked that the full-year dividend for the current financial year to September 30, 2011 will take into account the financial performance achieved and the conditions at the time of the recommendation next October.

BoV's capital ratios remain strong and well above the more stringent regulations due to be imposed by the Basle III regulations. This indicates that the bank should continue to maintain its dividend payout ratio of circa 50 per cent. However, the overall level of dividend will be dependent on the performance in the second half of the year.

The 2011 dividend league table published last week placed BoV's equity in third place with a net dividend yield of 4.4 per cent per annum. BoV could hold onto this position if it registers another satisfactory performance in the coming months helping the bank to reward shareholders appropriately. Meanwhile, announcements of further interest rate hikes in the coming months by the European Central Bank could enhance profitability growth as interest rate increases usually have a positive impact on the overall level of interest income generated by a bank.

“

The bank felt it necessary to take a higher provision in view of the increased downside risks due to unfolding developments in Libya

”

Rizzo, Farrugia & Co. (Stockbrokers) Ltd, "RFC", is a member of the Malta Stock Exchange and licensed by the Malta Financial Services Authority. This report has been prepared in accordance with legal requirements. It has not been disclosed to the issuer/s herein mentioned before its publication. It is based on public information only and is published solely for informational purposes and is not to be construed as a

solicitation or an offer to buy or sell any securities or related financial instruments. The author and other relevant persons may not trade in the securities to which this report relates (other than executing unsolicited client orders) until such time as the recipients of this report have had a reasonable opportunity to act thereon. RFC, its directors, the author of this report, other employees or RFC on behalf of its clients, have

holdings in the securities herein mentioned and may at any time make purchases and/or sales in them as principal or agent. Stock markets are volatile and subject to fluctuations which cannot be reasonably foreseen. Past performance is not necessarily indicative of future results. Neither RFC, nor any of its directors or employees accept any liability for any loss or damage arising out of the use of all or any part thereof and no

representation or warranty is provided in respect of the reliability of the information contained in this report.

© 2011 Rizzo, Farrugia & Co. (Stockbrokers) Ltd. All rights reserved
www.rizzofarrugia.com

