Stock Market Review

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BoV reports a two per cent increase in core profitability

For a number of weeks the local financial community and the investing public had been eagerly awaiting the publication of the financial results of Bank of Valletta plc for the year ended September 30, 2011. As was widely anticipated the performance was negatively impacted by the buy-back offer to the investors of the ill-fated La Valette Multi Manager Property Fund and the overall fair value charge on international securities resulting from the deepening eurozone sovereign debt crisis. In fact, these two line items were the major causes of the 35 per cent decline in pre-tax profits to €64.4 million.

While the financial impact of the €15 million in costs related to the Property Fund had been revealed by BoV in recent months, the extent of the size of the write-downs reflecting the eurozone sovereign debt crisis is always very difficult to gauge and renders BoV's performance volatile from one period to the next. BoV reported that a large part of the €25 million in total write-downs on the international bonds materialised during the last two months of the financial year on escalating fears surrounding some eurozone sovereign states including Italy and Spain.

This also includes a €6 million loss on BoV's exposure to securities of the periphery states of Greece, Ireland, Italy, Portugal and Spain. Although BoV indicated that the overall exposure of €23 million to these countries is modest in the context of the overall investment portfolio amounting to €2.4 billion, one would have expected a more detailed breakdown of the various investments also giving indications of the rankings of some of the financial and corporate bonds held.

Elsewhere, it is encouraging to note that the "core" profitability of the BoV Group actually improved during the past 12 months. The profits generated from the retail and corporate areas increased by two per cent to €100.3 million even after taking account of a four per cent increase in the cost base and a 24 per cent rise in loan impairments to a six year high of €16 million.

Net interest income improved by eight per cent to a record level of €137.3 million although the demand for new loans remained subdued reflecting the uncertain economic climate both locally as well as internationally. On the other hand, for the first time in several years, commission and trading income dropped by three per cent to €61.1 million.

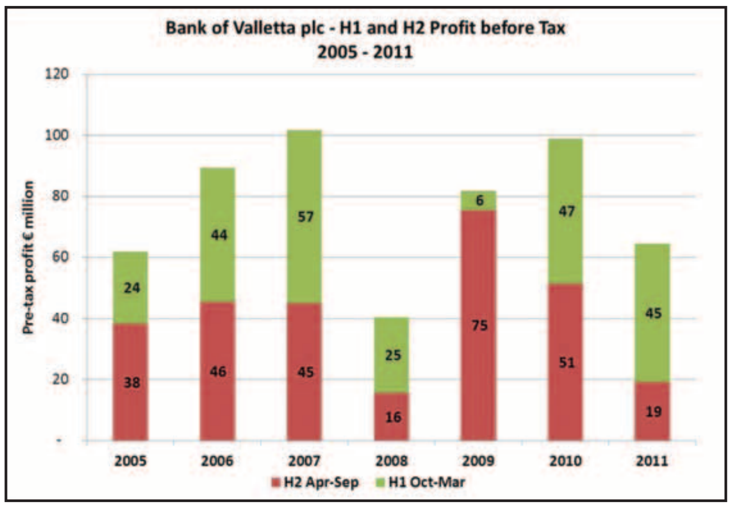
BoV chairman Roderick Chalmers explained that the continued strong performance from the card business and the increased volumes in foreign exchange transactions was offset by lower trade finance activities (due to the Libya political crisis) and a decline in revenue from the investment related business. While lower commission income from investments was partly reflective of the overall negative market conditions, this was accentuated by the lack of new bond issuance on the local capital market. BoV's chairman referred to a complete shutdown of the local new issuance capital market "principally as a result of the new regulations implemented by the Listing Authority in August 2010".

In a very detailed presentation to members of the financial community, BoV's chairman explained the backdrop of the challenging conditions faced by the bank during the past 12 months brought about by the "existential" crisis within the eurozone which recently led to the near collapse of the banking group Dexia mirroring the developments seen across the world only three years ago.

Mr Chalmers also made reference to last week's decisions taken by the EU summit on the eve of the publication of BoV's financial statements. One of these actions involves an overall recapitalisation of banks across the EU amounting to circa €106 billion. Banks are required to reach a nine per cent capital ratio by June 2012 and BoV's chairman was pleased to report on the strong capital ratios of the BoV Group. As at 30 September 2011, BoV's Tier 1 ratio of 10.5 per cent already meets the more stringent requirements and the European Banking Authority has confirmed that BoV is not required to raise additional capital.

This is very important for BoV and also for the entire local financial system. BoV shareholders should be pleased that the bank does not require to raise new equity from them and as a result the bank can maintain its current dividend policy of distributing half of after-tax profits to shareholders.

As such, the market should not be surprised at the decline in the final dividend being proposed for approval at next month's annual general meeting. Due to a decline in profit during the second half of BoV's financial year, the final dividend of €0.08 per share (before tax) is 40 per cent below the payment made in December 2010. When including the interim dividend of €0.0625 per share paid in May 2011 in respect of BoV's performance during the first six months (unchanged from the previous interim payment), the overall decline in the dividend this year is of 27 per cent.



As has become customary in recent years, BoV is also conducting a bonus share issue in order to further strengthen the permanent capital base of the bank. A total of €30 million will be transferred from accumulated retained earnings to the issued share capital of the bank. This will take place via a "1 for 8" bonus share issue to shareholders on the register as at close of trading on January 9, 2012.

When making reference to the more stringent focus being placed by regulators on the liquidity position of banks around the world, BoV's chairman also highlighted the fact that BoV continues to fully fund its loan book from its retail deposits and the bank is not dependent on loans from other banks which is crucial in conditions currently being faced where international banks have again stopped lending to one another. The strong funding base of BoV continued during the past 12 months with deposits growing at a faster pace compared to the loan book. As a result, the loan to deposit ratio eased to 68 per cent as at September 30, 2011. The balance sheet reveals that the increase in deposits at BoV is mainly reflected in a higher balance of holdings of Malta Government Treasury Bills and placements with the Central Bank of Malta reflecting the increased caution in the market.

The costs related to the settlement of the buy-back offer of the Property Fund of €15 million are a one-off hit to this year's financial performance and the bank may actually recover some of this loss from the third-parties involved in the actual day-to-day management of the fund. While not disclosing the amounts being negotiated by the bank, BoV's chairman explained that these will be written back to the income statement only if such negotiations are concluded successfully.

Notwithstanding a potential partial recovery of this loss, Mr Chalmers expects a challenging 2012 due to the ongoing eurozone sovereign debt crisis. BoV's chairman mirrored other views expressed by many international economists explaining that last week's summit did not halt the crisis altogether. Unfortunately this is likely to last longer due to the uncertainties on how the European Financial Stability Fund will increase in size to cope with the renewed concerns surrounding the debt obligations of Italy and Spain.

BoV's chairman also indicated that the weak demand for new loans experienced in recent months is likely to continue due to the bleak economic situation. While this is not positive for the overall level of profits for the bank, Mr Chalmers also highlighted that a low interest environment is also not generally positive for banks. BoV's chairman expects eurozone interest rates to very likely reverse the recent hikes and maintain these historically low levels for an extended period of time.

While a low interest rate scenario and subdued demand for credit could have a dampening effect on the financial performance of the bank and on returns to shareholders as measured by the return on equity (ROE), Mr Chalmers made a favourable comparison of BoV's 2011 ROE of 13.6 per cent to the substantially lower levels being achieved by many international banks. He revealed that the average ROE across banks in Europe is expected to be 9.5 per cent during 2011 with a ratio of only 5.5 per cent by banks in the US.

BoV's financial performance and strong capital ratios are further testament of the resilience and good health of Malta's commercial banks.

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