Stock Market Review

HSBC's 2011 financials impacted by a number of one-off items

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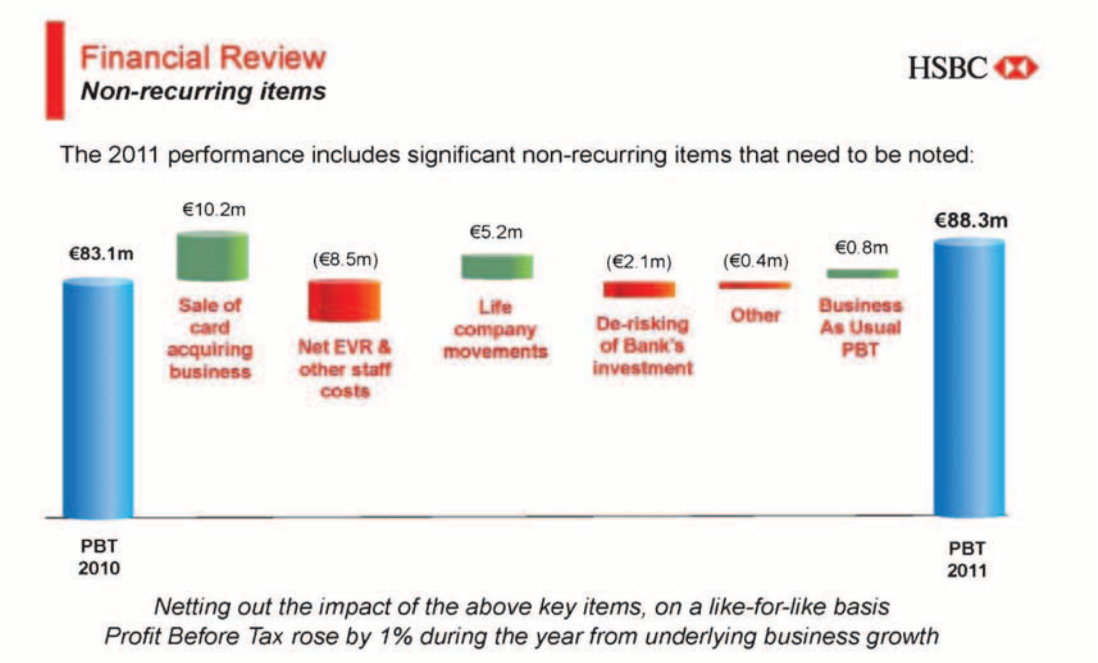

Last Friday afternoon, HSBC Bank Malta plc published its 2011 full-year financial statements showing a pre-tax profit of €88.3 million, representing an increase of 6.3 per cent from the previous year. At a briefing convened shortly after the publication of the results, HSBC's CEO Mark Watkinson was quick to point out that the financial performance of the HSBC Malta Group during 2011 was impacted by a number of one-off items, namely: (i) the sale of the card acquiring business; (ii) the positive effect on profitability following a change in methodology within the life insurance business; (iii) the costs related to the voluntary retirement scheme and (iv) the changes to the investment portfolio which resulted in a loss of €2.1 million following the sale of various debt positions of a number of peripheral eurozone countries.

HSBC's CEO explained the four major one-off items in detail and indicated that when excluding the effect of these items, the profitability during 2011 was almost identical to the pre-tax profit of €83 million generated during the previous financial year.

Mr Watkinson confirmed that the sale of the card acquiring business, which positively impacted HSBC Malta's financials by €10.2 million, came about as a result of HSBC's Global policy and a decision was taken to sell this business to an international specialist organisation in the field. When questioned on the effect of this sale on the future of HSBC Malta's financial performance, the CEO confirmed that the card acquiring business was not part of the core income stream of the group and therefore no material impact is expected on the business since this area of business activity used to generate only around €1 million in pre-tax profits.

Similarly, the CEO explained that the change in methodology adopted by the life insurance business also came about as a result of a revised policy undertaken by all HSBC life insurance companies around the world. The net impact on the 2011 financial performance was a positive contribution of €5.2 million.

On the other hand, the financials of HSBC Malta were negatively impacted by the costs related to the voluntary retirement scheme estimated at around €8.5 million and the €2.1 million loss following the sale of a number of international bonds during the year as part of the "de-risking" exercise of the bank's investment portfolio. The voluntary retirement scheme was also conducted in line with HSBC Group policy of streamlining the business for a more efficient operation as part of the overall strategy of focusing on "long-term sustainability". This should lead to significant annual savings for HSBC over the coming years.

Mr Watkinson also explained the rationale behind the closure of the six branches across Malta and indicated that this was not part of a cost saving exercise but mainly due to a change in customer behaviour where HSBC Malta experienced a 14 per cent drop in "across-the-counter" transactions and on the other hand a 13 per cent growth in internet banking transactions. Although the six branches will cease to offer traditional banking services and "across-the-counter" transactions following the decision taken a few months ago, the CEO clarified that an ATM service will continue being offered from these locations to assist the many customers who are increasingly using the bank's automated services.

An analysis of the financial statements of HSBC provides some interesting observations on developments that occurred during 2011. Net interest income grew by a further 5.2 per cent during the year to a record €129 million. HSBC's CEO confirmed that this reflected modest growth in the asset base and better management of the balance sheet with a focus on longer-term investments. HSBC's net fee and commission income shows a slight decline primarily due to the slowdown of new bond issuance on the local capital market.

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However, there was a significant increase in dealing income. Mr Watkinson revealed that HSBC Malta registered a 40 per cent increase in foreign exchange transaction volumes mainly driven by the increased activities coming from new fund business and insurance activities due to Malta's positioning as an international financial centre. This is the highest level of foreign exchange income since Malta adopted the euro in 2008 and the CEO is confident that this level of activity is sustainable in future years.

The year-end balance sheet of HSBC Malta shows a slight decline in deposits during the year to €4,403 million and a marginal growth in net loans (+€54 million) to €3,344 million. However, the additional loans granted during 2011 amounted to €656 million compared to €682 million in 2010. HSBC's CEO confirmed that the home loans business continued to perform well with little impairments.

On the other hand, the increase in non-performing loans emanates from the commercial business sector as some of the smaller corporates are struggling in the present difficult economic circumstances. Although the overall ratio of non-performing loans to gross loans deteriorated to 5.1 per cent (2010: 3.6 per cent), the level of impairments taken during 2011 at €8.3 million includes impairments of €4.2 million on the Greek exposure included in the life insurance portfolio. In fact, the overall level of impairments at the bank level in 2011 of €4 million is lower than that in the previous financial year. Mr Watkinson clarified that not all non-performing loans are automatically impaired since the majority are well secured by adequate collateral and therefore no impairments are required in such instances. The balance sheet of HSBC also reveals a decline in the holdings of "balances with the Central Bank of Malta, treasury bills and cash" and an offsetting increase in the bank's investment in longer-dated Malta Government Stocks.

The final dividend recommendation of €0.072 before tax represents a 6.5 per cent decline from last year's final dividend. However, following the increase in dividends at the interim stage, the total dividend for 2011 is only marginally lower than that distributed to shareholders in respect of the previous financial year. The normalised dividend payout ratio when excluding the non-cash movement of the change in methodology within the life business remained unchanged at 55 per cent. In recent months, HSBC had clearly indicated that the board is not considering a reduction in dividend payments to shareholders.

In the presentation delivered to the financial community and members of the press last Friday afternoon, Mr Watkinson concluded the presentation by explaining the bank's focus on long-term sustainability to maintain a healthy, efficient and profitable performance for all stakeholders. The actions taken in 2011 including the sale of the card business, the changes to the investment portfolio, the optimisation of the branch network and the significant investment upgrade being undertaken to the branch network and ATM's are part of the initiatives also being taken by the HSBC Group on an international scale.

The CEO also touched upon some macro-economic indicators and expressed his cautious optimism for 2012. He highlighted the various initiatives being undertaken to stimulate further growth opportunities for HSBC Malta. These include selective growth in assets especially in the home loan sector, leveraging on the international presence of HSBC and the benefits from capturing increased business as Malta gains further momentum as an international financial services centre of repute.

Although the 2011 financial performance was impacted by various measures, the sustained performance during the challenging conditions throughout the year demonstrates the strength of the HSBC business model. HSBC is clearly seeking to take advantage of the increasing opportunities presenting themselves as a result of Malta becoming an international financial services centre and this should translate into continued sustainable returns for HSBC Malta shareholders in the years to come.