Stock Market Review

Middlesea re-instates dividend after 3 years

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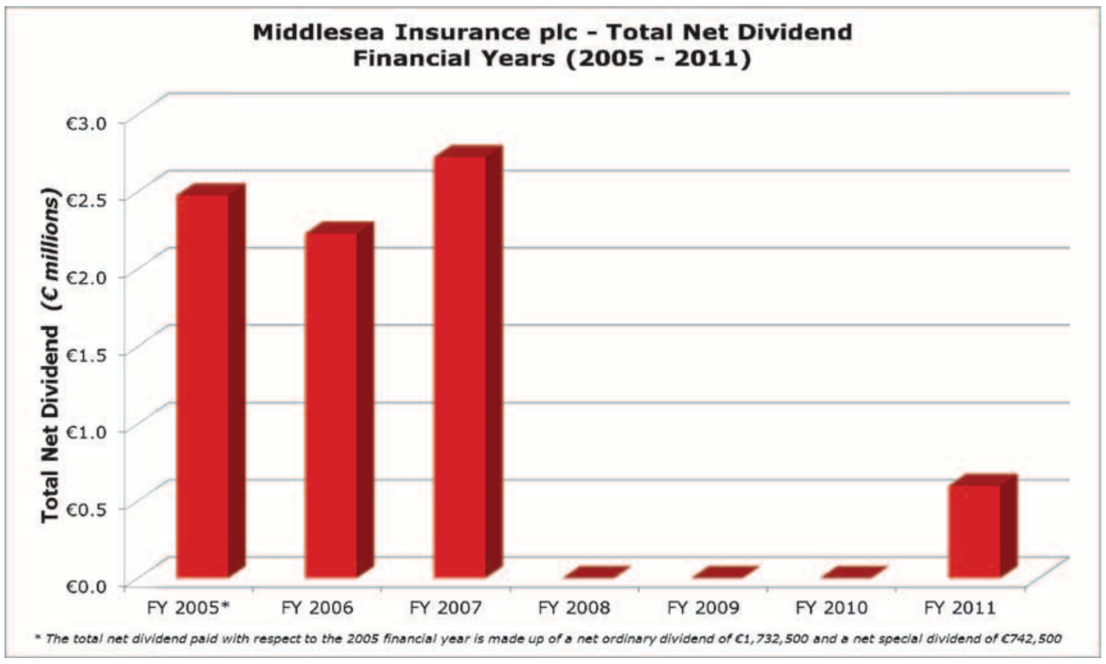

Last week, Middlesea Insurance plc published its financial statements for the year ended December 31, 2011. While the 51.6 per cent decline in pre-tax profits to €3.1 million may not be surprising given an insurance company's dependence on favourable stock market conditions, the re-instatement of a dividend to shareholders may have surprised many market followers. Although the dividend is minimal at just €0.01 per share gross of tax (representing a gross yield of only 1.43 per cent on the current share price of €0.70 per share), outgoing chairman Joseph F. X. Zahra emphasised that the major reason for the dividend declaration was to send a clear message to the market and to the investing community that Middlesea intends to return to its original roots by providing annual returns to shareholders. Naturally, the intention is for this dividend to grow to more generous levels in future years but this is dependent on more meaningful profitability levels by the group.

The 2011 financial statements are rather difficult to analyse due to the change in accounting treatment of the life insurance company, MSV Life plc. This company is equally owned by Middlesea Insurance plc and Bank of Valletta plc and both institutions used to treat this as an associate in their financial statements. However, following the acquisition of a majority stake by Mapfre Internacional in Middlesea Insurance, the two largest shareholders of Middlesea (Mapfre and Bank of Valletta plc) agreed on July 29, 2011, that the accounting method of MSV Life plc will be changed from that of an associate to that of a subsidiary of Middlesea.

As a result, the 2011 financial statements of Middlesea Insurance treat MSV Life plc as an associate until July 29, 2011 and as a subsidiary after this date. Therefore, as from July 30, the results of MSV are being fully consolidated on a line-by-line basis. The contribution from MSV Life plc as an associate until July 29, 2011 amounted to €1.6 million and during the remaining five months of the year MSV made a contribution of €0.4 million. The lower profitability of the life insurance business was in part due to a decrease in turnover following lower sales of single premium products and also as a result of the volatile financial markets.

Elsewhere, Middlesea reported that total premiums written decreased by 9.2 per cent during the year to €31.8 million solely due to the closure of the Gibraltar office as from January 1, 2011. The decision to cease writing business from Gibraltar was based on the new strategy being adopted by the major shareholders so that Middlesea is exposed only to the Maltese market. Middlesea's immediate aim is to identify areas of growth in the local insurance market. Middlesea reported a significant improvement in the technical insurance results following a better claims experience in 2011. However, this was offset by lower investment income which is the primary reason for the lower level of profits.

The group balance sheet as at December 31, 2011 shows total assets of €1,233 million following the consolidation of the financial statements of MSV Life plc which contributed to the significant increase in the value of property as well as other investments as part of the investment portfolio of the life insurance company. Group capital and reserves attributable to shareholders is €56.5 million (excluding the non-controlling interest representing the share of MSV Life attributable to BoV) and translates into a net asset value per share of €0.614.

Following the appointment of Alfredo Munoz Perez as chief executive officer of Middlesea Insurance plc and the new strategy adopted as a result of Mapfre's technical support, some significant shareholder changes took place during the year. An initial announcement had been made on April 29, 2011 notifying the market that an agreement had been reached between two of Middlesea's largest shareholders (i.e. Mapfre and the German company Munich Re), wherein Mapfre had agreed to acquire Munich Re's 19.9 per cent shareholding in Middlesea. At the time, Mapfre had already held an equity stake of 31.08 per cent in Middlesea which had increased to this level following the rights issue conducted in November 2009. However, this sizeable acquisition, which was subject to regulatory approval, was going to result in Mapfre's shareholding increasing to 50.98 per cent bringing into play a number of obligations imposed by the Listing Rules of the Malta Financial Services Authority, specifically those within Chapter 11 which oblige parties acquiring a controlling stake (i.e 50 per cent plus 1 share), to make a mandatory offer to all remaining shareholders.

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Middlesea's share price, which was at €0.85 per share at the time of the first announcement, climbed above the €1.00 level within a few weeks presumably as the market speculated on the price of the transaction agreed between the two parties. However, the price was only disclosed exactly three months later when the 18.3 million shares changed hands via a special trade on the Malta Stock Exchange at a price of €0.63 per share following regulatory approval.

The resultant price of the mandatory offer at €0.965 per share provided an exit route for the General Public shareholders at a price significantly higher than both the net asset value per share of the group at the time of €0.601 per share as well as the price of the substantial trade involving Mapfre and Munich Re. It was surprising that only a few shareholders accepted to sell their shares to Mapfre given the attractive price of the offer. In fact, out of the "free float" of 17.945 per cent eligible for the mandatory offer, only 3.585 per cent accepted the terms, representing a weak take-up of only 20 per cent. This brought the public's shareholding in Middlesea down to 14.36 per cent with two other shareholders owning the remaining equity as follows – Mapfre with 54.56 per cent and BoV at 31.08 per cent. Meanwhile, the share price in the market has adjusted downwards since the mandatory offer and is now closer to the €0.63 price at which the large transaction took place in July 2011.

Last week, Middlesea also issued another announcement informing the market that Joseph F. X. Zahra intends to stand down from the role of chairman following the next annual general meeting due to be held on April 20, 2012. This post will be filled by Martin Galea who had just been appointed as a non-executive director of Middlesea. At the briefing with the financial community also last week, Mr Zahra explained that when he had accepted the chairmanship role in 2009, he had done so on the understanding that this was to be for a limited period of time. Mr Zahra stated that the three large shareholders of Middlesea had approached him at the time asking him to play a specific role in de-risking and protecting Middlesea from the serious challenges resulting from the failure of their Italian subsidiary.

Middlesea has since then successfully re-positioned itself with a specific focus solely on the Maltese insurance market and with the input of Mapfre as strategic partners and majority shareholders the aim is to enhance the current portfolio through product innovation and also by introducing additional services to customers. One such initiative was the launch of a new company called Middlesea Assist offering a roadside and home assistance programme to its policyholders. The company is backed by the experience of Mapfre Asistencia, the assistance provider arm of Mapfre Internacional – Middlesea's majority shareholder. The input of an international strategic shareholder coupled with increased cost efficiencies and more favourable financial market conditions could in time enable Middlesea to return to its traditional strength and provide shareholders with stable and higher dividends in future years.