Stock Market Review

Higher impairments lead to lower profits at Lombard Bank

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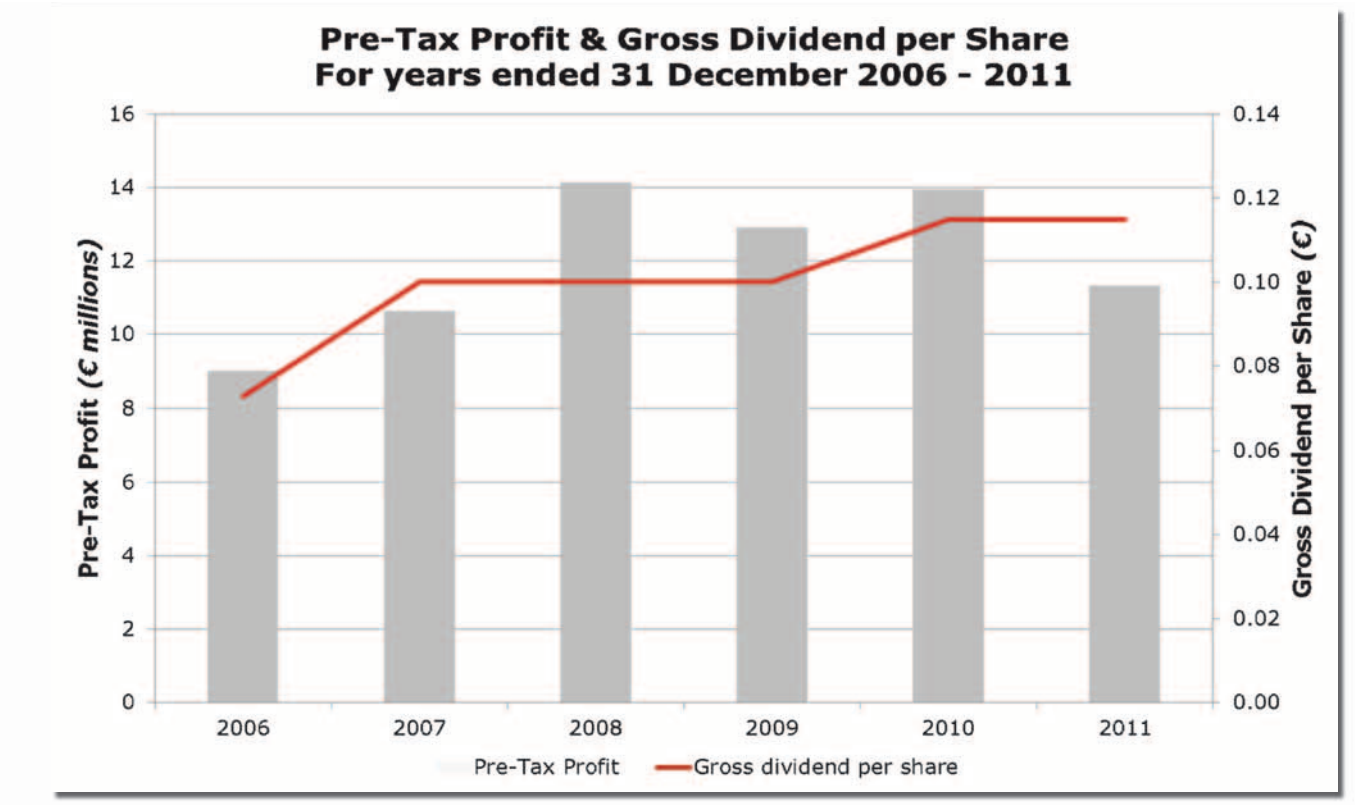

Reporting season continued last week with three companies publishing their 2011 full-year results. Although the major announcements came from Fimbank plc (mainly related to possible changes in the shareholding structure) and Go plc (skipping the dividend for the first time since 1998), the financial results of Lombard Bank Malta plc published last Thursday are also worth reviewing since they provide an insight into the current developments across the local banking sector.

Lombard Group's net interest income declined by 11.7 per cent to €14.2 million due to a drop in customer lending (minus seven per cent) reflecting the bank's prudent credit policies and continued downward pressure on interest margins in view of significant competition for deposits.

Likewise, net fee and commission income declined by 10.6 per cent to €1.99 million when compared to the same period of last year (2010: €2.23 million). Maltapost plc contributed positively with revenue from the postal operator edging three per cent higher to €20.4 million. The lower net interest income and fee and commission revenue was offset by a profit of €2 million from the disposal of non-trading financial instruments. This helped overall operating income to edge marginally higher to €39 million during 2011.

Group expenses increased by 3.5 per cent to €24.1 million giving a cost to income ratio of 61.8 per cent (2010: 60.1 per cent). Wages and salaries were only marginally higher but other operating costs increased by 7.4 per cent to €9.7 million. At the time of the publication of the 2011 interim results, Lombard had explained that the higher cost base was due to the investment in IT services such as internet banking and card products. At bank level, the cost to income ratio remains very healthy at only 35.9 per cent – well below the levels of other local banks.

The major item which impacted Lombard Group's performance was a higher level of impairments during the second half of the financial year. During the first six months of 2011, impairment provisions had declined to a mere €188,000 but at the year-end, total impairments amounted to over €2.2 million. In a short review of the results published last week, Lombard Bank claimed that the higher level of impairments was due to the prevailing economic climate and the prudent approach to lending. A more detailed analysis could be carried out once the 2011 annual report is published in the coming weeks.

The higher level of impairments was the main contributor to the 18 per cent decline in group pre-tax profits to €11.3 million. After accounting for an income tax expense of €4.1 million and profits attributable to non-controlling interests, Lombard Group's profit for the year of €6.6 million gives an earnings per share figure of €0.183. At the current share price of €2.52 per share, Lombard's equity is trading on a price to earnings multiple of 13.8 times – very much in line with those of the other two major banks listed on the Malta Stock Exchange.

The balance sheet as at December 31, 2011, shows a decline of seven per cent in loans and advances to customers to €310.4 million (2010: €333.7 million) while customer deposits dropped by 2.2 per cent to €462.3 million (2010: €472.7 million). Shareholders' funds of €74.9 million translate into a net asset value per share of €2.075, with the equity currently trading at a 20 per cent premium to book value.

For the second successive year, Lombard's dividend recommendation did not include a scrip dividend option and a cash dividend will be distributed to all shareholders. Despite the decline in profitability, the cash dividend remained unchanged at €0.115 gross per share. This translates into a dividend yield of 4.56 per cent per annum. The unchanged dividend is probably also a result of the bank's healthy financial indicators with the capital adequacy ratio as at the year-end of 19.8 per cent. This is well above the minimum regulatory requirement of eight per cent.

In recent months, Lombard provided additional information to the market on its overall exposures and on its relationship with its largest shareholder, Marfin Popular Bank Company Ltd. On February 29, Marfin published its 2011 financial results revealing a €3.3 billion loss mainly after taking a 60 per cent write-down of its Greek government bond holdings. Following the loss incurred and the requirements set by the European Banking Authority to achieve a nine per cent capital ratio by June 2012, Marfin explained that it plans to raise cash from shareholders amounting to €1.8 billion through a rights issue or through a private placement of shares to new investors.

In this respect, Marfin announced that they are being approached by a number of credible strategic investors with some sections of the international media speculating that the Russian Commercial Bank, a subsidiary of VTB, is one of the interested investors.

Last week, Marfin was once again downgraded by the rating agency Moody's by one ranking to B3 (equivalent to 'B' by S&P and Fitch), which is below investment grade. The primary reason for the downgrade was the erosion of the capital base following the significant loan impairments incurred and the losses from the holdings of Greek government bonds.

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Additionally, the rating agency also commented about Marfin's deteriorating liquidity and funding capabilities following the sizable deposit outflows which amounted to around 21 per cent of total deposits during 2011.

Following coverage in the local media about the developments at Marfin, Lombard Bank clarified that Marfin is not the majority shareholder in Lombard, although it is the single largest shareholder with an equity stake of 48.9 per cent. Moreover, Lombard Bank confirmed that it holds no exposure whatsoever to any member of the Marfin Group or to any other Greek or Cypriot entity. Additionally it has no exposure to any form of non-Maltese sovereign or corporate securities. This should give comfort to Lombard's shareholders.

In last week's full-year results announcement, Lombard once again re-iterated that the bank has no exposure to international sovereign or corporate debt and claimed that it will maintain its prudent and cautious approach to treasury management. Lombard, however, acknowledged that this investment policy will result in lower interest income earned as evidenced in the decline in such income during 2011.

Lombard's equity has been on a downward trend for some time touching a 17-month low of €2.50 earlier this week. Although this, in part, reflects the overall continued under-performance of the local equity market, this is possibly also a result of the negative news regarding Marfin. Lombard have clarified on various occasions that it holds no exposures to the Cypriot-based bank or to other debt instruments outside Malta.