

Stock Market Review

What will be the catalyst for turning around the local equity market?



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The MSE Share Index (a benchmark of the performance of the local equity market) recently touched its lowest level since May 2009. At the time, the Index had begun to gradually recover from the April 2009 multi-year low following the onset of the international financial crisis. The recent downturn of Malta's equity market contrasts with the strong turnaround across international bourses especially over the last eight months. However, global equity markets suffered a renewed setback in recent days and European indices touched their 2012 lows in reaction to the political uncertainty across Europe following the elections in France and Greece.

International markets had recovered strongly from their October 2011 lows on evidence of improved data from the US and other important economies as well as generally upbeat performances from various companies. On the other hand, the local market has very often failed to respond to local macro-economic data and also seems to be isolated from international developments as it underperformed markedly since the 2008 downturn. However, it is worth highlighting that the lackluster performance of Malta's equity market came about on generally weak volumes showing the overall lack of investor enthusiasm towards the companies listed on the Malta Stock Exchange.

The local political uncertainty that gripped the headlines in recent months seems to have played a role in weakening sentiment among the investor community. Notwithstanding the political issues, the IMF's updated report on Malta published last week showed that the local economy had a general positive performance during 2011 when viewed in the context of the overall state of the eurozone area. The budget deficit was reduced to three per cent in 2011 compared with much larger deficits in the troubled eurozone peripheral states and also many of the larger countries within the EU.

More importantly is the fact that Malta is among a very few countries that aims to reduce its deficit to below the three per cent threshold during 2012. Also important to note is the overall level of unemployment in Malta compared to the EU average and also in comparison to the very high levels being registered in Spain and Greece especially at the youth level at over 50 per cent in both countries. Malta's unemployment at 6.4 per cent is substantially below the EU average of 10 per cent a further signal of the stable and resilient economy with continued positive performances in the tourism and services sectors.

The equity market is not responding to the

encouraging macro-economic indicators and except for the odd trading session when some large trades take place in specific equities, overall investor sentiment still seems to be overly cautious despite the general strong financial performance by a number of companies and the dividends that continue to be distributed to shareholders from the well-established and more stable companies.

Moreover, it is worth highlighting that a further important characteristic of the local equity market is the strength and stability of the banking sector. None of the banks required shareholder or government intervention unlike in most overseas jurisdictions. Despite this positive development, the continued attractive dividends distributed to shareholders even during the international financial crisis and the stable financial results and conservative composition of their balance sheets, the share price performance of the banks was also rather lackluster in recent months.

The lack of investor interest towards the equity market in recent years (especially 2009 and 2010) could have been due to the vast amount of investment opportunities presented by the local bond market. In prior years, the property sector also absorbed a fair share of the liquidity within the financial system. Following the marked slowdown in both these sectors for very different reasons, the equity market has the potential to attract a larger portion of the idle liquidity. However, a catalyst is possibly required to spark renewed investor enthusiasm and the much-needed turnaround in the local equity market. So what could be this catalyst?

Go plc surely contributed to the negative investor attitude following the significant negative impact from its Greek investment and the resultant decision to suspend dividends to shareholders this year for the first time since 1998. This led to a further sharp downturn in the share price in recent months to a level below the net asset value of the company. The various resolutions presented by a group of minority shareholders at last week's historic annual general meeting instigated the board of directors and senior management of Go to provide more detailed information to shareholders.

One resolution related to the transfer of properties which had contributed to growing concerns among shareholders. This was one of the instances where the market was surely in need of increased transparency on the matter. In a brief but accurate presentation to shareholders, one of Go's directors confirmed

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that Go plc set up a new holding company for the various properties it owns including the former head office. This Special Purpose Vehicle (SPV) called Malta Properties Company Limited has a property portfolio which is currently valued at €50 million. Go also confirmed during the AGM that the transfer of properties between the company and the government which had been approved by Parliament earlier in the week will result in a gain of €11.4 million in Go's income statement during 2012.

Go's chairman also gave a clear and detailed account of recent developments especially in Greece and provided some very upbeat comments on the situation at the Greek telecom company Forthnet. Deepak Padmanabhan confirmed that following the impairments taken in 2011, the current value of Forthnet in Go's balance sheet was reduced to a mere €3.6 million and this is therefore the maximum amount that could be written-off even if the situation deteriorates further.

However, Mr Padmanabhan who is also the chairman of Forthnet reassured shareholders that the "worst is over" for Forthnet and there is "only upside from now on". These strong statements by the chairman of Go to the numerous shareholders present at the meeting coupled with the overall profit which should be registered by Go during the first half of 2012 as a result of the gains from the property transfer could start to improve sentiment to the local telecoms company.

While Go could prove to be one of the catalysts for improved sentiment, other developments could also help kickstart the turnaround in the equity market.

A further catalyst could be a successful outcome to the international roadshow currently taking place by International Hotel Investments plc. On April 23, IHI provided an update to the market with respect to its inten-

tion to raise new equity in order to expand its portfolio of hotels and mixed-use properties internationally. IHI announced that it identified a number of potential investors (consisting primarily of sovereign funds and other institutions) and it is holding talks with these potential investors to participate in the subscription of new shares on a private placement basis. IHI's chairman Alfred Pisani informed the financial community last week that the valuations prepared by third parties on the property values, point to a significant premium compared to the current market price. An allotment of new shares at a price higher than the nominal value of €1 per share could lift sentiment towards the third largest capitalized company and this could potentially have a ripple effect across the entire market.

The developments at FimBank plc could also provide an interesting outcome for local investors as Burgan Bank of Kuwait is seeking to acquire majority control of FimBank via the purchase of a 38.8 per cent equity stake from the present largest shareholder coupled with the allotment of new shares by the board of directors. This will require shareholders' approval in a general meeting and may also lead to a mandatory offer to all minority shareholders being made in the event that shareholders vote in favour of such a development.

The major catalyst required to achieve a meaningful turnaround in sentiment across the local investing community may either materialise from developments within companies described above or similar developments across other companies. As such, investors who advocate a value investing approach may take advantage of the currently weak sentiment to accumulate exposures in those companies which have the potential to spark the turnaround in sentiment.

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