Stock Market Review

Investor education and the BOV AGM

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A theme brought up for discussion by shareholders during the annual general meeting of Bank of Valletta plc on December 19 was the impact of the bonus share issue which was one of the items on the agenda.

Unfortunately, it was evident from the questions being asked that some of the shareholders present did not have a correct understanding of the objective of a bonus issue and its effect on the market price.

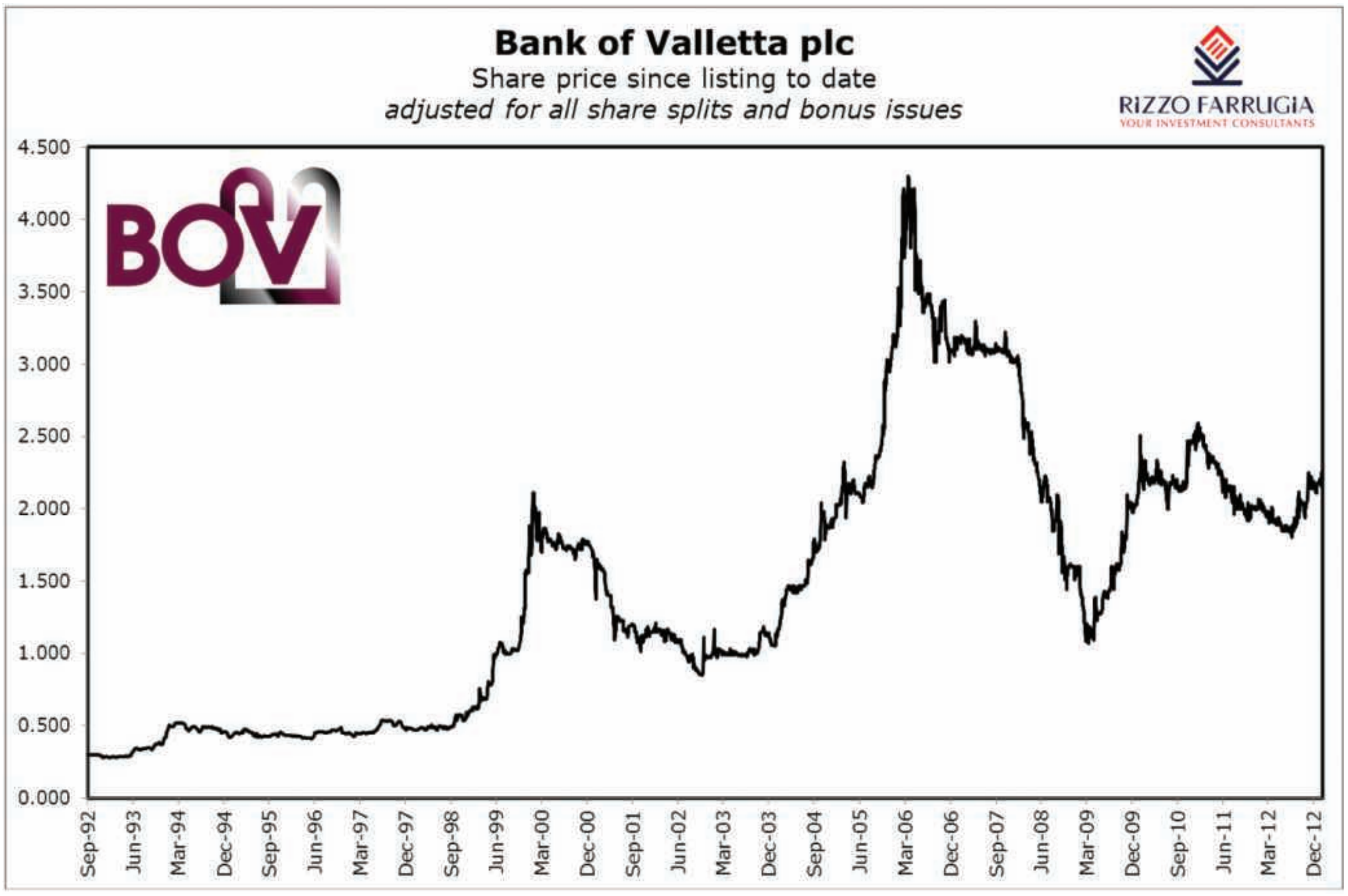
This topic was explained in *The Times Business* recently by Robert Suban, a University of Malta lecturer, who was also among the candidates for the post of a director on the board of BOV. In addition to the well-penned explanation on the impact of the bonus share issue, I would like to explain the rationale for such a corporate action and address the misconceptions of the impact on the market.

A bonus share issue simply entails a transfer of retained earnings (representing accumulated profits of the bank which were not distributed to shareholders over the years) to the issued share capital of the bank. In BOV's case, the proposed resolution concerned a transfer of €30 million from retained earnings to issued share capital. Both the retained earnings and share capital form part of shareholders' funds or the net asset value.

Therefore, such a transfer does not involve a change in the 'value' of the bank represented by shareholders' funds, but it increases the issued share capital and therefore the net asset value *per share* decreases to reflect the new number of shares in the hands of shareholders as a result of the allotment of the bonus shares.

BOV has undertaken this exercise for the past six consecutive years and, in the process, the issued share capital increased from €83.1 million to €300 million, also in part due to the capitalisation of €33.3 million in early 2009 to increase the nominal value per share from €0.75 to €1. This is an important exercise in the eyes of international credit rating agencies since it alters a substantial part of shareholders' funds from retained earnings (which may be distributed to shareholders at the discretion of directors) to issued share capital (which is non-distributable to shareholders since it represents permanent capital). In essence, the amount of issued share capital is an important signal of the strength of a bank especially now as there is increasing regulatory pressure on the required capital levels to be held by financial institutions. As such, a bonus share issue is an important exercise in the eyes of credit rating agencies and correspondent banks.

The distribution of more shares to shareholders also improves the liquidity aspect of an equity. The local market is often criticised as being one which lacks depth and consequently it is a market where investors would generally find it difficult to easily trade in a security.



However, the increasing number of BOV shares in public hands has clearly made the equity more liquid as is evident from trading statistics over recent years. Another factor which makes BOV shares a more liquid instrument is the large free float compared to other companies and the wide shareholder base with more than 18,000 shareholders.

The price adjustment exercise that necessarily follows a bonus share issue (i.e. the 'lowering' of the absolute share price) is also beneficial since it makes such shares more 'affordable' in the eyes of the investing public. This is also beneficial for the entire shareholder base since a lower price encourages more activity and therefore creates a more liquid market.

One of the misconceptions raised by a few shareholders during the recent AGM was that the share price "halves" once bonus shares are allotted. This is not correct. This graph shows the adjusted share price of BOV going as far back as 1992. In none of the bonus share issues that have taken place over the years has the share price halved as a result. Taking the more recent bonus issue exercise as an example, the share price of BOV was trading in the region of €2.40 ahead of the cut-off date for the entitlement to the bonus shares. Since this year's bonus issue was of one new share for every nine held, the adjusted share price of Tuesday, January 15, should have been €2.16. What actually happened was that on the day, the equity initially traded at €2.19 and closed at €2.20 (equivalent to €2.44 prior to the bonus share issue).

Therefore, the bonus share issue which took place two weeks ago was actually beneficial to shareholders since the share price actually increased by 1.9 per cent on the day. Activity in BOV shares remained high since then and the continued demand helped the share price rise to a high of €2.27 (equivalent to €2.52 prior to the bonus share issue). In our daily articles reviewing stock market developments, we indicated that BOV's equity is now at its highest level in the past 20 months although the price until January 14 was of €2.40.

Another misconception raised by a shareholder was the reference to a share price of €24 in the year 2000. This is also incorrect. The graph shows the adjusted share price performance since 1992. This graph indicates that even shareholders who had purchased BOV shares during the first bull market in 1999/2000 are still making a positive return despite the wide volatility over the past 13 years. In fact, using the peak of January 12, 2000 as a reference point, equates to an adjusted price of €2.108, representing a capital gain of 7.2 per cent. In addition to the difference in the share price, one would also need to include the dividend payments received every six months.

This equates to a total return of 48 per cent after tax. The actual share price in 2000 was of Lm5.88 (equivalent to €13.70), however this needs to be adjusted for the share splits and the numerous bonus share issues over the years since the number of shares held would have increased to 6,496 if one purchased say 1,000 shares at the time.

The large majority of BOV shareholders who held on to the bank's shares have therefore achieved positive returns throughout the years.

Meanwhile, it is only those shareholders who acquired their shares solely during the periods from August 30, 2005, to May 6, 2008, and from November 1, 2010, to early May 2011 who are still sitting on 'paper losses'.

The long-term graph is also useful to compare the financial ratios in different periods of time. During the rally of 2005/6 when investor sentiment was particularly bullish, the price to earnings multiple ranged between 19.7 times and 31 times. However, this multiple is currently at nine times implying that the market is attributing a lower multiple compared to the bank's profitability. The decrease in this ratio is also reflective of international developments. Since the international financial crisis of September 2008, valuation multiples for banks and all other companies dropped significantly.

From this long-term chart, it is also interesting to compare current valuation multiples to the recent low points in 2002 and 2009. The current p/e multiple of nine times based on the September 2012 full-year results is lower than the multiple of 11.9 times in 2002 and 12.4 times in 2009. From a dividend perspective, the current dividend yield of 7.57 per cent (the highest on the local market) is below the 2009 level of 8.3 per cent but higher than the 2002 yield of 6.75 per cent.

Investor education remains a key objective in my contributions. Likewise, public companies and other industry stakeholders should continue to do their utmost to educate retail investors in the interest of the continued development of the local financial services industry.

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