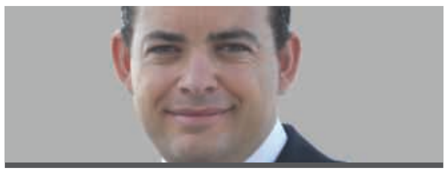
Stock Market Review

HSBC Bank Malta seeing gradual improvement in business pipeline



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HSBC Bank Malta plc, the largest company on the Malta Stock Exchange measured by market capitalisation, published its interim financial statements mid-way through last Monday's trading session on the Borza. This happened concurrently with the publication of the half-year results by HSBC Holdings plc, its parent company.

A quick look at the headline figures for the Malta business shows a very stable performance with pre-tax profits unchanged at €53 million. In view of the fact that the dividend payout ratio was maintained at 55 per cent, the gross interim dividend was also unchanged at €0.10 per share. The dividend is payable on September 5 to all shareholders as at close of business next Monday, August 12.

Some interesting facts emerge from a more detailed analysis of the figures available from the company announcement and from the presentation made to the financial community and members of the press on Monday afternoon.

Essentially, from the income side of the business, during the first half of 2013, the HSBC Malta Group suffered a 6.1 per cent decline in net interest income to €63.5 million. The reduction in revenue from its largest income contributor was due to a 7.4 per cent drop in gross interest income to €82.3 million reflecting the lower interest generated from the bank's loan book (as a result of repricing in the prevailing low interest rate environment together with lower average lending balances) as well as due to the lower interest income earned on debt securities as the proceeds of matured bonds had to be reinvested at lower yields. The negative impact from the lower interest income was only partially offset by the 11.7 per cent drop in interest expenses to €18.8 million as customers opted for shorter dated deposits which carry lower rates of interest – a clear sign of the cautious attitude by investors but also an indication of the amount of idle funds awaiting opportunities for re-investment at higher rates.

Net fee and commission income was largely unchanged at €15.6 million, however, the bank did register an 8 per cent increase in trading profits (foreign exchange related activities) at €4.9 million.

HSBC explained that it placed increased emphasis on international trade including assisting clients to explore opportunities in overseas markets to exploit HSBC's global network coverage. HSBC's CEO Mark Watkinson believes foreign exchange is one of the areas where the bank can grow in future years.

Moreover, HSBC booked a 60 per cent increase in gains on the disposals of available for sale investments amounting to €3.6 million. HSBC Malta's CFO Josephine Magri explained that these gains were registered after the bank sold long-dated Malta Government Stocks and re-invested in shorter maturities.

This rotation is a clear signal of the bank's outlook of the bond market and the potential for a decline in prices of bonds having a long-term to maturity.

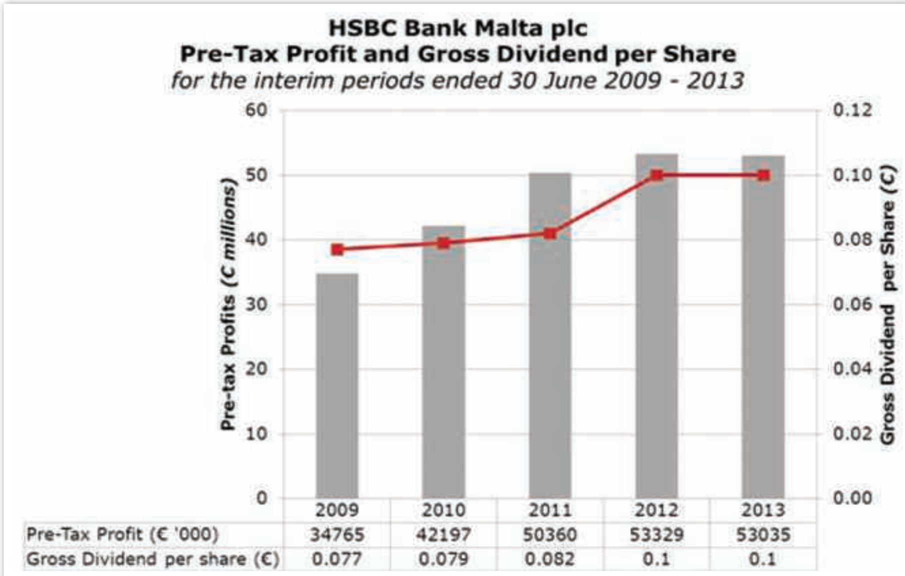
The life insurance company also positively impacted HSBC's first half performance with an increase in profits reflecting positive investment returns and the beneficial financial effect of an improved performance by a number of insurance products. Further enhanced performances from this subsidiary could be expected as a result of the management of the €1.1 billion insurance policy book as from 2014 which was acquired from the Irish-domiciled HSBC Life (Europe) Limited.

Meanwhile, from a cost perspective, overall expenses were also largely unchanged at €45.2 million as the higher administrative expenses (+1.1 per cent to €42.1 million resulted mainly from a higher contribution to the depositor guarantee scheme and a rise in compliance, security and fraud-risk related costs) was mostly offset by a 5.3 per cent drop in depreciation and amortisation. In fact, the cost to income ratio only deteriorated marginally to 45.9 per cent. When replying to questions from the floor, Mr Watkinson stated that the deposit guarantee scheme is an essential policy for every banking jurisdiction and although HSBC and Bank of Valletta plc are bearing the cost of the increased payments to the scheme, he believes that future contributions should be calculated on a risk-based approach with higher payments from institutions taking on greater risks.

"With a gross dividend yield of 6.6 per cent per annum, investors may start considering HSBC Malta shares as an income play rather than a growth stock"

Loan impairments remained very low despite the challenging economic conditions. During the first half of the year, there was a net increase in provisioning of only €0.35 million as the recoveries during the period of almost €0.5 million offset the new loan impairments. HSBC's ratio of non-performing loans at five per cent is very much in line with their major competitor.

The balance sheet also shows some important trends with overall customer deposits dropping by €70 million to €4.5 billion as the volatility in corporate and institutional deposits was offset by higher retail customer inflows despite stiff competition from various other institutions as well as the regular issuance of Malta Government Stocks. Meanwhile, overall loans dropped by €18 million since the start of the 2013 financial year to €3.3 billion. However, during the meeting on Monday afternoon, both the CEO and the CFO clarified that new lending during the first half of the year grew by 16 per cent equivalent to €318 million. On the other hand, this was offset by loan repayments from various customers signaling the continued strategy of reducing debt levels by many corporates. Mr Watkinson explained that the bank gradually started to experience a modest improvement in the business pipeline for new loans reflecting a slow pick-up in confidence following the general elections that took place earlier this year. While this may not be indicative of a definite trend towards more risk and investment opportunities by corporate customers, the CEO is hopeful that this moderate improvement in confidence will slowly translate into higher loan growth possibly in 2014 leading to increased interest income levels.



The HSBC CEO spoke in some detail about the conditions of the global economy, the eurozone as well as Malta's performance and outlook. Mr Watkinson again emphasised the very challenging global economic backdrop. The CEO explained that although there are mild signs of recovery in the US, the eurozone remains very unsettled and when viewed against such conditions, Malta's economic performance is fairly resilient with 1.4 per cent GDP growth expected for 2013. Furthermore, this is forecast to improve to 1.8 per cent next year. Mr Watkinson noted that Malta is one of the better positioned economies in the eurozone with low unemployment levels and strong growth in tourism figures. The CEO also commented that the investment grade rating confirmed by the rating agency Standard & Poor's with a stable outlook is a further endorsement of the resilience of the local economy. Mr Watkinson was also fairly confident on the opportunities for growth in Malta mainly centred around tourism and trade to exploit Malta's geographical positioning.

HSBC's top executives again emphasised the Bank's strong capital base and high levels of liquidity. Although the CEO indicated that an appropriate dividend payout level is discussed regularly, it is evident that the current level of 55 per cent is maintainable.

HSBC's CEO Mark Watkinson.

HSBC wants to continue to reward shareholders but at the same time also needs to build appropriate capital levels to sustain its financial performance in the future.

With a gross dividend yield of 6.6 per cent per annum based on the current market price, investors may start considering HSBC Malta shares as an income play rather than a growth stock. This should appeal to many income-oriented investors.