Lombard Bank Malta p.l.c.

Executive Summary:

We are initiating our coverage on Lombard Bank Malta p.l.c. ("LOM" or the "Group") with a Hold recommendation and a 12-month price target of €2.36.

The Bank's return on equity and earnings yield as per 2019 LTM results currently stand at a healthy level of 7.7% and 8.9% respectively, reflecting the Bank's recent growth trajectory, primarily emanating from an increase in its loan book, both from a retail and commercial perspective.

However, the broader context of the Banking industry in Malta, as well as internationally, remains relatively unattractive, with larger capital requirements as a consequence of more stringent regulation, increased costs mainly related to risk management, compliance and ICT; coupled with a backdrop of punishingly low interest rates which are affecting interest margins across the board.

The Group's financial performance is also linked to MaltaPost p.l.c.'s operational performance, which recently has registered a decline in activity concerning foreign letter mail. Albeit, we expect the upward revision in the rates for the domestic single and bulk mail, combined with the improved rates on the local and foreign registered mail to positively contribute to the MaltaPost p.l.c.'s revenues and profitability. However, we still remain cautious that MaltaPost p.l.c. is experiencing a decreasing letter mail volume.

At a target price of €2.36, the forward earnings yield for FY 2019 and FY 2020 remains relatively attractive at 9.0%, in line with the Bank's anticipated positive performance in the short-to-medium term.

The Hold recommendation is a result of the lack of visibility into forecasted earnings. Once we have more clarity on the projections, the required funding for the Bank's investment projects, together with updates regarding the future regulatory capital requirements, we will update our stance accordingly.

Company Overview:

Lombard Bank Malta plc is licensed as a credit institution and as an investment service provider. It offers the full range of traditional retail and commercial Banking activities, including also home loans, deposit accounts, credit and debit cards, trade finance and asset management. The Bank is mainly focused on financing commercial-related activities.

Redbox limited, a wholly owned special purpose vehicle subsidiary, owns 71.5% of MaltaPost plc, which is Malta's leading postal services company and the sole Universal Service Provider of postal services on the Maltese Islands.

The Lombard Group has 51% of its shares freely traded on the Malta Stock Exchange and 49% owned by the National Development and Social Fund (NDSF). NDSF has the intention to dispose of all or part of its shareholding in the Bank.

Stock Rating — Hold

Price target (1Yr) €2.36

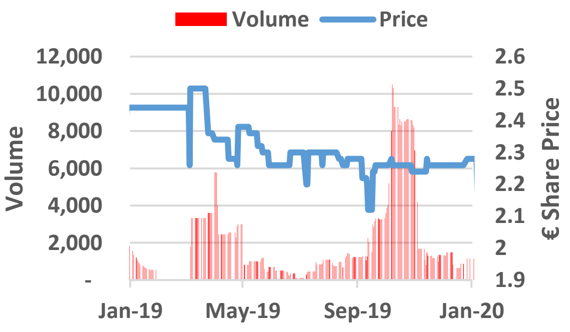
Country	Malta
Industry	Financial Services
Ticker	LOM
Price (as at 19/01/2020)	€2.18
Price Target (1-Year)	€2.36
Upside / downside to PT	+8.3%
12m cash div. (Forecast)	€0.033
12m Total S'holder Return	+9.8%
Market Cap	€96.3 million
Shares Outstanding	44.2 million
Free Float	51%
Net Dividend Yield*	1.5%
Current P/E*	11.3x
Forward P/E**	11.1x

***Based on the 2019 Last Twelve Months (LTM)**
****CC estimates**

1-Year Range:

Exchange	Malta Stock Exchange ('MSE')
52-week range	€2.12 - €2.50

Price and Volume Movement (20 day moving average)



Source: Bloomberg

Market Research

Andrew Fenech
Financial Analyst
+356 25 688 133
andrewfenech@cc.com.mt

Rowen Bonello
Financial Analyst
+356 25 688 305
rowenbonello@cc.com.mt

Company Update:

Dividends - The Board of directors of LOM paid a net dividend of €0.0325 per share based on FY 2018 (FY 2017: €0.026), equivalent to a net total dividend of €1.4 million (FY 2017: €1.1 million). In line with the Group's policy, the Board did not declare a dividend based on June 2019 interim financials, and will determine the extent of dividend distribution for 2019 based on the full year results of FY 2019.

SWOT Analysis

Strengths

- ✓ Strong capital position and strong liquidity profile
- ✓ Operating in a robust economy with a favourable outlook
- ✓ The Group currently has no financial debt and this will prove to be beneficial for the Bank to manage its capital adequacy ratios
- ✓ Qualified and experienced staff
- ✓ A consistent track record of dividend distribution
- ✓ The initial application of the new IFRS 9 standard did not materially impact the Bank's Equity, reflecting the high quality of the Bank's financial assets as well as the collateral cover held
- ✓ Growth in the Bank's commercial loan book which typically attracts higher interest rates. This reflects the Group's ability to find an alternative for the current low interest rate environment

Weaknesses

- ✗ Highly exposed to the Maltese economy
- ✗ Low interest rate environment weighs on profitability of core Banking segment
- ✗ Large regulatory burden and compliance obligations present significant challenges
- ✗ The Bank's dividend pay-out ratio is low and restricted due to increasing capital adequacy requirements
- ✗ The stock is very illiquid

Opportunities

- o Investment in the ICT systems and infrastructure should benefit the Bank from a cost perspective long term
- o A strengthening economy would increase business opportunities
- o Increased market presence through the extension of the Bank's ATM network and acquisition of new sites

Threats

- ! Property market crisis
- ! Country risk, mainly an economic slow-down as well as political risk
- ! Lack of available skilled workforce
- ! Data or system breaches
- ! Increase in regulatory burden, which may affect dividend payments
- ! Potential increased impairments in view of the new IFRS 9 stricter expected credit loss approach

Investment Stance

We are initiating our coverage on Lombard Bank Malta p.l.c. ("LOM" or the "Group") with a Hold recommendation and a 12-month price target of €2.36.

The Bank's return on equity and earnings yield as per 2019 LTM results currently stand at a healthy level of 7.7% and 8.9% respectively, reflecting the Bank's recent growth trajectory, primarily emanating from an increase in loan book, both from a retail and commercial perspective.

However, the broader context of the Banking industry in Malta, as well as internationally, remains relatively unattractive, with larger capital requirements as a consequence of more stringent regulation, increased costs mainly related to risk management, compliance and ICT; coupled with a backdrop of punishingly low interest rates which are affecting interest margins across the board.

Although the Common Equity Tier 1 Ratio (CET1) currently stands at 14.3%, which is above the regulatory minimum requirement of 4.5% at present, we are cautious of the risk associated with the Group's future dividend distribution due to unfavourable regulatory capital requirements arising from the MREL and Basel IV requirements forcing the Bank to increase the level of own funds. This concern is exacerbated through the drop in the Group's CET1 ratio, whereby in FY 2015 this stood at 16.4% and dropped to 14.3% as at LTM 2019.

The Group's financial performance is also linked to MaltaPost p.l.c.'s operational performance, which recently has registered a decline in activity concerning foreign letter mail. Albeit, we expect the upward revision in the rates for the domestic single and bulk mail, combined with the improved rates on the local and foreign registered mail to positively contribute to the MaltaPost p.l.c.'s revenues and profitability. However, we still remain cautious that MaltaPost p.l.c. is experiencing a decreasing letter mail volume.

At the current price of €2.18, the Group is currently trading at a Price to Book (P/B) multiple of 0.83x (2019LTM), in which we deem to be justified given the concerns discussed above. Consequently, we used a P/B forward multiple of 0.85x for FY 2019 and FY 2020 in our valuation in order to cater for the concerns circulating within the Banking industry in general.

At a target price of €2.36, the forward earnings yield for FY 2019 and FY 2020 remains relatively attractive at 9.0% in line with the Bank's anticipated positive performance in the short-to-medium term. We expect the valuation to remain at such levels unless the above concerns materialise.

The Hold recommendation is a result of the lack of visibility into forecasted earnings. Once we have more clarity on the projections, the required funding for the Bank's investment projects, together with updates regarding the future regulatory capital requirements, we will update our stance accordingly.

Valuation

Our one year price target is €2.36. The price target is calculated using a Price-to-book value approach (P/B) with a discount rate of 8.8%. We used a P/B forward multiple of 0.85x for FY 2019 and FY 2020 in our model.

Lombard Bank Malta - €'000s (unless otherwise indicated)	FY 2017	FY 2018	2019 LTM	FY2019F	FY2020P
Net Interest Income	**15,434**	**17,511**	**18,724**	**20,360**	**20,563**
Net Fee and Commission Income	**4,133**	**4,716**	**5,222**	**5,244**	**5,500**
Postal sales and other revenues	37,371	39,254	31,920	33,438	35,832
Dividend Income	326	369	306	352	363
Net Trading Income	619	880	1,029	1,000	1,000
Other Operating Income	-	55	13	50	50
Operating Income	**57,883**	**62,785**	**57,214**	**60,444**	**63,308**
Employee compensation and benefits	(19,945)	(20,765)	(21,648)	(22,556)	(23,502)
Other operating costs	(24,695)	(26,477)	(18,945)	(19,228)	(20,800)
Depreciation and amortisation	(1,411)	(1,588)	(1,602)	(1,812)	(1,933)
Provisions for liabilities and other charges	(23)	(60)	(59)	(60)	(60)
Credit impairment losses	(2,835)	(234)	(1,180)	(2,728)	(2,773)
Operating Profit	**8,974**	**13,661**	**13,780**	**14,060**	**14,240**
Share of profit/(loss) of investment accounted for using the equity method net of tax	(106)	109	91	100	100
Profit before taxation	**8,868**	**13,770**	**13,871**	**14,160**	**14,340**
Income tax expense	(3,165)	(4,831)	(4,840)	(4,956)	(5,019)
Profit for the year	**5,703**	**8,939**	**9,031**	**9,204**	**9,321**
Attributable to:					
Equity holders of the Bank	5,129	8,447	8,526	8,658	8,687
Non-controlling interests	574	492	505	546	634
Profit for the year	**5,703**	**8,939**	**9,031**	**9,204**	**9,321**
Earnings Per Share	**0.116**	**0.191**	**0.193**	**0.196**	**0.197**
Price/Earnings Ratio	n/a	11.4x	11.3x	11.1x	11.1x
Earnings Yield	n/a	8.8%	8.9%	9.0%	9.0%
Dividend Yield	n/a	1.5%	1.5%	1.5%	1.5%

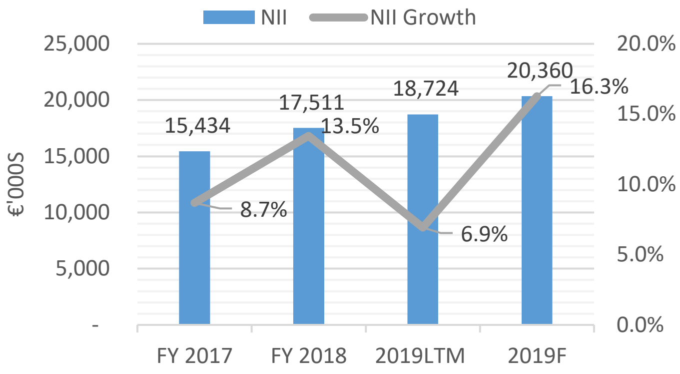
Equity Evaluation	FY 2017	FY 2018	2019 LTM	FY2019F	FY2020P
Equity excluding non-controlling interests - €'000s	96,140	108,310	111,493	115,496	122,706
Book value per share - €	2.18	2.45	2.52	2.61	2.78
P/B Multiple	n/a	0.89x	0.86x	0.85x	0.85x

Source: Audited Financial Statements and CC estimates

Investment Thesis Variables

- **Net Interest Income –** Interest income is mainly composed of interest receivable by the Group on loans and advances to Banks and customers. Interest income is also receivable on fixed income instruments and on balances held with the Central Bank of Malta.

  During FY 2018, improvements in net interest income was generated on the back of strong growth in terms of the Bank's loan book, as the portfolio became more diversified, including an encouraging take up of home loans. Such improvement is also attributable to the growth attained in terms of the Bank's commercial loan book, which typically involve higher margins.

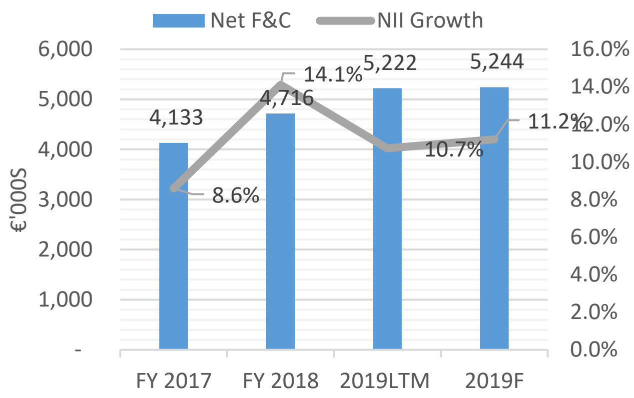


Source: Audited Financial Statements and CC Estimates

  During H1 2019, loans and advances to customers rose by 5.8% over H1 2018, contributing towards an increase in interest income of 9.3% in comparison to H1 2018. Customer deposits during the period also increased by 1.8%. Subsequently, net interest income as per 2019 LTM results further improved to €18.7 million from €17.5 million during FY 2018. We expect net interest income to increase to €20.4 million during FY 2019.

- **Net Fee and Commission Income –** Fee and commission income consists of fees and commissions receivable by Lombard concerning retail Banking customer fees together with brokerage and other fees.

  Net fees and commissions as per 2019 LTM results increased by 10.7% to €5.2 million when compared to FY 2018, as a result of increased credit facilities, wealth management services and transaction Banking activity. Going forward, we expect net fee and commission income to remain at this level during FY 2019.



Source: Audited Financial Statements and CC Estimates

- **Postal sales and other revenues –** These mainly include income generated by MaltaPost p.l.c. through its operations. As per H1 2019 results, MaltaPost p.l.c.'s operations were conditioned by particularly unfavourable circumstances due to a reduction in foreign mail revenue. However, local postal services are expected to be positively affected by an improvement in rates in both the domestic single and bulk main (as from 30 May 2019), and the local and foreign registered mail (as from 1 Jan 2019). Consequently, this line of revenue is expected to amount to €33.4 million during FY 2019.

- **Dividend Income** – This is composed of dividend income derived from equity shares measured at fair value. In line with the results for H1 2019, we expect dividend income €0.4 million during FY 2019.

- **Net Trading Income** – This mainly includes gains on foreign exchange activities. We expect net trading income to amount to €1 million during FY 2019, in line with the results attained by the Group during H1 2019.

- **Employee compensation and benefits –** Compensation and benefits, being the major cost item incurred by the Group increased by 4.3% from €20.8 million during FY 2018 to €21.6 million as per 2019 LTM results, reflecting the need to recruit more specialized expertise and to retain existing staff in a tight labour market characterised by wage inflation. The upsurge in employee compensation is also attributable to the signing a new collective agreement with the Malta Union of Bank Employees. We expect employee compensation and benefits to increase to €22.6 million in FY 2019 in line with management expectations and the highly competitive labour market.

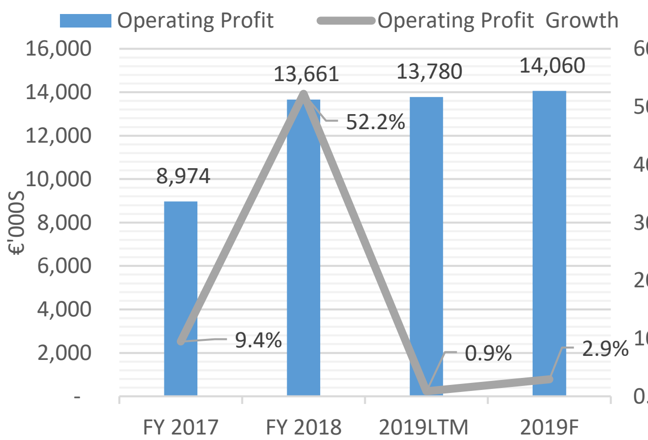
- **Other operating costs –** These mainly are composed of foreign outbound mail expenses, utilities and insurance costs, IT support telecommunications costs, repairs and maintenance, operating lease rental charges and other administrative expenses. As previously discussed, most of the decrease in other operating costs are proportionate to the reduction in foreign mail revenue. In this regard we expect other operating costs to amount to €19.2 million during FY 2019.

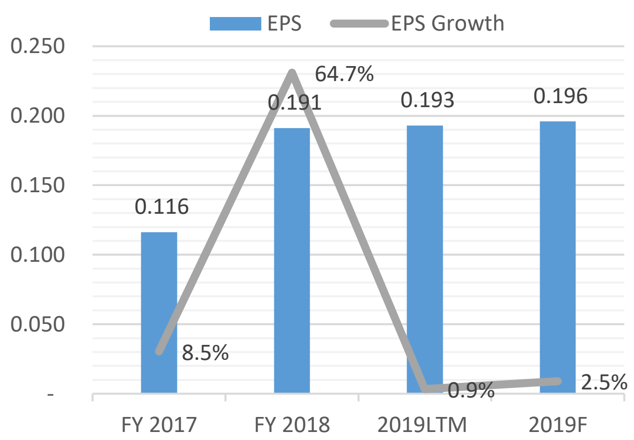
- **Credit impairment losses –** From FY 2018 onwards, impairment allowances were based on statistical methods prescribed by the new accounting standard IFRS 9. The calculations following the new methodology did not reveal any significant divergences in the required level of provisioning from previous estimates, thus reflecting the high quality of the Bank's financial assets as well as the collateral cover held. The impairment charge for FY 2018 stood at €0.2 million. The change in credit impairment losses for H1 2019 was €2.0 million resulting from further alignment to IFRS 9. We expect credit impairment losses to amount to €2.7 million during FY 2019, representing 0.5% of the anticipated balance of loans and advances to customers for the respective year.

- **Operating profit –** The main uplift in operating profit as per FY 2018 results mainly reflects the undertaking of a lower credit impairment losses charge. Upon taking the above factors into consideration we expect operating profit to further improve to €14.1 million during FY 2019 from €13.7 million during FY 2018.

- **Income tax –** The Group is subject to a corporate tax rate of 35% on its profit before tax.

- **Profit for the year and Earnings per Share –** In line with the above assumptions we expect the Group's net profit to amount to €9.2 million during FY 2019, translating to an EPS of €0.196 compared to €8.9 million or €0.191/ share as per FY 2018 results.





Source: Audited Financial Statements and CC Estimates

Key Financial Indicators

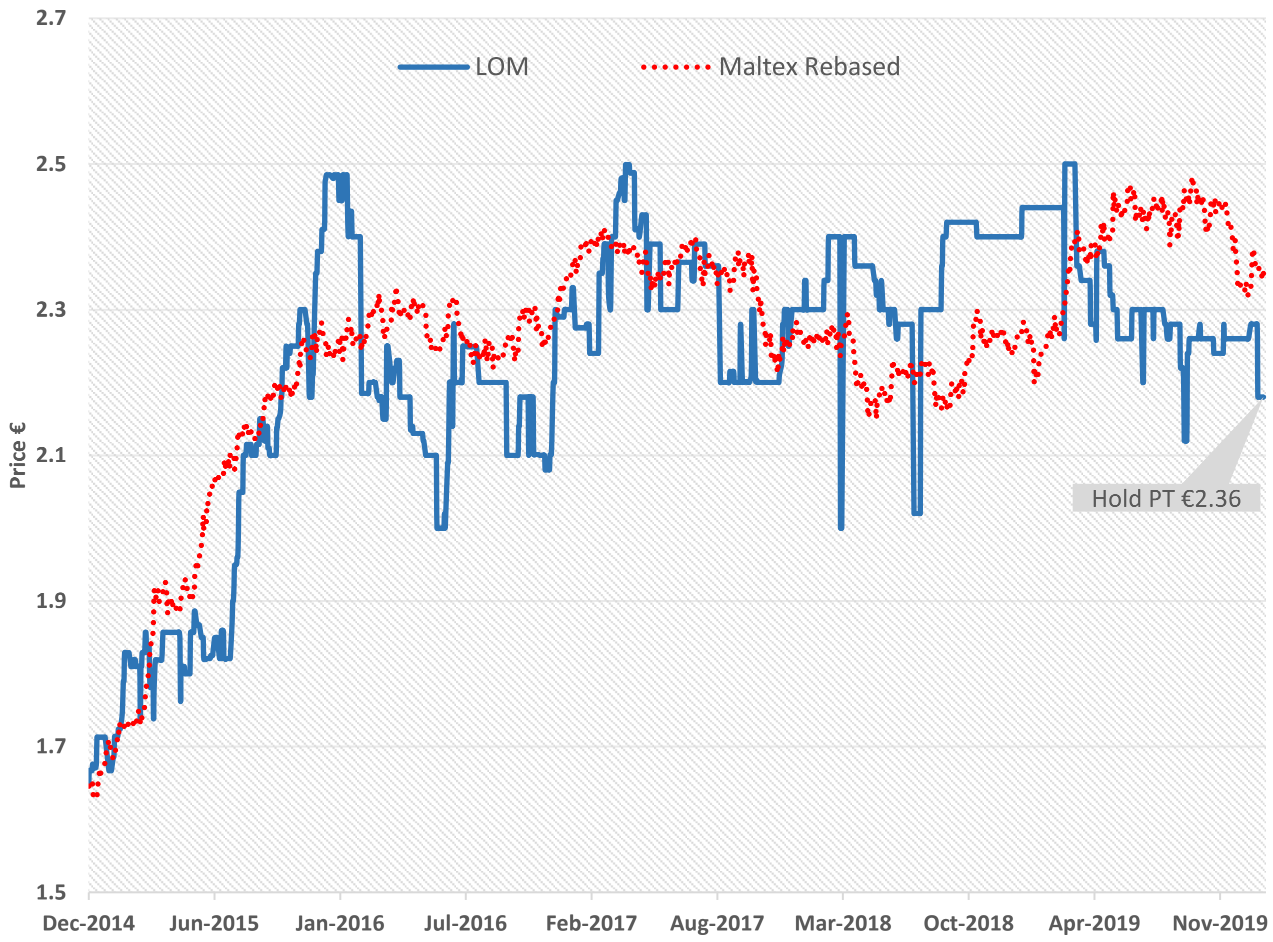
Lombard Bank Malta p.l.c. - €'000's (unless otherwise stated)	Dec-2017	Dec-2018	2019LTM
Income Statement			
Net Interest Income	15,434	17,511	18,724
Net Fee and Commission Income	4,133	4,716	5,222
Postal Sales and Other Revenues	37,371	39,254	31,920
Operating Income	57,883	62,785	57,214
Operating Expenses	(44,640)	(47,242)	(40,593)
Credit Impairment Losses	(2,835)	(234)	(1,180)
Operating Profit	8,974	13,661	13,780
Profit / (loss) for the year	5,703	8,939	9,031
Earnings per share	0.116	0.191	0.193
Net Interest Margin (%)	1.9%	2.0%	2.1%
Cost/Income (%)	77.1%	75.2%	70.9%
Balance Sheet			
Interest Earning Assets	807,304	867,850	880,479
Gross Loans	525,659	651,705	675,463
Total Deposits	738,513	788,898	808,455
Shareholders' Equity	96,140	108,310	111,493
Return on Common Equity (Net Income / Common Equity)	5.6%	8.2%	7.7%
Risk Weighted Assets	619,320	672,948	n/a
Tier 1 Capital	87,451	98,677	n/a
Total Capital	88,826	98,677	n/a
Shares Outstanding	44,178	44,178	44,178
Net Impairment / Gross Loans	0.5%	0.0%	0.2%
CET 1 Ratio	14.1%	14.7%	n/a
Tier 1 Ratio	14.1%	14.7%	n/a
Total Capital Ratio	14.3%	14.7%	n/a

Reported CET 1 ratios as per published interim results - H1 2019	%
Bank of Valletta plc	19.1%
HSBC Bank (Malta) plc	16.2%
Lombard Bank Malta plc	14.3%
APS Bank Ltd (as at FY 2018)	13.9%
MeDirect Bank	13.2%

Source: Audited Financial Statements

Historical 1-Year Price Target

Reference	Date	Price	Price Target	Analyst	Recommendation
LOM	20.01.2020	€2.18	€2.36	Andrew Fenech & Rowen Bonello	Hold



Source: Bloomberg

Glossary and Definitions

Income Statement	
Net Interest income	Interest Income minus Interest Expense.
Operating Profit	Operating profit for financial services firms is the difference between operating income (revenue generation) and operating expenses (typically administrative expenses).
Profit after tax	Profit after tax is the profit made by the Group during the financial year both from its operating as well as non-operating activities.
Earnings per share ("EPS")	Earnings per share is the portion of a company's net profit allocated to each outstanding share of common stock. Earnings per share serves as an indicator of a company's profitability.
Profitability and other ratios	
Costs / Income ratio	It is an indicator of overall company efficiency. The ratio is calculated dividing total costs by total Operating Income.
Net interest margin	Net interest margin is the Net Interest Income for the year as percentage of average Interest-Earning assets.
Earnings yield	Earnings yield are the earnings per share for the most recent 12-month period divided by the current market price per share. Reciprocal of P/E ratio.
Return on common equity	Return on common equity (ROE) measures the rate of return on the shareholders' equity of the owners of issued share capital, computed by dividing the net income by the average common equity (average equity of two years financial performance).
Balance Sheet	
Interest Earnings Assets	Non-current asset are the Group's long-term investments, which full value will not be realised within the accounting year. Non-current assets are capitalised rather than expensed, meaning that the Group allocates the cost of the asset over the number of years for which the asset will be in use, instead of allocating the entire cost to the accounting year in which the asset was purchased. Such assets include intangible assets (goodwill on acquisition), investment properties, and property, plant & equipment.
Gross Loans	Gross Loans and Leases comprise Gross Loans to Customers net of Unearned Income, Allowance for Loan Losses, and other deductions from Gross Loans.
Total Deposits	Total Deposits include all customer and institutional deposits held at the Bank. They are essentially the core liabilities of Banking institutions.
Shareholders' equity	Shareholders' Equity as reported by the Bank. Comprises Common Stock and Treasury Stock, Capital Surplus, Retained Earnings, Revaluations, Minority Interest and other components of Shareholders' Equity.
Risk Weighted Assets	Sum of all Risk-Weighted Assets as required for Regulatory Capital ratio measures.
Tier 1 Capital	Sum of permanent Shareholders' Equity (issued and fully paid ordinary shares/common stock and perpetual non-cumulative preference shares) and Disclosed Reserves (share premiums, retained profit, general reserves and legal reserves). In the case of consolidated accounts, this also includes minority interests in the equity of subsidiaries that are less than wholly owned. Excludes revaluation reserves and cumulative preference shares.
Total Capital	Sum of Net Tier 1 Capital and other more senior forms of capital (Tier 2 and Tier 3).
Financial Strength / Capital Adequacy Ratios	
Net impairment / gross loans	Net impairment gain/ (loss) on financial assets divided by gross loans.
Tier 1 ratio	Tier 1 Capital as a percentage of Risk-Weighted Assets.
Total Capital Ratio	Total Capital as a percentage of Risk-Weighted Assets.

Explanation of Equity Research Ratings

Buy: Based on a current 12- month view of total shareholder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock.

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, we do not recommend either a Buy or Sell. Current shareholders should consider buying on dips and selling on peaks.

Disclaimer