11th February 2021

Update to Price Target and Investment Stance

The approval of a number of COVID-19 vaccines in late 2020, and early 2021, in addition to fiscal efforts and the prolonged easing measures taken by monetary politicians, emerged as catalysts for a brighter macroeconomic outlook in 2021.

Although we maintain our **Hold** recommendation on Bank of Valletta plc ("BOV" or the "Bank"), in view of the aforementioned macroeconomic positive developments, we increased our 1-year price target on the Bank from €0.86 to €1.02.

Nonetheless, we reiterate our stance that apart from the pandemic related issues, the Bank is still facing several challenges. We are of the view that the uncertainty surrounding the Bank's pending Deiulermar case, which also impacted the bank's dividend policy, in addition to the lack of clarity concerning the Bank's ability to maintain a US dollar correspondence relationship, are key risks going forward. Furthermore, we believe that the Bank's transformation programme, and the current de-risking exercise are realistic threats for the Bank's profitability in the short-to-medium term.

Changes to valuation model:

- **Expected credit losses (ECLs):** As the global COVID-19 surge intensified with rising hospitalisations and deaths, major banks across the globe, including Europe's largest banks, adopted a prudent approach by increasing provisions to combat possible defaults in their books. Inevitably, such depressed environment was ultimately reflected in the price to book multiples, with the European average dropping to a low point of below 0.55x.

  On a positive note, as we started seeing an improvement in business sentiment during Q2'20, European banks started reversing part of their provisions. However, we are not privy to the same moves amongst local banks, given the fact that local banks report semi-annually, whereas European peers report quarterly. In this regard, we maintained the same levels of ECLs for FY20 in our model, until we have further visibility in the near future. For 2021, in line with the specific risks surrounding BOV, we believe it would be appropriate and prudent to assume a net increase in ECLs provision amounting to €1.1m.

  More constructively, we believe that beyond 2021, the Bank should be in a brighter spot and it will reverse parts of its ECLs. However, we opted for a prudent approach and conservatively we are assuming a minor ECLs reversal of €1.2m in FY22.

- **Price to Book (P/B) multiple:** Notwithstanding the above mentioned positive traits, we believe that the banking industry is still facing a number of headwinds with the low inflationary

Stock Rating	**Hold**
Price target (1Yr)	**€1.02**
Country	Malta
Industry	Banking
Ticker	BOV
Price (as at 10/02/2021)	€0.93
Price Target (1-Year)	€1.02
Upside/ Downside to PT	9.8%
12m cash div. (Forecast)	€0.016
12m Total S'holder Return	11.5%
Market Cap	€543.0m
Shares Outstanding	583.8m
Free Float	64.8%
Net Dividend Yield	N/a
Current P/E (LTM20)	15.4x
1Yr Forward P/E (FY21e)	16.4x
Current P/B (LTM20)	0.51x

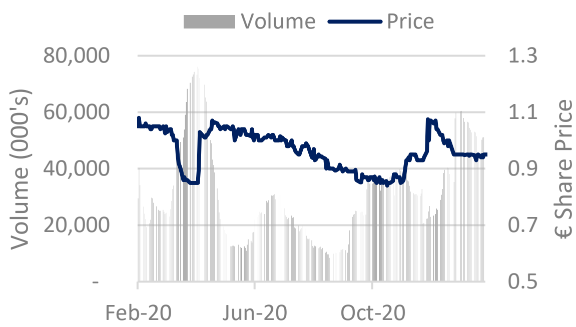
Group Overview:

Bank of Valletta p.l.c. is licensed to carry out the business of banking and investment services as well to act as a tied insurance intermediary of MSV Life Assurance Company Limited.

The main companies forming part of the "Group" include Bank of Valletta p.l.c., BOV Asset Management Limited, BOV Fund Services Limited and BOV Investments Limited.

Exchange	Malta Stock Exchange (MSE)
52-week range	€0.84 - €1.08

Price and Volume Movement (20 day moving average)



Source: Malta Stock Exchange

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environment, namely in Europe, conditioning remarkably the forward looking expectations for the banking industry. Apart from the pandemic and the current low interest rate scenario, we are also conscious of possible demand/supply imbalances in the local property market, to which the Bank is highly exposed, in addition to the uncertainty brought about by the Moneyval saga.

Furthermore, idiosyncratically to BOV, we also believe that the elevated operating expenditure currently being incurred by the Bank in relation to its ongoing de-risking exercise and transformation programme, will continue to hinder the Bank's profitability in the near future. However, we still believe that given the improved macroeconomic outlook, it is appropriate to increase our P/B multiple from the 0.55x level in FY20 to 0.60x in FY23.

The adjusted FY23 multiple is close to pre-pandemic levels. This is mainly attributable to the fact that apart from the above mentioned specific challenges, the European banking industry is also expected to remain highly impacted given the increased debt levels undertaken by several European Governments to combat the implications brought about by the pandemic. Consequently, we are of the opinion that it will be very difficult for the ECB to increase interest rates in such an environment, especially in the short to medium term. This will in turn, continue to put pressure on the Bank's net interest margins.

That said, we will adjust our multiple accordingly once we have more visibility from the pandemic outcome and its impact on the banking industry, together with further updates concerning the Bank's transformation programme and de-risking exercise progress and other important developments such as the Bank's USD correspondence relationship.

- **Dividends:** Last December, the European Central Bank (ECB) lifted its ban on dividend payments for banks, whereby banks in the Eurozone are now able to pay modest dividends to shareholders in 2021 under strict limits outlined by ECB (below 15% of the FY19-FY20 cumulated profit and not higher than 20 basis points of the Common Equity Tier 1 (CET1) ratio, whichever is lower). To this end, we are of the opinion that BOV might possibly hold the capacity to distribute a dividend in FY21, in line with the aforementioned guided parameters. For clarities sake, as at H1-20, BOV's CET1 ratio stood at a healthy level of 19.8%, way above from the regulatory trigger levels.

In conclusion, the COVID-19 outbreak sparked a serious economic downturn and is increasingly posing severe stress on the banking system, also given the prolonged low yielding environment. However, when considering the cohort efforts taken by both fiscal and monetary politicians in combating the pandemic, we believe that 2021 should be a year of normalisation. Nevertheless, moving forward, close monitoring is imperative, namely in relation to specific pandemic related events. The possible roll-out vaccine disruptions, and possibly the unprecedented new COVID-19 variants, might continue to condition the economic recovery path, and ultimately hinder the banking industry's outlook. Moreover, other crucial developments at an industry level include the upcoming MREL and Basel IV regulations. Given the aforementioned uncertainty we believe that a **Hold** recommendation with a 1-year price target of €1.02 on the shares of BOV is warranted.

Company Update

- **Litigation Cases:** The Bank recently announced that further to BOV's application before the European Court of Human Rights (ECHR) in relation to the Bank's complaint that the Italian law does not provide a remedy for its fair hearing concerns in connection to the Deiulemar case, the ECHR decided that the Bank's application is, at this stage of proceedings, inadmissible. The basis of the ECHR's decision is that BOV still has remedies to exhaust in Italy regarding its fair hearing concerns, and not because it considered the Bank's complaint unmeritorious.

  BOV reiterated its position that the curators' claim is entirely without any legal or factual basis, as has been unequivocally confirmed by opinions provided by independent legal experts. The Bank will continue to pursue its defence vigorously, including its fair hearing concerns, before the Italian courts, and if those prove unsuccessful, it will petition the ECHR again once the Italian remedies will have been fully exhausted.

- **USD Correspondent Bank:** Further to the BOV's announcement issued last October, whereby the Bank stated that Raiffeisen Bank International is seeking to terminate its USD correspondence relationship with effect from 31st March 2021, the Bank clarified that such USD correspondence relationship is being extended by two months to 31st May 2021. The Bank further explained that the Bank is also currently considering alternative routes to diversify the available channels for its USD correspondent transactions.

Valuation

Our 1-year price target of €1.02 is calculated using a P/B multiple of 0.6x on FY23 forecasted earnings. We substantiated our price target using the residual income method and implemented a discount rate of 14% within our valuation model.

Bank of Valletta plc for the year ended 31 Dec €'000s (unless otherwise indicated)	FY17A	FY18A	FY19A	LTM20	FY20F	FY21P	FY22P
Net Interest Income	146,358	156,546	152,850	147,600	146,771	148,239	149,721
Net fee and commission income	69,031	81,137	73,828	68,882	63,285	63,918	64,876
Operating income	240,378	257,766	249,764	230,913	221,572	228,356	233,797
Total Operating Expenses (excl. Impairment losses/gains)	(121,001)	(130,598)	(163,018)	(171,224)	(179,894)	(185,950)	(174,369)
Net impairment losses/gains	4,982	10,816	11,562	5,036	(15,000)	(1,137)	1,171
Operating Profit before Litigation provisions	124,359	137,984	98,308	64,725	26,678	41,269	60,600
Litigation provisions	-	(75,000)	(25,000)	(25,000)	500	-	-
Operating Profit	124,359	62,984	73,308	39,725	27,178	41,269	60,600
Share of results of equity accounted investees	15,430	8,214	15,897	8,739	4,500	6,000	8,000
Profit before tax	**139,789**	**71,198**	**89,205**	**48,464**	**31,678**	**47,269**	**68,600**
Income tax expense	(44,190)	(19,788)	(25,713)	(13,243)	(9,503)	(14,181)	(20,580)
Profit for the period	**95,598**	**51,410**	**63,492**	**35,221**	**22,175**	**33,088**	**48,020**
Earnings per share	**0.16**	**0.09**	**0.11**	**0.06**	**0.04**	**0.06**	**0.08**

Equity Evaluation - €'000s (unless otherwise indicated)	FY17A	FY18A	FY19A	LTM20	FY20F	FY21P	FY22P
Equity*	978,110	994,133	1,062,305	1,068,728	1,080,823	1,113,911	1,161,931
Book value per share - €	1.68	1.70	1.82	1.83	1.87	1.76	1.84
Price/Book Ratio	n/a	n/a	0.52x	0.51x	0.55x	0.55x	0.60x

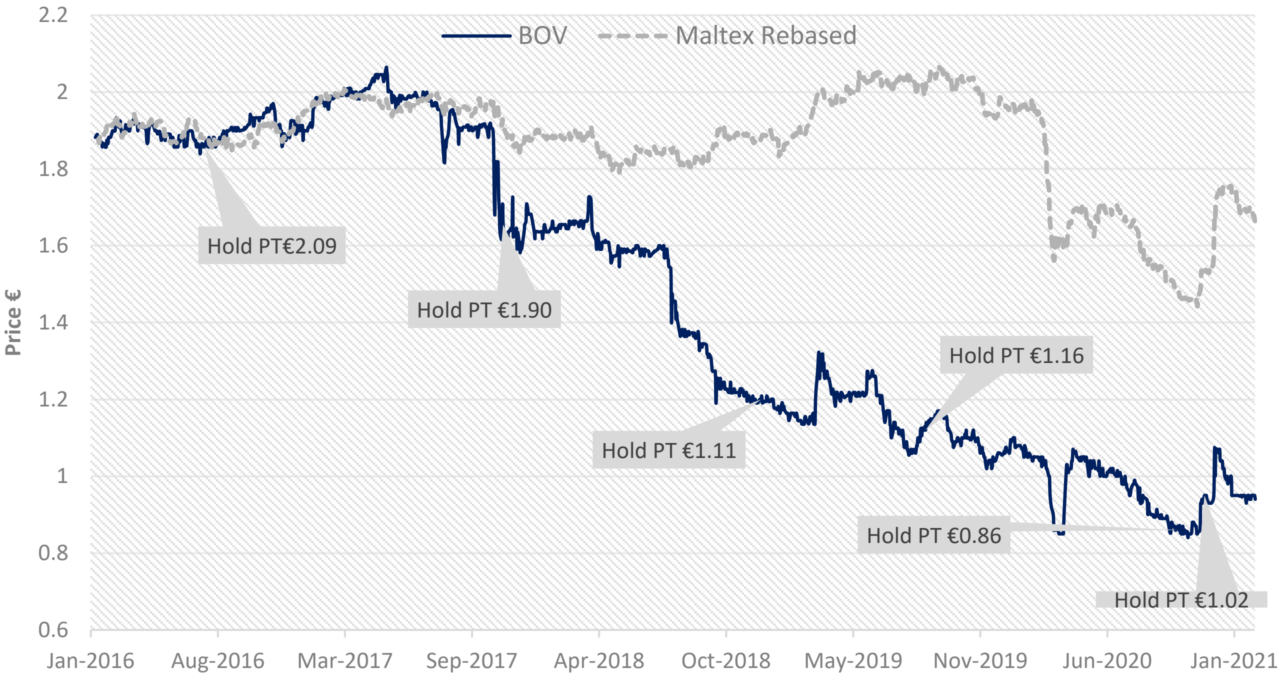
* Forecasted equity is calculated by aggregating the profitability with previous year closing equity, less any expected common dividend.

Ratio Analysis	FY17A	FY18A	FY19A	LTM20	FY20F	FY21P	FY22P
Cost Efficiency Ratio	50.3%	50.7%	65.3%	74.2%	81.2%	81.4%	74.6%
Net Interest Margin	1.29%	1.34%	1.29%	1.21%	1.20%	1.20%	1.20%
Net Interest Income Growth	-1.7%	7.0%	-2.4%	-3.4%	-4.0%	1.0%	1.0%
Net Fee and Commission Income Growth	4.5%	17.5%	-9.0%	-6.7%	-14.3%	1.0%	1.5%
Net Operating Income Growth	-4.1%	7.2%	-3.1%	-7.5%	-11.3%	3.1%	2.4%
Growth in normalised EPS (YoY)	42.2%	-46.2%	23.5%	-44.5%	-65.1%	49.2%	45.1%
Price/ Earnings Ratio	n/a	n/a	8.6x	15.6x	24.7x	16.6x	11.4x
Return On Equity	9.9%	5.2%	6.0%	3.3%	2.1%	3.0%	4.2%
Earnings Yield	n/a	n/a	11.6%	6.4%	4.0%	6.0%	8.7%
Dividends per share	€0.058	€0.047	n/a	€0.010	€0.016	€0.017	€0.024
Dividends Yield	n/a	n/a	n/a	n/a	1.7%	1.8%	2.6%
Dividend pay-out ratio	35.4%	53.1%	15.8%	n/a	41.6%	30.0%	30.0%

Source: BOV's Financial Statements and CC workings

Historical 1-Year Price Target

Reference	Date	Price	Price Target	Analyst	Recommendation
BOV MV	11.02.2021	€0.93	€1.02	Andrew Fenech & Rowen Bonello	Hold
BOV MV	16.11.2020	€0.92	€0.86	Andrew Fenech & Rowen Bonello	Hold
BOV MV	04.09.2019	€1.13	€1.16	Simon Psaila	Hold
BOV MV	19.12.2018	€1.20	€1.11	Simon Psaila	Hold
BOV MV	08.11.2017	€1.66	€1.90	Simon Psaila	Neutral
BOV MV	26.07.2016	€1.86	€2.09	Simon Psaila	Neutral



Source: Bloomberg

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.

Newly issued research recommendations and target prices supersede previously published research.

Disclaimer

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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.
Dividends yield	This ratio indicates how much a Group pays out in dividends each fiscal year relative to its share price. It is computed by the dividing the Dividend per Share by the share price as at year-end.
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).
Return on Assets	Return on assets (ROA) is computed by dividing net income by the average total assets (average assets 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.