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Update to Price Target and Investment Stance

Since our latest coverage on HSBC Bank Malta plc ("HSBC" or the "Bank"), the macroeconomic outlook improved when compared with the crisis which ensued after the COVID-19 outbreak. In view of this positive development, we increased our 1-year price target from €0.76 to €0.91, however we maintained our **Hold** recommendation on HSBC.

In terms of the Bank's fundamentals we reiterate our underlying assumptions as discussed in detail in our previous report. We anticipate that HSBC's loan book will continue to grow at a marginal rate, however negative interest rates are expected to continue to drag the Bank's NIM. NFI is expected to start recovering gradually as the COVID-19 situation normalises, while operating expenses are expected to continue decreasing (at least in the short term), in view of HSBC's aggressive cost cutting measures.

- **Economy:** The local economy is expected to start recovering as from the second quarter of 2021. This recovery is supported by the Government's fiscal support also through its participation in the €750bn EU Recovery Fund, in addition to the continuous easing measures taken by monetary politicians. Moreover, the recent breakthrough from the vaccine front and its subsequent global distribution, are critical to the said recovery.

  The strong efforts taken by governments to support households' balance sheets have been an important aspect of this recovery. In fact, a sizeable portion of governments' support packages has been aimed at people whose jobs would otherwise have been made redundant.

  In contrast to previous recessions, the banks' capital ratios remained strong, even though significant provisions for expected credit losses (ECLs) were booked during 2020. As at H1-2020, HSBC's CET1 ratio stood at a healthy level of 16.6%, comfortably from the trigger levels. In view of the improved economic sentiment and relatively low default rates, European peers started to reverse a portion of ECLs in the second half of 2020. However, we are not privy to the same moves amongst local banks given the fact that local banks report semi-annually, whereas foreign banks report quarterly. Nevertheless, we still anticipate that in line with its European peers, HSBC will be able to reverse some of its ECLs booked during FY20. Therefore, we adopted a conservative approach where we are assuming a minor reversal of ECLs in FY21 (€1.4m) and close to breakeven in FY22 (€0.4m).

Stock Rating	**Hold**
Price target (1Yr)	**€0.91**
Country	Malta
Industry	Banking
Ticker	HSB
Price (03/02/2021)	€0.84
Price Target (1-Year)	€0.91
Upside to PT	8.3%
12m cash div. (Forecast)	€0.013
12m Total S'holder Return	9.9%
Market Cap	€302.7m
Shares Outstanding	360.3m
Free Float	30.0%
Net Dividend Yield	N/a
Current P/E (LTM2020)	18.8x
1Yr Forward P/E (FY21e)	11.0x
Current P/B	0.65x
Exchange	Malta Stock Exchange
52-week range	€0.70 - €1.10

Price and Volume Movement (20 day moving average)

Source: Bloomberg

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- **Dividends:** In December 2020, the ECB lifted its request made in March 2020 for EU banks to suspend capital returns. Even though the ECB still calls on banks to refrain or limit dividends until 30 September 2021, we see this as a positive development and a step towards normalisation. Based on our forecast for H2 2020 and ECB's guidelines (dividends are to remain below 15% of cumulated 2019-20 profits and not higher than 20bps of CET1 ratio), we believe that the Bank holds the capacity to distribute a dividend in 2021, in line with the guided parameters. Surprisingly or not, we've seen selective European peers distribute petty levels over the past days, despite having weaker capital ratios.

- **Valuation Model:** Despite the positive traits noted above, the banking industry still faces several downside risks. The various government support packages throughout Europe came at a hefty price of increased debt levels, with the debt-to-GDP ratios reaching unprecedented levels in some countries. Additionally, the EU expects inflation to only rebound to 1.0% in 2021 (2020: 1.1% and 2023: 1.4%), therefore still under the ECB's inflation target of 2%. 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.

  In view of the above developments, we believe it is appropriate to increase our P/B multiple from 0.55x to 0.65x, reflecting the improvement in the macroeconomic outlook, however we remain mindful of the headwinds impacting the banking industry given the prolonged low yielding environment brought about by the pandemic. Thus we believe it is difficult to justify increasing the P/B multiple to pre-pandemic levels.

- **Update on Q3 2020 performance:** The Bank noted that its Q3 results were better than those achieved in each of the prior two quarters, however performance continued to be impacted by COVID-19. Revenue continued to be negatively impacted by HSBC Life Assurance subsidiary, mainly as a result of adverse market movements. However, in line with H1-2020, underlying net interest income (NII) was relatively stable on a comparative basis. ECLs remained significantly higher, whereas operating expenses were lower on a comparative basis reflecting the Bank's cost management drive. Compared to December 2019, loans and advances to customers increased, driven by growth in mortgages, with commercial banking balances remaining stable at December 2019 levels. The Bank also noted that its liquidity position remained exceptionally strong and regulatory capital ratios continued to exceed regulatory capital requirements.

- **Conclusion:** Despite the depressed environment caused by the pandemic, HSBC performance remained resilient, with most of the negative impact attributable to the life assurance business. The Bank's NII remained stable and HSBC continued to drive down its costs, which we believe is essential in the current negative interest rate environment for the achievement of better profitability margins.

  Recent developments indicate that we are edging closer to normalisation, however recovery risks still remain, including potential delays in the vaccine rollout and mutations of COVID-19 which could be more deadly or resilient to vaccines. Post COVID-19, the EU still faces a number significant economic challenges, with interest rates expected to remain subdued at least in the short to medium term. Additionally, European banks continue to face increasingly stringent capital requirements, including the upcoming MREL and Basel IV regulations. Consequently, although we like HSBC given it is effectively driving down its costs and improving profitability margins, we remain cognisant that the outlook for European banks remains negative, hence we are issuing a Hold recommendation on HSBC.

Group Update

In line with ECB's recommendation, the Bank has not distributed a dividend in FY20. Additionally, during 2020 HSBC continued to drive down its costs, whereby it closed another 4 branches and reopened 2 branches as tellerless. Such actions reflect the shift towards digital banking, which has been further accelerated by the pandemic. HSBC also noted, that it will continue to invest in its principal branches, providing a wider range of services and improved accessibility.

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Valuation

Our 1-year price target of €0.91 is based on a P/B multiple of 0.60x in FY21 increasing to 0.65x in FY23. We have substantiated our price target using the residual income method.

HSBC Malta plc for the year ended 31 Dec €'000s (unless otherwise indicated)	FY17A	FY18A	FY19A	LTM20	FY20F	FY21P	FY22P
Net Interest Income (NII)	120,660	108,622	110,111	109,987	108,173	109,255	111,541
Net fee and commission income (NFI)	22,735	22,776	22,750	22,030	21,613	22,045	22,375
Total operating income	147,945	140,109	142,026	141,218	137,125	137,330	139,946
Insurance segment operating income	12,944	8,264	8,386	(2,711)	(3,500)	1,000	5,500
Net operating income before ECLs	160,889	148,373	150,412	138,507	133,625	138,330	145,446
ECLs and other credit impairment chrg.	2,968	(1,460)	982	(8,730)	(12,477)	1,368	421
Net Operating income	163,857	146,913	151,394	129,777	121,148	139,698	145,867
Total Operating Expenses	(114,034)	(108,357)	(120,685)	(118,194)	(99,398)	(97,534)	(97,534)
Profit before tax	**49,823**	**38,556**	**30,709**	**11,583**	**21,750**	**42,164**	**48,333**
Income tax expense	(18,968)	(9,860)	(10,541)	(3,854)	(7,612)	(14,757)	(16,917)
Profit for the period	**30,855**	**28,696**	**20,168**	**7,729**	**14,137**	**27,406**	**31,416**
Earnings per share (EPS) - €	**0.086**	**0.080**	**0.056**	**0.021**	**0.039**	**0.076**	**0.087**
CC extraordinary adjustments	3,770	(892)	8,346	8,346	-	-	-
CC Adjusted Net Profit	34,625	27,804	28,514	16,075	14,137	27,406	31,416
CC EPS Normalised	**0.096**	**0.077**	**0.079**	**0.045**	**0.039**	**0.076**	**0.087**
Dividend per share	**0.111**	**0.038**	**0.011**	**-**	**0.013**	**0.023**	**0.026**

Equity Evaluation	FY17A	FY18A	FY19A	LTM20	FY20F	FY21P	FY22P
Equity*	479,038	458,778	469,966	468,870	479,434	498,618	520,610
Book value per share (discounted) - €	1.33	1.27	1.30	1.30	1.33	1.38	1.44
Price/Book Ratio	n/a	n/a	0.67x	0.68x	0.55x	0.60x	0.65x

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

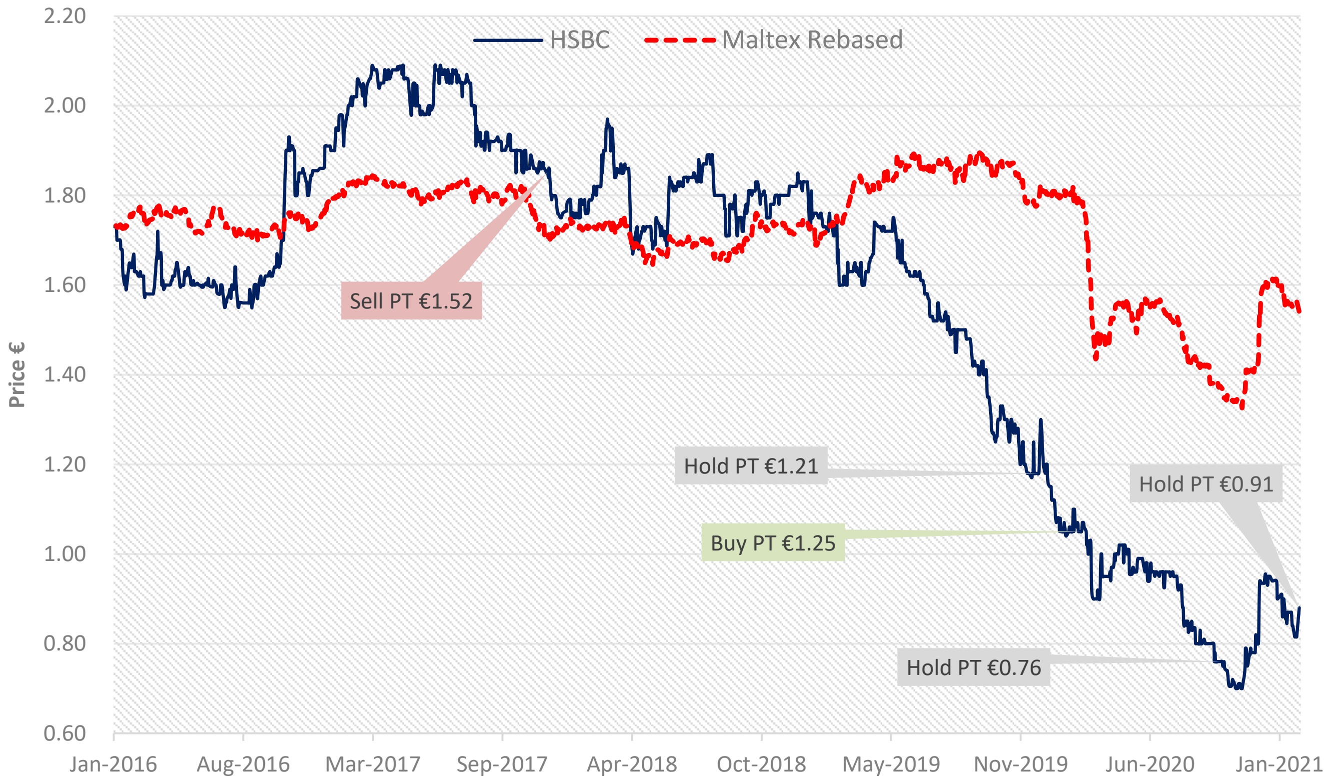
Ratio analysis	FY17A	FY18A	FY19A	LTM20	FY20F	FY21P	FY22P
Cost Efficiency Ratio	70.9%	73.0%	70.0%	91.1%	82.0%	69.8%	66.9%
Net Interest Income Growth	-4.6%	-10.0%	1.4%	-0.1%	-1.8%	1.0%	2.1%
Net Fee and Commission Income Growth	-4.3%	0.2%	-0.1%	-3.2%	-5.0%	2.0%	1.5%
Net Operating Income Growth	-0.4%	-10.3%	3.1%	-14.3%	-20.0%	15.3%	4.4%
Growth in normalised EPS (YoY)	-12.8%	-19.7%	2.6%	-43.6%	-50.4%	93.9%	14.6%
Net Interest Margin	2.05%	1.95%	1.95%	1.90%	1.85%	1.85%	1.87%
CC Adjusted Price/Earnings Ratio	n/a	n/a	10.6x	18.8x	21.4x	11.0x	9.6x
Return On Equity	7.3%	5.9%	6.1%	3.4%	3.0%	5.6%	6.2%
CC Adjusted Earnings Yield	n/a	n/a	9.4%	5.3%	4.7%	9.1%	10.4%
Dividends Yield	n/a	n/a	1.3%	0.0%	1.5%	2.7%	3.1%
Dividend pay-out ratio	129.6%	47.7%	19.7%	0.0%	33.0%	30.0%	30.0%

HSBC Bank Malta plc - €'000s (unless otherwise indicated)	Dec-17	Dec-18	Dec-19	Jun-20
Balance Sheet				
Interest earning assets	5,557,252	5,567,170	5,733,756	5,847,206
Loans and advances to banks	1,059,308	1,097,714	676,031	663,771
Loans and advances to customers	3,128,833	3,110,412	3,257,433	3,289,755
Loans and advances to banks growth yoy	-1.7%	3.6%	-38.4%	-1.8%
Loans and advances to customers growth yoy	-5.8%	-0.6%	4.7%	1.0%
Total deposits	4,820,698	4,890,015	4,977,420	5,152,313
Total deposits growth yoy	-3.8%	1.4%	1.8%	3.5%
Shareholders' equity	479,038	458,778	469,966	468,870
Shares Outstanding	360,306	360,306	360,306	360,306
Net impairments / gross loans	N/A	0.08%	0.01%	0.22%
CET1 Ratio	13.9%	14.6%	16.4%	16.6%
Tier1 Ratio	13.9%	14.6%	16.4%	16.6%
Total Capital Ratio	14.4%	17.0%	19.0%	19.3%

Source: HSBC's Financial Statements and CC Workings

Historical 1-Year Price Target

Reference	Date	Price	Price Target	Analyst	Recommendation
HSBC	04.02.2021	€0.84	€0.91	Rowen Bonello & Andrew Fenech	Hold
HSB	02.10.2020	€0.76	€0.76	Rowen Bonello & Andrew Fenech	Hold
HSB	02.03.2020	€1.05	€1.25	Rowen Bonello & Andrew Fenech	Buy
HSB	27.12.2019	€1.18	€1.21	Simon Psaila	Hold
HSB	29.11.2017	€1.85	€1.52	Simon Psaila & Elisabetta Gaudiano	Sell



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.