

HSBC Bank Malta p.l.c.

Preliminary Accounts 2018

COMPANY ANNOUNCEMENT

The following is a Company Announcement issued by HSBC Bank Malta p.l.c. pursuant to the Listing Rules issued by the Listing Authority.

HSBC BANK MALTA p.l.c. PRELIMINARY STATEMENT OF ANNUAL RESULTS 31 DECEMBER 2018

Strategy Execution

- Transformation to achieve highest global standards of financial crime compliance is now complete.
- Lower profitability in 2018 as we completed the final phase of our de-risking strategy and managed the ongoing impact of negative interest rates.
- HSBC Malta has commenced transition to a new phase focused on growth and value creation. The Bank targets to grow revenue faster than costs and increase return on equity over time.
- Increased focus on customer service and growth is a priority in 2019.
- Retail Banking and Wealth Management business volumes continue to increase supported by increased sales capacity and new digital innovations.
- Strong capital position enabling 47% dividend payment ratio for the full year with a final dividend of 30%.

Financial Performance

- Reported profit before tax of €38.6m for the year ended 31 December 2018, a decrease of €11.3m, or 23%, compared with prior year.
- Adjusted profit before tax, which excludes the effect of notable items, was €36.5m, a decrease of €19.1m or 34%.
- Recommend gross final dividend of 1.8 cents per share (1.2 cents per share net of tax) resulting in a full year dividend of 5.8 cents per share (3.8 cents per share net of tax).
- Strong capital base with an increase in common equity tier 1 ratio to 14.6% from 13.9% as at 31 December 2017. Total capital ratio was 17.0% compared with 14.4% at 31 December 2017.
- Adjusted cost efficiency ratio of 73% compared with 66% in 2017.
- Earnings per share of 8.0 cents compared with 8.6 cents in 2017.
- Return on equity of 6.1% for the year ended 31 December 2018, compared with 6.5% in 2017.
- The advances to deposits ratio was marginally lower at 64%.
- Net loans and advances to customers were €3,110m, down 1% compared with 31 December 2017.
- Customer deposits increased by 3% to €4,887m as at 31 December 2018.



Dr George Brancaleone LL.D.

Company Secretary

Financial Performance Overview

The reported profit before tax for the year ended 31 December 2018 was €38.6m. This represents a decrease of €11.3m or 23% compared to prior year. The adjusted profit before tax was €36.5m, a decrease of €19.1m or 34% compared to 2017. The adjusted results exclude the impact of the following notable items:

- a collective agreement provision charge of €7.6m in 2017; and
- a provision release relating to the brokerage remediation of €1.8m in 2017 and an additional €2.0m release in 2018.

Profit attributable to shareholders was €28.7m resulting in earnings per share of 8.0 cents compared with 8.6 cents in 2017.

The year under review was characterised by broadly stable but persistently low interest rates and excess liquidity in the market while attractive investment opportunities continued to remain limited.

Net interest income of the bank decreased by 10% to €108.6m compared with the prior year principally due to the reduction in the corporate loan book and margin contraction in the bonds portfolio. The average yield of the investment book declined further due to higher yielding bonds maturing. The European Central Bank negative deposit rate remained unchanged during 2018 resulting in additional interest expense on the bank's excess liquidity.

Net non-interest income remained broadly in line with 2017 with increased commissions in RBWM offsetting reductions in CMB. Over 10% more mortgages were sanctioned in 2018 which drove the increase in RBWM commissions.

Operating expenses were €108.4m, €5.7m or 5% lower compared with prior year. 2017 included a provision of €7.6m relating to the collective agreement, excluding this, adjusted operating expenses increased by €1.9m or 2% driven by continued investments in regulatory programmes, financial crime compliance and business growth. The bank continues to exercise rigorous cost control and to implement initiatives at cost base streamlining, outsourcing and process optimisation.

On 1 January 2018, the bank adopted IFRS 9 'Financial Instruments'. Since adoption the bank registered a charge in Expected Credit Loss ("ECL") of €3.5m, €4.7m higher than the €1.2m loan impairment release under IAS 39 in 2017. The year on year increase is driven by the review of the provisioning approach relating to aged defaulted mortgages which led to a recovery in 2017.

There was a €2m positive movement in the provision for brokerage remediation costs in 2018. In 2016, the Bank raised a provision totalling €8m in relation to a remediation of the legacy operational failure in the bank's brokerage business. During 2017, the remediation programme was largely completed and it was assessed that a partial reversal of the conservatively estimated provision was warranted. In this regard, a reversal of €1.8m was effected in 2017. In 2018, there was an additional reversal of €2m.

The effective tax rate was 26%. This translated into a tax expense of €9.9m, €9.1m lower than the €19.0m expense for 2017. During 2018, the bank benefited from a different tax treatment applied on a specific transaction.

HSBC Life Assurance (Malta) Limited reported a profit before tax of €3.7m, €3.6m lower than prior year. The decline was largely due to positive market movements in 2017 (+€2m) that were not repeated in 2018 (-€0.2m). A Unit Linked Employee Pension Plan was successfully launched to all HSBC Bank Malta employees in December 2018.

Net loans and advances to customers decreased by 1% to €3,110m. The decline was driven by the corporate loan book due to both risk management actions and a reduction in non-performing loans. The retail loan book grew by 2% compared with the prior year partially offsetting the reduction in corporate lending. The bank continued to improve the asset quality by managing down non-performing exposures by over 19% versus 31 December 2017.

Customer deposits grew by 3% to €4,887m with a 4% increase in retail deposits more than offsetting the 3% reduction in commercial deposits. The bank maintained a healthy advances to deposits ratio of 64% and its liquidity ratios were well in excess of regulatory requirements.

The financial investments portfolio decreased by 2% to €905m. The bank's risk appetite for investment quality remained unchanged. This portfolio is managed as a high-quality liquidity buffer and consists entirely of securities of sovereign and supranational issuers rated A- (S&P) or better. While the bank partially replaced maturing bonds during the year, attractive investment opportunities in an environment of record low interest rates in Europe were extremely limited.

The bank's capital ratios continued to improve with CET1 increasing from 13.9% to 14.6% and the total capital ratio improving from 14.4% to 17.0%. The additional subordinated loan issued in December was the main driver for the increase in the total capital ratio. The bank continued to have a strong capital base and is fully compliant with the regulatory capital requirements.

The European Central Bank recently introduced new requirements which require the bank to hold additional capital for any unsecured non-performing loans aged over 2 years and secured non-performing loans aged over 7 years that are not 100% provided for through IFRS 9 ECL, regardless of security held. To ensure that the bank holds sufficient capital to support future growth as well as meeting these new requirements, the Board has recommended a final dividend pay-out ratio of 30% of net profit. This will bring the full year 2018 dividend pay-out ratio to 47%. The final gross dividend will be 1.8 cent per share (1.2 cent per share net of tax) which brings the total dividend for 2018 to 5.8 cents (3.8 cents net of tax). The final dividend will be paid on 25 April 2019 to shareholders who are on the bank's register of shareholders at 18 March 2019.

Andrew Beane, Chief Executive Officer at HSBC Bank Malta p.l.c., said:

"I am proud of the progress HSBC has made to implement the highest global standards of compliance which, while reducing profitability, has enabled us to build a stronger and safer bank for our shareholders, customers, employees and the jurisdiction. More broadly, 2018 was difficult for the local financial services sector which suffered further reputational damage. It is essential that all market participants ensure anti money-laundering standards are fully implemented without delay in order to avoid more significant long-term risks. We welcome new initiatives announced by the local authorities which the industry must fully embrace and support.

The local economy continues to perform strongly and, as we enter 2019, HSBC is now able to re-focus our business to be able to deliver measured growth. Our retail and wealth management business is trading well and this year we are also in a position to return our commercial division to measured growth following completion of an extensive restructuring process. New digital innovations will create enduring competitive advantage for HSBC as we bring a range of new world class solutions to benefit our customers and our new account opening process is delivering record volumes.

However, it is also now clear that the new ECB requirements relating to the treatment of non-performing loans ("NPLs") mean that Malta's current framework for the recovery of security in the event of default requires reform. Banks will be required to hold additional capital against fully secured NPLs as a direct result of the long time to recover through current legal processes. For HSBC the expected impact relates to loans where the bank does not expect to incur additional losses even though the recovery process currently takes years.

Looking to the future, the Board is focused on enabling the bank to generate growth for shareholders in this next phase while also ensuring full compliance with the new ECB requirements. Accordingly, whilst we will sustain the bank's position as a strong dividend generating company, the Board has recommended a final dividend pay-out ratio of 30% in order to allocate additional capital to grow the business and meet the new ECB NPL requirements in the event that reforms to the current system are not forthcoming."

Income statements

for the year ended 31 December

	Group		Bank	
	2018 €000	2017 €000	2018 €000	2017 €000
Interest and similar income				
– on loans and advances, balances with Central Bank of Malta and Treasury Bills	109,272	120,309	109,272	120,310
– on debt and other fixed income instruments	9,671	12,541	9,659	12,378
Interest expense	(10,321)	(12,190)	(10,321)	(12,190)
Net interest income	108,622	120,660	108,610	120,498
Fee income	24,114	25,061	19,695	20,039
Fee expense	(1,338)	(2,326)	(1,134)	(1,361)
Net fee income	22,776	22,735	18,561	18,678
Net trading income	5,386	5,273	5,386	5,273
Net income from assets and liabilities of insurance operations, including related derivatives, measured at fair value through profit and loss	N/A	15,480	N/A	–
Net income from financial instruments of insurance operations mandatorily measured at fair value through profit and loss	(20,289)	N/A	–	N/A
Dividend income	18	–	11,425	–
Net insurance premium income	58,500	73,502	–	–
Movement in present value of in-force long-term insurance business	(5,774)	(1,675)	–	–
Other operating income/(expense)	3,307	(723)	2,976	(681)
Total operating income	172,546	235,252	146,958	143,768
Net insurance claims, benefits paid and movement in liabilities to policyholders	(24,173)	(74,363)	–	–
Net operating income before changes in expected credit losses and provisions/loan impairment charges and provisions	148,373	160,889	146,958	143,768
Change in expected credit losses and other credit impairment charges	(3,488)	N/A	(3,488)	N/A
Net reversal of loan impairment charges	N/A	1,168	N/A	1,168
Movement in provision for brokerage remediation costs	2,028	1,800	2,028	1,800
Net operating income	146,913	163,857	145,498	146,736
Employee compensation and benefits	(50,158)	(56,192)	(47,506)	(53,510)
General and administrative expenses	(53,024)	(52,278)	(48,171)	(46,856)
Depreciation of property, plant and equipment	(3,401)	(3,632)	(3,401)	(3,630)
Amortisation of intangible assets	(1,774)	(1,932)	(1,681)	(1,861)
Profit before tax	38,556	49,823	44,739	40,879
Tax expense	(9,860)	(18,968)	(12,148)	(15,894)
Profit for the year	28,696	30,855	32,591	24,985
Earnings per share	8.0c	8.6c		

Statements of comprehensive income

for the year ended 31 December

	Group		Bank	
	2018 €000	2017 €000	2018 €000	2017 €000
Profit for the year	28,696	30,855	32,591	24,985
Other comprehensive income				
Items that will be reclassified subsequently to profit or loss when specific conditions are met:				
Financial investments at fair value through other comprehensive income / Available-for-sale investments:	(2,547)	(4,739)	(2,537)	(4,640)
– fair value losses	(3,919)	(7,290)	(3,903)	(7,139)
– income taxes	1,372	2,551	1,366	2,499
Items that will not be reclassified subsequently to profit or loss:				
Properties:	382	–	382	–
– surplus arising on revaluation	424	–	424	–
– income taxes	(42)	–	(42)	–
Defined benefit obligation:	(334)	–	(334)	–
– remeasurement of defined benefit obligation	(514)	–	(514)	–
– income taxes	180	–	180	–
Other comprehensive income for the year, net of tax	(2,499)	(4,739)	(2,489)	(4,640)
Total comprehensive income for the year	26,197	26,116	30,102	20,345

Statements of financial position

for the year ended 31 December

	Group		Bank	
	2018 €000	2017 €000	2018 €000	2017 €000
Assets				
Balances with Central Bank of Malta, Treasury Bills and cash	190,768	164,059	190,768	164,059
Items in the course of collection from other banks	5,404	18,158	5,404	18,158
Financial investments designated at fair value attributable to insurance operations	N/A	727,270	N/A	–
Financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations	694,081	N/A	–	N/A
Held for trading derivatives	4,956	5,175	4,956	5,175
Loans and advances to banks	1,097,714	1,059,308	1,092,773	1,045,699
Loans and advances to customers	3,110,412	3,128,833	3,110,412	3,128,833
Financial investments	904,920	926,096	904,918	924,881
Prepayments and accrued income	27,312	24,236	22,760	20,199
Current tax assets	16,728	13,911	15,960	13,440
Reinsurance assets	85,205	85,887	–	–
Assets attributable to disposal group held for sale	–	473,797	–	–
Other non-current assets held for sale	5,908	7,411	5,908	7,411
Investments in subsidiaries	–	–	30,859	30,859
Investment property	9,714	10,600	7,515	7,500
Property, plant and equipment	55,413	56,308	55,520	56,415
Intangible assets	59,136	64,062	5,831	4,575
Deferred tax assets	21,509	16,488	21,509	16,488
Other assets	21,814	16,384	20,531	15,686
Total assets	6,310,994	6,797,983	5,495,624	5,459,378
Liabilities				
Deposits by banks	2,542	54,703	2,542	54,703
Customer accounts	4,887,473	4,765,995	4,940,980	4,850,931
Held for trading derivatives	4,991	5,228	4,991	5,228
Accruals and deferred income	19,151	17,838	17,063	15,303
Current tax liabilities	538	–	538	–
Liabilities under investment contracts	166,347	203,136	–	–
Liabilities under insurance contracts	620,781	658,792	–	–
Provisions for liabilities and other charges	20,689	20,099	19,752	19,410
Deferred tax liabilities	23,427	26,295	5,119	5,578
Subordinated liabilities	62,000	29,277	62,000	30,000
Liabilities attributable to disposal group held for sale	–	473,797	–	–
Other liabilities	44,277	63,785	38,857	58,088
Total liabilities	5,852,216	6,318,945	5,091,842	5,039,241
Equity				
Called up share capital	108,092	108,092	108,092	108,092
Revaluation reserve	34,265	36,430	34,265	36,420
Retained earnings	316,421	334,516	261,425	275,625
Total equity	458,778	479,038	403,782	420,137
Total liabilities and equity	6,310,994	6,797,983	5,495,624	5,459,378
Memorandum items				
Contingent liabilities	149,783	122,959	149,785	122,961
Commitments	1,433,773	1,215,457	1,434,634	1,215,501

The financial statements were approved and authorised for issue by the Board of Directors on 19 February 2019 and signed on its behalf by:



Sonny Portelli
Chairman



Andrew Beane
Chief Executive Officer

Statements of changes in equity

for the year ended 31 December

	Group			
	Share capital €000	Revaluation reserve €000	Retained earnings €000	Total equity €000
At 31 December 2017	108,092	36,430	334,516	479,038
Impact of transition to IFRS 9	–	–	(8,048)	(8,048)
At 1 January 2018	108,092	36,430	326,468	470,990
Profit for the year	–	–	28,696	28,696
Other comprehensive income				
Financial investments at fair value through other comprehensive income:				
– fair value losses, net of tax	–	(2,547)	–	(2,547)
Properties:				
– surplus arising on revaluation, net of tax	–	382	–	382
Defined benefit obligation:				
– remeasurement of defined benefit obligation, net of tax	–	–	(334)	(334)
Total other comprehensive income	–	(2,165)	(334)	(2,499)
Total comprehensive income for the year	–	(2,165)	28,362	26,197
Transactions with owners, recognised directly in equity				
Contributions by and distributions to owners:				
– dividends	–	–	(38,409)	(38,409)
Total contributions by and distributions to owners	–	–	(38,409)	(38,409)
At 31 December 2018	108,092	34,265	316,421	458,778
At 1 January 2017	108,092	41,333	324,099	473,524
Profit for the year	–	–	30,855	30,855
Other comprehensive income				
Available-for-sale investments:				
– fair value losses, net of tax	–	(4,739)	–	(4,739)
Properties:				
– transfer to retained earnings upon realisation through disposal, net of tax	–	(164)	164	–
Total other comprehensive income	–	(4,903)	164	(4,739)
Total comprehensive income for the year	–	(4,903)	31,019	26,116
Transactions with owners, recognised directly in equity				
Contributions by and distributions to owners:				
– share-based payments	–	–	8	8
– dividends	–	–	(20,610)	(20,610)
Total contributions by and distributions to owners	–	–	(20,602)	(20,602)
At 31 December 2017	108,092	36,430	334,516	479,038

Statements of changes in equity (continued)
for the year ended 31 December

	Bank			
	Share capital €000	Revaluation reserve €000	Retained earnings €000	Total equity €000
At 31 December 2017	108,092	36,420	275,625	420,137
Impact of transition to IFRS 9	–	–	(8,048)	(8,048)
At 1 January 2018	108,092	36,420	267,577	412,089
Profit for the year	–	–	32,591	32,591
Other comprehensive income				
Financial investments at fair value through other comprehensive income:				
– fair value losses, net of tax	–	(2,537)	–	(2,537)
Properties:				
– surplus arising on revaluation, net of tax	–	382	–	382
Defined benefit obligation:				
– remeasurement of defined benefit obligation, net of tax	–	–	(334)	(334)
Total other comprehensive income	–	(2,155)	(334)	(2,489)
Total comprehensive income for the year	–	(2,155)	32,257	30,102
Transactions with owners, recognised directly in equity				
Contributions by and distributions to owners:				
– dividends	–	–	(38,409)	(38,409)
Total contributions by and distributions to owners	–	–	(38,409)	(38,409)
At 31 December 2018	108,092	34,265	261,425	403,782
At 1 January 2017	108,092	41,224	271,078	420,394
Profit for the year	–	–	24,985	24,985
Other comprehensive income				
Available-for-sale investments:				
– fair value losses, net of tax	–	(4,640)	–	(4,640)
Properties:				
– transferred to retained earnings upon realisation through disposal, net of tax	–	(164)	164	–
Total other comprehensive income	–	(4,804)	164	(4,640)
Total comprehensive income for the year	–	(4,804)	25,149	20,345
Transactions with owners, recognised directly in equity				
Contributions by and distributions to owners:				
– share-based payments	–	–	8	8
– dividends	–	–	(20,610)	(20,610)
Total contributions by and distributions to owners	–	–	(20,602)	(20,602)
At 31 December 2017	108,092	36,420	275,625	420,137

Statements of cash flows

for the year ended 31 December

	Group		Bank	
	2018 €000	2017 €000	2018 €000	2017 €000
Cash flows from operating activities				
Interest, fees and premium receipts	193,161	234,213	127,123	149,039
Interest, fees and claims payments	(75,222)	(296,742)	(12,049)	(14,745)
Payments to employees and suppliers	(100,533)	(106,740)	(92,660)	(99,585)
Cash flows from/(used in) operating activities before changes in operating assets/liabilities	17,406	(169,269)	22,414	34,709
(Increase)/decrease in operating assets:				
– financial investments designated at fair value attributable to insurance operations	N/A	189,207	N/A	–
– financial investments mandatorily measured at fair value through profit or loss attributable to insurance operations	11,372	N/A	–	N/A
– reserve deposit with Central Bank of Malta	(1,176)	290	(1,176)	290
– loans and advances to customers and banks	(89,233)	60,397	(89,216)	60,428
– Treasury Bills	(15,527)	(18,214)	(15,527)	(18,214)
– other receivables	(5,543)	8,997	(4,339)	4,570
(Decrease)/increase in operating liabilities:				
– customer accounts and deposits by banks	66,657	(172,436)	35,209	(146,746)
– other payables	(40,880)	(43,580)	(2,616)	3,282
Net cash used in operating activities before tax	(56,924)	(144,608)	(55,251)	(61,681)
– tax paid	(14,452)	(12,086)	(10,183)	(13,609)
Net cash used in operating activities	(71,376)	(156,694)	(65,434)	(75,290)
Cash flows from investing activities				
Dividends received	18	–	7,618	–
Interest received from financial investments	20,091	32,305	18,282	21,724
Purchase of financial investments	(242,523)	(139,115)	(242,523)	(139,115)
Proceeds from sale and maturity of financial investments	254,972	231,950	253,759	228,515
Purchase of property, plant and equipment and intangible assets	(5,194)	(2,999)	(5,018)	(2,219)
Proceeds from disposal of investment property	1,300	–	–	–
Net cash from investing activities	28,664	122,141	32,118	108,905
Cash flows from financing activities				
Dividends paid	(38,409)	(20,610)	(38,409)	(20,610)
Issue of subordinated liabilities	62,000	–	62,000	–
Repayment of subordinated liabilities	(29,277)	(58,158)	(30,000)	(58,172)
Net cash used in financing activities	(5,686)	(78,768)	(6,409)	(78,782)
Net decrease in cash and cash equivalents	(48,398)	(113,321)	(39,725)	(45,167)
Cash and cash equivalents at beginning of year	848,649	949,504	835,035	867,736
Effect of exchange rate changes on cash and cash equivalents	1,631	12,466	1,631	12,466
Cash and cash equivalents at end of year	801,882	848,649	796,941	835,035

Basis of preparation

The preliminary statement of annual results is published pursuant to Listing Rule 5.54 of the MFSA Listing Authority and Article 4 (2) (b) of the Prevention of Financial Markets Abuse (Disclosure and Notification) Regulations, 2005. Figures have been extracted from HSBC Bank Malta p.l.c.'s Annual Report and Accounts which have been audited by PwC.

These financial statements have been prepared and presented in accordance with International Financial Reporting Standards as adopted by the EU.

HSBC Holdings plc, the parent company of the HSBC Group, is headquartered in London. The Group serves customers worldwide in 66 countries and territories in Europe, Asia, North and Latin America, and the Middle East and North Africa. With assets of US\$2,558bn at 31 December 2018, HSBC is one of the world's largest banking and financial services organisations.

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