

Analysing the Results Of Bank of Cyprus – 1Q14

Bank of Cyprus published its Q12014 last week and the local and international media were quick to hail the results. With the help of Exito Capital International, we looked a little deeper and despite reporting a positive result of €31mn, we still found some concerns which makes us believe it is far too early to suggest that the biggest Cypriot bank has turned the corner for good or not.

Key Facts

- BoC has reported €944mn outflow in customers' deposits from €14.9bn to €14bn which is a decrease of 6% within 3 months.
- The Bank is still heavily dependent on emergency funding from central banks which still stands at €10.9bn and without this funding the bank would basically be illiquid (and thus potentially insolvent).
- Its loan book is very much concentrated in Cyprus which represents c. 86% of the overall loan portfolio – c.65% of the Cyprus loan portfolio relates to construction, real estate and private individuals (of which 65% relates to housing). Thus, one can conclude that the Bank's outlook is very closely linked to Cyprus' real estate sector and the macroeconomic growth.
- The portion of overdue and impaired loans has further increased from 53.2% as of year end 2013 to 53.8% as of 1Q 2014 and only 44% of the impaired loans are provisioned for. In the 1Q2014, the bank only set aside €184mn in new provisioning (whereas in 2013 the average quarterly provisioning was €320mn) which is just 2% of the total value of impaired loans and overdue loans. Furthermore, €6bn of loans have been rescheduled of which €1.27bn have already been classified as impaired up from €1.18bn as of YE2013.
- The liquidity ratio (the ratio of liquid assets to total deposits and other liabilities falling due in the next twelve months) has fallen from 12.28% at YE2013 to 12.14% as of 1Q2014
- The sale of its Ukrainian subsidiary will result in an accounting loss of €100mn in the second quarter.

Outlook

BOC is the largest banking institution in Cyprus and given its very high credit exposure to the Cypriot businesses and households, the Bank's future financial performance is interlinked with the Cypriot economy, real estate market and is highly correlated with the trajectory of economic activity in Cyprus.

The Troika also noted that while the recession in 2014 is expected to be somewhat less severe than anticipated, the outlook remains challenging. The contraction of output for 2014 has been revised down to 4,2% from 4,8%, given the better-than-expected outturn for 2013 and other recent indicators pointing to gains in confidence. Unemployment remains very high, and large non-performing loans are constraining the ability of banks to supply credit to the economy. As a result, the recovery is now expected to be more subdued than previously forecast, with moderate growth projected at 0,4% in 2015 and gradually improving thereafter, as domestic demand is weighed down by the need to reduce very high levels of indebtedness. Borrowers are expected to continue facing challenges, while property prices may fall even further (Exito Capital, 2014).

The ability of Bank of Cyprus to continue as a going concern is dependent on:

1. The successful implementation of the Group's Restructuring Plan and the realisation of the macroeconomic scenario which formed the basis of its preparation.
2. The period over which the restrictive measures and capital controls are in place.
3. The continuing reliance on and availability of the Central Bank liquidity facilities.
4. The actual outcome of litigation and claims mainly relating to the bail-in of deposits and the absorption of losses by the holders of equity and debt instruments of the Bank.



Summary

Though there are signs that things are slowly stabilising at BOC and hence chances of survival have increased, it is obvious that the bank (speaking in medical terms as per Ben Rosenberger – Exito Capital) is still in intensive care and on life support. Without the emergency funding from the ECB the bank would literally be illiquid with potentially severe consequences.

The outlook is challenging and linked to a lot of uncertainties. The recovery –if successful- will certainly take several years. As Ben Rosenberger (Exito Capital) stated, media suggestions that the bank may be floated on the London stock exchange in the near term is in our view totally unfounded. It would be suggesting that a patient who is just recovering from a cardiac arrest can participate in the next London marathon.

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