Muses from “il-Borża”

by David Curmi

The reporting season is currently in full swing. Companies are in the midst of announcing their full year results or are preparing for their upcoming Annual General Meeting. It is an important time for shareholders. Perhaps not used to the full. AGMs not only offer the opportunity for shareholders to get free food – it is amazing to see how pushy some shareholders get when free food is on offer – but more importantly it is a time to listen to the board of directors review the year past and give some insight into the months ahead. It is also a time to vote on important issues that are put to the body of shareholders and to ask pertinent questions to the board.

The upcoming Lombard Bank AGM should prove to be an interesting event. This is because the shareholder base of Lombard is likely to see a significant change in the forthcoming months. A change that can have a major bearing on the future direction of the bank.

Cyprus Popular Bank (CPB), formerly known as Marfin Bank, holds a 49.01% stake in Lombard Bank. Back in 2013, as a result of the financial crisis in Cyprus, CPB was split into two, a good bank and a bad bank. All foreign operations, including the 49.01% in Lombard were put into the hands of a special administrator whose role is to dispose of such investments and manage the assets held as part of the bad bank.

There are a number of resolutions related to the above mentioned transaction that the board have put to shareholders to vote upon in the upcoming AGM. Notably, the board is proposing that shareholders give them the right to purchase up to 50% of the shareholding of Lombard i.e. to take part in the bidding process. This is somewhat unorthodox in the context of a bank wanting to purchase such a large percentage of its own shares, especially at a time when banks are being asked to maintain greater levels of capital to strengthen their defensive mechanisms in the event of another crisis. Regulators will be looking at this closely I assume. I must admit I have never seen such a proposal before, whether domestically or internationally. That’s not to say that it has never been done. Nor do I want to give the impression that there is anything illegal in this proposal. As discussed in the shareholder notice, issued by the bank, the board believes that the sale of CPB’s stake provides an opportunity for the bank to influence the sale process and thus perhaps ensure that the bank continues to execute its present strategy. This is not surprising. Lombard has had a major shareholder with 49% for many years, without reaping any major strategic benefit. In this sense it perhaps makes sense to try and be involved in the process.

The complication arises on how to finance the purchase in the event that the bank is successful in purchasing its own shares, and the impact the presence of Lombard as a bidder will have on the sale process. In terms of the first part, the bank has said that it will first offer the remaining shareholders the opportunity to subscribe to new shares, possibly in the form of a rights issue. This way, existing shareholders will be able to effectively double their holding in the bank if they take up their rights. Interestingly though the bank also wants shareholders to give up their pre emption rights. A pre emption right is a means to protect existing shareholders of an entity from having their holding diluted. It is important therefore to better understand why the board felt the need to include this given it may lead to shares being offered to an outside party to a greater degree than what will be offered to existing shareholders on a pro rata basis.

The other complication arises out of the presence of Lombard at the bidding table. Essentially it is bidding for itself. This to my mind may raise eyebrows. Will a prospective bidder be comfortable with the bidding process, if it is aware that one of the bidders for Lombard is the bank itself? If nothing else, the level of knowledge that the individuals who will put the bid together on behalf of the bank will be vastly superior to that of an external person who is looking at the bank from the outside. This may put off potential bidders and if they are put off, is this good for both the seller and the remaining body of shareholders? I suspect not. It would be interesting to see what say both the seller and regulators have in the matter. Interesting times ahead.

In the meantime a Happy Easter to all.