# THE GREAT BREXIT GET-OUT CLAUSE

## From bankers to stockbrokers, everybody's blaming everything on Brexit. But are they right?

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Blame Brexit. No matter what the problem is, it can probably in some way be traced back to the shambles of Britain leaving the European Union. In the wake of the latest Brexit crisis, shares in Irish banks fell heavily, as did most other Irish stocks, hardly surprising given the devastation it could wreak on the economy.

"Indiscriminate Brexit selling" was the explanation that one market watcher gave for the sell-off in Irish bank share prices last week.

Brexit is, of course, a major issue for Bank of Ireland and AIB. Not only do both banks have substantial operations in Britain, but there could be second-order impacts through loans extended to exposed sectors of the Irish economy from the agriculture, food and hospitality sectors.

What about Permanent TSB? In recent days, its shares hit their lowest level since its 2015 capital raise. The bank has now lost more than 70 per cent of its value since that time. PTSB, 74 per cent of which is still owned by taxpayers, has no direct Brexit exposure.

Even before the threat of a no-deal Brexit ramped up, Irish financial shares were weak. It's hard to attribute the declines to December's global stock market wobble: they have been out of favour with investors for much longer than that. In what is the fastest-growing economy in Europe, it is puzzling for shareholders.

Executives are usually cautious about public comments on their companies' share prices, even though they pay close attention to movements.

When asked last month about the disconnect between the performance of the bank and its share price, PTSB boss Jeremy Masding said: "Really, what the markets want is, every half year, the [chief executive] and [chief financial officer] to show good quality earnings and good growth, and that's what we are about. I have a real core belief that I can't manage the market. All I can do is maximise the intrinsic value of this business. My core belief is that, over time, with consistent delivery and the right story, market value and intrinsic value align."

Bernard Byrne of AIB

Jeremy Masding of Permanent TSB

Francesca McDonagh of Bank of Ireland

Last month, AIB, Bank of Ireland and PTSB all reported their annual results for 2018, which saw improvements in dealing with legacy non-performing loans and an expansion in new lending. In the weeks since, only Bank of Ireland's share price has been trading marginally ahead of where it was beforehand.

Over the last month, the banks have been touring the main investor hubs to meet major shareholders and set out their case.

The reaction has been far from positive. Although no major brokers have downgraded their recommendations on Irish banks, many have pulled back their share price targets and many financial estimates for the next couple of years.

The latest cut came to AIB last week from Investec, which trimmed its price target from €5.20 to €4.80. Shares in the bank are trading about 15 per cent lower than the price at which the state reduced its stake in the lender less than two years ago.

Investec analyst Owen Callan pointed out that while he was "impressed by the strong top-line earnings power and capital generation", there were concerns about costs rising as a result of pressure on pay and technology investment, and also about the ongoing level of exceptional items the bank was incurring.

Analysts at credit ratings agency Fitch said that should the worst case scenario of a no-deal Brexit emerge, the banks should still be able to withstand the shock.

"We believe that Irish banks are reasonably well positioned to absorb the impact of the weaker domestic growth likely in the event of a no-deal Brexit, given their generally improved fundamentals," Fitch said in a report on the banking sector last week.

"Large Irish banks' ratings have benefited from rapidly improving fundamentals in recent years: reducing [non-performing loan] stocks, a return to normalised funding, adequate profitability and a much reduced risk appetite, primarily in residential mortgage origination. Capital at the largest banks is managed well above regulatory requirements."

Those strong capital levels should also allow the banks, with the exception of PTSB, to return some of it to investors. Bank of Ireland is raising its dividend payout to shareholders to €173 million from €124 million. AIB is raising its payment by 42 per cent to €461 million.

Investec's Callan said AIB had about €2.3 billion of excess capital right now on its balance sheet and this could rise to €2.7 billion by 2021. That is money it could return to shareholders. The prospect of both banks paying out half their annual profits in dividends should surely improve sentiment towards them.

But there are still lingering issues for them to deal with. Cost-to-income ratios are far too high. Part of that is much higher regulatory charges, which won't be going away any time soon.

And the banks themselves will have to slim down. AIB's financial solutions group, which deals with borrowers in arrears, employs almost 1,400 staff. PTSB, too, has said its troubled loans unit will shrink as it pares costs.

Also hovering over them is the prospect of political interference to prevent non-performing loans being sold off, which would probably mean the banks would have to spend much more time (and capital) dealing with arrears, and moves to change what offers lenders can pitch to new mortgage customers which could impact their new lending.

Does that explain the weakness of the banking sector? Possibly. International institutions fret when they hear headlines that could affect the value of their investment. Perhaps they are also looking at the low rates of returns the banks are generating in a roaring-hot economy. If the banks cannot make higher returns now, what are the prospects if the economy weakens in the years ahead?

In the meantime, everyone can happily blame Brexit.