Friday, November 24, 2017 | special comment

Regulator Issues 2018 Dividend Guidelines for Banks

Banks, Poland

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Poland's financial regulator KNF has announced the rules for 2018 dividend distributions by banks, setting the criteria for offering dividend payout ratios of 50%, 75%, and 100%. KNF says it changed the formula for calculating the minimum capital requirements needed to warrant a payout, but otherwise the eligibility criteria have not changed from last year. Since the new formula uses data not yet publicly disclosed by any of the banks in our coverage, we are not able to say for sure at this time which ones are eligible to offer 100% dividend payout ratios next year. However we can make a relatively educated guess that Pekao and Handlowy do meet all the requirements. Based on the proportions of foreign-currency mortgage loans in the respective portfolios, used as an adjustment factor for payout ratios, we can predict with a degree of certainty that Pekao and Handlowy will be allowed to pay out at least 75% of the net earnings for 2017 as dividends, with the payout ratios anticipated for other banks at 50% ING BSK and 25% (with a very low likelihood of a payout up to 50%) PKO BP. Otherwise, the banks we cover fall short of the requirements to pay dividends at all next year. Accordingly, we are guessing the KNF's announcement today will give a boost to the shares of PKO BP (with potential 2018 DPS at PLN 0.60 vs. PLN 0.41 expected by the market according to Bloomberg), while Pekao, Handlowy, Millennium, and BZ WBK, will suffer as investors adjust their dividend expectations.

According to the updated criteria, in order to pay dividends next year, a bank cannot be undergoing restructuring, and it has to have a Polish SREP (BION) score greater than 2.5. A 50% payout ratio requires a Tier 1 capital ratio of 6% + 75% of the CHF exposure buffer + combined OSII buffer, conservation buffer, and systemic risk buffer, increased by 1.5%. A 75% payout ratio requires fulfillment of all of the criteria for a 50% payout ratio plus a target conservation buffer of 2.5%. A 100% payout ratio requires all of the above plus an additional TCR buffer against a bank's sensitivity to unfavorable shifts in economic conditions.

Further, banks with significant FX mortgage exposure are required to adjust their planned payout ratios for two additional factors: Factor K1, calculated based on the share of FX mortgages in the total portfolio of loans to non–financial organizations, and Factor K2, calculated based on the proportion of FX mortgages issued in 2007 and 2008 (these are the loans that will decide the extent of losses that a bank may incur after the implementation of the planned FX borrower relief measures). The prescribed adjustments are to be as follows:

Factor K1:

- A 20ppt downward adjustment to the payout ratio for banks with an FX mortgage ratio over 10%,
- A 30ppt downward adjustment to the payout ratio for banks with an FX mortgage ratio over 20%,
- A 50ppt downward adjustment to the payout ratio for banks with an FX mortgage ratio over 30%.

Factor K2:

- A 30ppt downward adjustment to the payout ratio for banks with a 2007-2008 FX mortgage ratio over 20%,
- A 50ppt downward adjustment to the payout ratio for banks with a 2007-2008 FX mortgage ratio over 50%.

Any bank wanting to pay dividends from undistributed earnings has to meet the requirements set out above, and has to ask the KNF for permission.

You will find a summary of our calculations as regards the 2018 dividend-paying potential of the banks in our coverage on the next page.

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Calculation of 2018 dividend-paying potential of selected Polish banks

	PKO	PEO	BZW	MIL	BHW	ING	ALR
50% Payout Ratio Requirements							
Tier1 ratio	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
TCR	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
CHF exposure buffer*	0.45%	0.00%	0.62%	3.09%	0.00%	0.00%	0.00%
OSII buffer	0.75%	0.75%	0.50%	0.25%	0.25%	0.50%	0.00%
Conservation buffer	1.88%	1.88%	1.88%	1.88%	1.88%	1.88%	1.88%
Systemic risk buffer	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
KNF-mandated buffer	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
Total CET1	**13.46%**	**13.13%**	**13.34%**	**14.94%**	**12.63%**	**12.88%**	**12.38%**
Total TCR	**15.58%**	**15.13%**	**15.50%**	**17.72%**	**14.63%**	**14.88%**	**14.38%**
75% Payout Ratio Requirements							
Tier1 ratio	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
TCR	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
CHF exposure buffer*	0.45%	0.00%	0.62%	3.09%	0.00%	0.00%	0.00%
OSII buffer	0.75%	0.75%	0.50%	0.75%	0.75%	0.75%	0.75%
Conservation buffer	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Systemic risk buffer	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
KNF-mandated buffer	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
Total CET1	**14.09%**	**13.75%**	**13.97%**	**16.07%**	**13.75%**	**13.75%**	**13.75%**
Total TCR	**16.20%**	**15.75%**	**16.12%**	**18.84%**	**15.75%**	**15.75%**	**15.75%**
100% Payout Ratio Requirements							
Tier1	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%	6.00%
TCR	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
CHF exposure buffer*	0.45%	0.00%	0.62%	3.09%	0.00%	0.00%	0.00%
OSII buffer	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%	0.75%
Conservation buffer	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%	2.50%
Systemic risk buffer	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%
KNF-mandated buffer	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%	1.50%
Economic shock buffer	?	?	?	?	?	?	?
Total CET1	**?**	**?**	**?**	**?**	**?**	**?**	**?**
Total TCR	**?**	**?**	**?**	**?**	**?**	**?**	**?**
Solvency Ratio Estimates as of AGM date or as of 30 September 2017							
CET1	15.55%	16.04%	15.00%	20.51%	17.35%	14.74%	12.00%
TCR	16.39%	17.04%	15.93%	20.51%	17.35%	15.67%	14.03%
Eligible for payout ratio of:	75.0%	100.0%	50.0%	100.0%	100.0%	50.0%	0.0%
Adjustment for factors K1 and K2	50.0%	0.0%	70.0%	100.0%	0.0%	0.0%	0.0%
Expected dividend payout ratio	**25.0%**	**100.0%**	**0.0%**	**0.0%**	**100.0%**	**50.0%**	**0.0%**
DPS	0.60	7.46	0.00	0.00	3.99	5.55	0.00
DPS at 75% payout ratio		5.59			2.99		
Dividend Yield	**1.4%**	**5.8%**	**0.0%**	**0.0%**	**5.2%**	**2.7%**	**0.0%**
Dividend Yield at 75% payout ratio		**4.3%**			**3.9%**		

Source: Banks, estimates by Dom Maklerski mBanku; *Our estimate

List of abbreviations and ratios contained in the report:
EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

OVERWEIGHT (OW) – a rating which indicates that we expect a stock to outperform the broad market
NEUTRAL (N) – a rating which indicates that we expect the stock to perform in line with the broad market
UNDERWEIGHT (UW) – a rating which indicates that we expect the stock to underperform the broad market

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