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Banks – 2018 6M Earnings Update

Banks, Poland

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KNF released banking sector figures for the first half of 2018. Net income grew by 17.1% YoY from January to June 2018. Higher net income and robust net trading income are a cause for complacency. On the other hand, a slowdown in net interest income observed in 2018, a likely sign of tough competition in the deposit segment, alongside rising operating costs and high risk costs (91 bps in June), spark worries. Assuming that the banking sector will perform at the June level until the end of 2018, net profit for the year may go up by +18% YoY to PLN 16.3 billion. In Q2 2018 alone, net profit picked up by 13% YoY. At the same time, KNF reminded that banks expected a 5.2% YoY hike in net profit in 2018. In our opinion, the strong performance of the banking sector seen so far in 2018 may weigh in favour of passing the CHF bill.

H1 2018 results

Over the first six months of the year, net interest income went up by 8.8% YoY amid a 7.4% YoY growth in interest income and a 3.7% YoY rise in interest costs. Net interest margin increased by 3 bps to 2.53% and by 3 bps compared with May 2017. Other interest income rose by 2.7% YoY in H1 2018, coupled with a 2.9% YoY drop in net commission income and soaring net trading income (+30.7% YoY). Personal costs went up by 6.6% YoY, while other administrative costs rose by 4.9% YoY. By the end of June 2018, the number of employees in the banking sector grew by 559, but compared with the previous year, the overall headcount dropped by 1,728. Net provisions went up slightly in H1 2018 (+0.6%) YoY with the cost of risk still high at 91 bps in June.

Non-Consolidated financial results for 6M 2018

| (PLN m) | Jun'17 | May'18 | Jun'18 | Y/Y | M/M | M6'17 | M6'18 | Y/Y |
|---|--------------|--------------|--------------|--------------|--------------|---------------|---------------|--------------|
| Interest revenue | 4,736 | 3,568 | 5,176 | 9.3% | 45.1% | 28,290 | 30,388 | 7.4% |
| Interest expenses | 1,156 | -267 | 1,332 | 15.2% | - | 7,664 | 7,944 | 3.7% |
| Net interest income | 3,580 | 3,835 | 3,844 | 7.4% | 0.2% | 20,626 | 22,444 | 8.8% |
| Fee income | 1,192 | 1,186 | 1,086 | -8.9% | -8.5% | 6,835 | 6,635 | -2.9% |
| Dividends | 324 | 157 | 791 | 144.2% | 402.4% | 1,079 | 1,411 | 30.7% |
| Other income | 625 | 497 | 510 | -18.5% | 2.5% | 2,872 | 3,031 | 5.5% |
| Non-interest income | 2,141 | 1,841 | 2,386 | 11.5% | 29.6% | 10,787 | 11,077 | 2.7% |
| Total income | 5,720 | 5,676 | 6,230 | 8.9% | 9.8% | 31,412 | 33,521 | 6.7% |
| Payroll costs | 1,408 | 1,473 | 1,546 | 9.8% | 5.0% | 8,217 | 8,759 | 6.6% |
| Administrative expenses | 1,273 | 1,298 | 1,380 | 8.4% | 6.3% | 8,500 | 8,920 | 4.9% |
| Other costs | 244 | 243 | 244 | -0.3% | 0.1% | 1,437 | 1,460 | 1.6% |
| Total costs | 2,926 | 3,014 | 3,169 | 8.3% | 5.2% | 18,153 | 19,139 | 5.4% |
| Operating income before provisioning | 2,795 | 2,663 | 3,061 | 9.5% | 15.0% | 13,259 | 14,382 | 8.5% |
| Provisioning | 830 | 816 | 916 | 10.4% | 12.2% | 4,169 | 4,192 | 0.6% |
| Operating income | 1,965 | 1,846 | 2,145 | 9.2% | 16.2% | 9,090 | 10,190 | 12.1% |
| Extraordinary gains/losses | 0 | -3 | -9 | - | - | 0 | -28 | - |
| Pre-tax income | 1,965 | 1,844 | 2,136 | 8.7% | 15.9% | 9,090 | 10,162 | 11.8% |
| Tax | 446 | 382 | 1,086 | 143.5% | 184.6% | 2,444 | 2,171 | -11.2% |
| Equity in profits of associates | -9 | 17 | -356 | - | - | -52 | 150 | - |
| Discontinued operations | 0 | 0 | 0 | - | - | 0 | -1 | - |
| Net income | 1,528 | 1,445 | 1,405 | -8.1% | -2.8% | 6,699 | 7,841 | 17.1% |

| (%) | Jun'17 | Dec'17 | Jan'18 | Feb'18 | Mar'18 | Apr'18 | May'18 | Jun'18 |
|--|--------|--------|--------|--------|--------|--------|--------|--------|
| Net interest income (over avg. assets) | 2.50 | 2.50 | 2.51 | 2.52 | 2.51 | 2.45 | 2.47 | 2.53 |
| Cost or risk | 0.86 | 1.31 | 0.50 | 0.59 | 0.77 | 0.64 | 0.79 | 0.91 |
| Costs/Income | 51.14 | 55.21 | 71.90 | 60.50 | 52.37 | 55.55 | 53.09 | 50.86 |
| Costs / Avg. Assets | 2.04 | 2.11 | 2.58 | 2.16 | 1.96 | 2.05 | 1.94 | 2.09 |
| ROE | 9.82 | 5.74 | 3.40 | 7.00 | 10.19 | 9.63 | 8.38 | 8.46 |

Source: KNF, Dom Maklerski mBanku

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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ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%
HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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