

Thursday, December 11, 2014 | update

# Komercni Banka: reduce (upgraded)

**KOMB CP; BKOM.PR | Banks, Czech Republic**

## Under Pressure

We are upgrading Komercni Banka from sell to reduce with the new 9-month price target at CZK 4,549 per share. KOMB shares (in US dollars) have retreated 0.5% since the beginning of the year, but they still far outperformed the Polish WIG-Banks index which fell 8.0% and MSCI EM Financials which plummeted 23.6%. Komercni offers one of the highest dividend yields in the sector but at the same time it faces the same struggle with unfavorable market conditions as its Polish peers. We believe the Czech bank deserves to be valued at a smaller discount to Polish banks than the historical average, but today's premium is too much pay for its shares.

## Overoptimistic market expectations

We have raised our 2014 net profit estimate for Komercni by 2% to reflect much lower-than-originally anticipated risk reserves. At the same time, the total income this year fell short both of the expectations of market analysts and the Bank itself. For 2015, we anticipate continuing earnings pressure and so we have lowered our projection accordingly by 5.8%. Our adjusted 2015 and 2016 forecasts today are 3.1% and 5.2%, respectively, lower than the average market consensus as per Bloomberg.

## Earnings pressure to persist in 2015

Komercni Banka expects stable growth in total income in 2015 on rising interest income combined with 2-3% contraction in fee income. Interest margins next year will remain under pressure from low market rates. Loans are set to increase at a rate of 5-6%. Costs will remain under tight control next year but cost of risk is set to normalize at around 35bps. This guidance matches our own forecasts for Komercni, implying a 1.6% decline in net profit in 2015.

## High dividend yield

Enjoying one of the highest solvency ratios in the region, Komercni decided to increase future dividend distributions to 70-100% of annual earnings. To keep the Tier-1 ratio at or over the internal target of 15-16%, we believe the payout ratios in the coming years will hover around 90%, implying dividend yield at 6.1% in 2015 and 2016.

## Fair discount to Polish banks

Komercni is trading at a 5% premium on 2015E P/E of 14.9x relative to Polish banks valued at an average 14.2x. In our view, given the Bank's growth prospects, the premium is undeserved, though at the same time we consider excessive the 13% discount at which KOMB is trading on historical 12-month forward P/E.

Current Price	CZK 4,920
Target Price	CZK 4,549
Market Cap	CZK 185.8bn
Free Float	CZK 112.2bn
ADTV (3M)	CZK 411.3m

## Ownership

Société Générale S. A.	60.40%
Others	39.60%

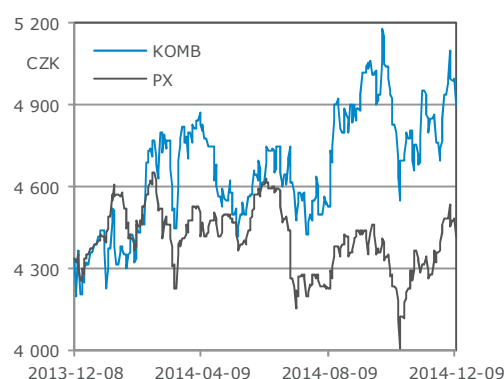
## Company Profile

Komercni Banka is one of the largest banks in the Czech Republic. It offers universal banking services to corporate as well as retail clients. The Bank is valued by investors for its high dividends and capital adequacy ratios.

## Upcoming events

12. Feb. 2015 – FY2014 annual earnings announcement

## KOMB vs. PX



(CZK m)	2013	2014E	2015E	2016E
Net interest income	21,207	21,396	21,642	22,904
Noninterest income	9,687	9,087	9,027	9,138
Operating costs	13,148	13,026	13,069	13,335
Operating profit*	17,746	17,456	17,601	18,706
Net profit	12,528	12,667	12,468	13,066
Costs/Income (%)	42.6	42.7	42.6	41.6
ROE (%)	13.1	13.3	12.9	13.5
P/E (x)	14.8	14.7	14.9	14.2
P/BV (x)	2.0	1.9	1.9	1.9
DPS	230.0	230.0	300.0	300.0
Dividend Yield (%)	4.7	4.7	6.1	6.1

\*before provisioning

## Analyst:

Michał Konarski  
+48 22 438 24 05  
[michal.konarski@mdm.pl](mailto:michal.konarski@mdm.pl)

## Investment Case

We are upgrading Komerční Banka from sell to reduce with the 9-month price target raised to CZK 4,549 per share. We believe the Bank deserves to be valued at a discount, albeit smaller than the historical average, relative to the Polish bank sector. Next year, Komerční is poised for the same struggle with unfavorable market forces like low interest rates and downward pressure on noninterest income (through reduced interchange fees) as its Polish peers. The Bank's own guidance predicts low interest margins, weak fee income, and rising cost of risk, next year, all conspiring in our view to bring the annual net profit down from 2014. For these reasons, despite offering a high dividend yield (which is actually equally generous to the yields offered by Pekao and Bank Handlowy), we believe KOMB should continue to trade at a discount to Polish banks which, although they also face a tough 2015, especially in the first six months, seem to us to be the better investment pick than their overpriced Czech counterpart.

### Komerční earnings guidance vs. our forecasts

Y/Y pct. change	2014E		2015E	
	KB*	mDM	KB**	mDM
Net interest income	+2%	+0.9%	+	+1.2%
NIM (bps)	-5bps max	-14 bps	(-)	-6 bps
Loans	+6%	+2.2%	+5-6%	+4.3%
Fee income	(-)	-5.0%	(2%-3%)	-2.0%
Trading income		-10.0%	+	+3.0%
Total income	+0.9-1.0%	-1.3%	=	+0.6%
Costs	+1%	-0.9%	=	+0.3%
Cost of risk	=	-9 bps	~35 bps	31 bps
Div. payout ratio			70-100%	89%

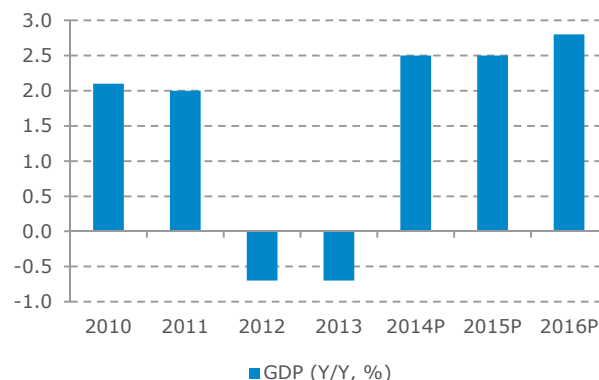
\*guidance issued in Q3 2013; \*\*guidance issued in Q3 2014

Source: Komerční Banka, Dom Maklerski mBanku

## Economic Outlook

Using projections by the Czech Central Bank, we expect Czech GDP growth to be 2.5% in 2014-2015 followed by a slight acceleration to 2.8% in 2016 (this compares to KB's projection of 2.3% growth each in 2014 and 2015 and forecasts of respective economic expansion at rates of 2.5% and 2.7% by Ceska Sporitelna). The GDP growth expected this year is supported by stronger domestic demand, low interest rates, a weak koruna, and a rebound in public investment. It is hoped that it will strengthen job growth in the Czech Republic. The Czech National Bank expects that as interest rates are maintained at the lowest level on record until 2016 the CZK/EUR exchange rate will remain at 27 CZK/EUR at least until Q1 2016. In Q2 2016, the CNB is planning an interest rate hike by about 0.8%. As for the inflation rate, the central bank anticipates gradual acceleration to over 2ppts in 2016.

### Annual GDP growth in Czech Republic (%)



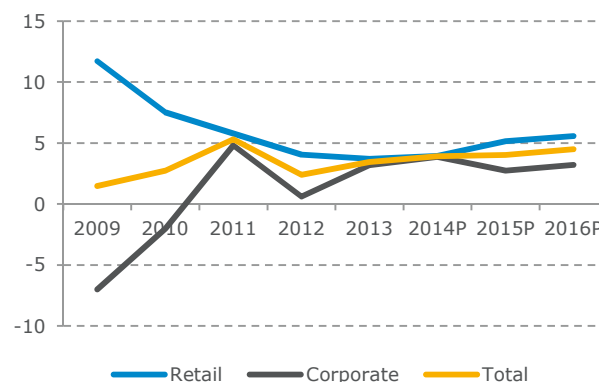
Source: Czech National Bank, Dom Maklerski mBanku

We take as accurate the CNB's plans to maintain interest rates low through 2015 but for 2016 we rely on Bloomberg consensus predicting rate hikes of 50bps max, less than the CNB's 80bp prognosis. The market consensus for the Czech 10-year government bond yields is that they will remain below 1.5% for the next three years.

## Loans

We anticipate gradual lending improvement in the Czech Republic in the coming years. According to MFI statistics for 2014, Czech loan sales in year through September were up 1.9%, driven mainly by mortgage borrowing (+3.8% YTD). The growing home loan sales are reflected in interest rates, with the spread to the 3-month PRIBOR rate tightened by 21 basis point in the last twelve months. General government lending posted strong, ytd growth of 14.8% in the period from a low year-ago base. We would attribute the relatively slow expansion in the Czech retail lending to a high risk aversion of the local borrowers. This is confirmed by a ratio of loan payments to income which in 2010-2010 averaged 13-14%, with average LTV at 58.9%. Moreover, the high risk aversion is reflected in the rate of retail loan growth relative to GDP growth. Going forward, as the economic situation in the Czech Republic improves, we anticipate gradual acceleration in lending growth to 4.0% in 2015 and 4.5% in 2016. The growth potential is additionally reinforced by a low loan penetration rate in the Czech Republic compared to countries in the Euro Area, which paints a buoyant outlook for lending going forward, especially for retail credit where the gap in the penetration rate is gradually closing.

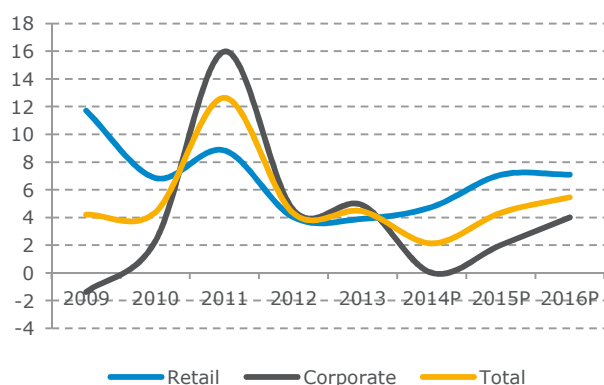
### Loan growth in Czech Republic (%)



Source: Czech National Bank, Dom Maklerski mBanku

The economic recovery will no doubt generate more business for Komerční Banka's lending division, however we have to note that the growth in case of the Czech bank will continue to lag its Polish peers. Komerční Banka has seen total loan sales rise 0.7% since the beginning of the year, with retail lending up 2.3% and corporate lending down 0.7%. In retail, it is worth noting a 6.3% ytd increase in home equity borrowing. We expect loan growth at a rate of 4.3% in 2015 and 5.5% in 2016 at Komerční.

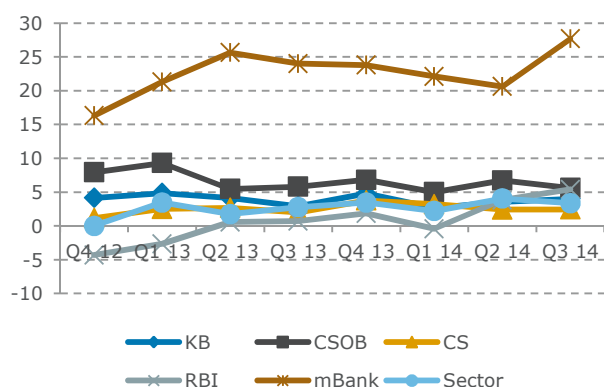
### Loan growth projection for Komerční (%)



Source: Komerční Banka, Dom Maklerski mBanku

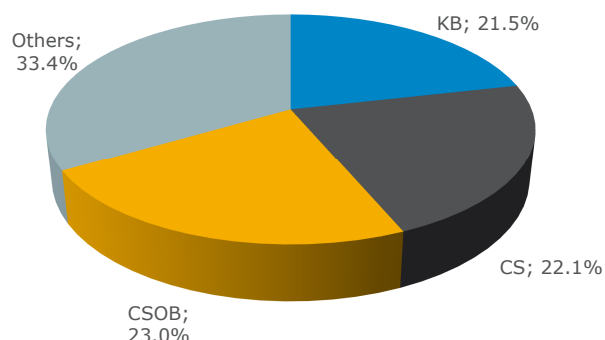
The slow loan growth experienced by Komerční is experienced by all of its Czech competition as well, evidenced by ytd (through 30 September) expansion of 0.7% compared to Česká Spořitelna's (CS) 0.5% (as per Erste Bank) and CSOB's 4.1% (as per KBC). More dynamic growth has been experienced only by banks which are just starting to build a presence in the Czech Republic such as Raiffeisen (RBI, +4.1%) and mBank (+21.1%). That said, note that the top three players between them control about 67% of the Czech lending market.

### Y/Y quarterly loan growth at Czech banks



Source: Banks, Dom Maklerski mBanku

### Czech bank market shares in loans (%)



Source: Banks, Czech National Bank, Dom Maklerski mBanku

### Deposits

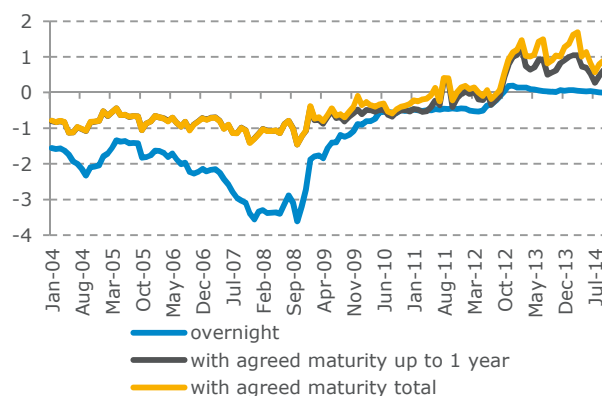
The Czech deposit market contracted 0.6% in the year through September 2014 as a 3.2% increase in retail deposits was offset by a 5.4% drop in corporate deposits. Even after considerable ytd narrowing of 42bps the deposit interest rates remain high as 89bps over 3M PRIBOR, pointing to fierce competition. Our 2014 Czech deposit growth projection is 0.8%, followed by expansion at a rate of 3.2-3.3% in 2015-2016, in line with the projected growth in lending. As a result, the ratio of loans to deposits in the next two years should not exceed 71%.

### Deposit growth in Czech Republic (%)



Source: Czech National Bank, Dom Maklerski mBanku

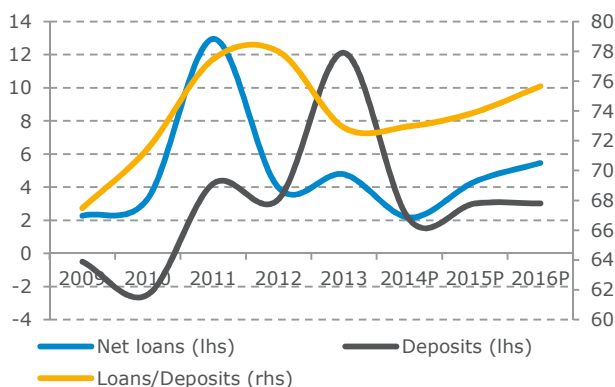
### Interest rate spread: deposits vs. 3M PRIBOR (bps)



Source: Czech National Bank, Dom Maklerski mBanku

At Komerční Banka, we predict that deposits will increase at a slower rate than loans going forward, though with a loans/deposits ratio at a safe 70.0% the Bank has no need to compete for new savings in a tough market. Nevertheless, to stem excessive withdrawals, Komerční has put in place rewards to help retain clients via the "MojeOdmeny" program. We project deposit growth at a rate of 3.0% each in 2015 and 2016 at Komerční Banka.

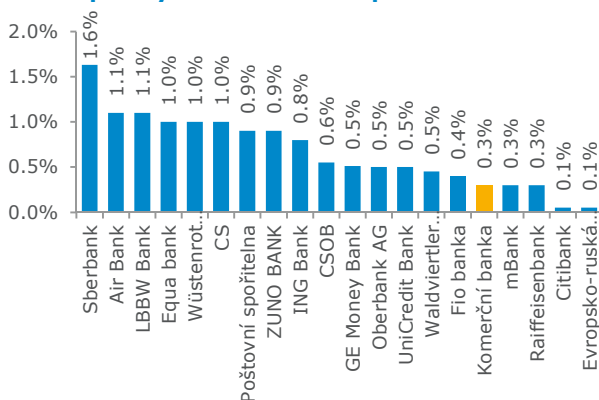
#### Loan and deposit growth projection for Komerční (%)



Source: Czech National Bank, Dom Maklerski mBanku

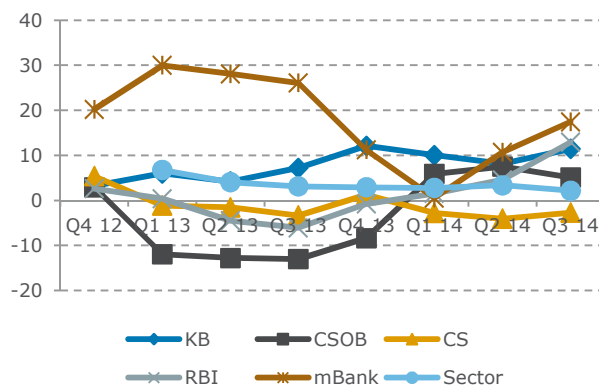
The situation in the Czech market for retail deposits remains challenging for local banks. Like in the case of loans, savings growth in the sector is driven mainly by smaller players seeking to capture meaningful share in a market controlled by just three players. This is reflected in the market statistics for the first nine months of 2014 showing high deposit growth recorded by small newcomers such as mBank (14.4%) and Raiffeisen (+7.0%) compared to little growth or even contraction reported by the majors (CSOB -0.7%; CS -8.0%, KB +4.6%) which between them controlled 58% of the Czech deposit market at 30 September 2014. Due to intense competition, margins achieved on term deposits from individuals have been negative as the interest rates offered to clients at an average 0.97% are much higher than the 3M PRIBOR rate of 0.35%. The banks currently offering the highest deposit yields are Sberbank (1.63%), Air Bank and LLBW Bar (1.1%), and CS, Equa Bank and Wüstenrot (1.0%). With 0.3%, KB's yield is among the lowest on the market.

#### Term deposit yields in Czech Republic



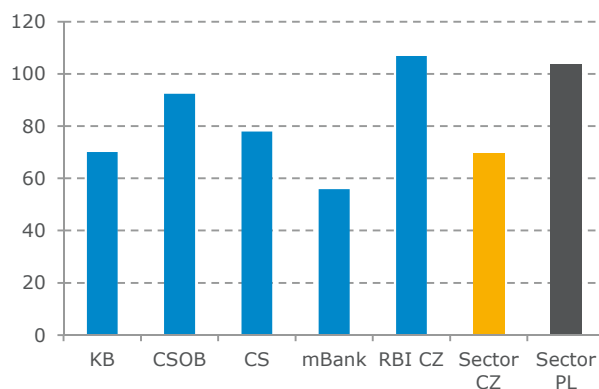
Source: Air Bank, Dom Maklerski mBanku

#### Y/Y quarterly deposit growth (%)



Source: Banks, Dom Maklerski mBanku

#### Loans/Deposits at 30 Sep. 2014 (%)

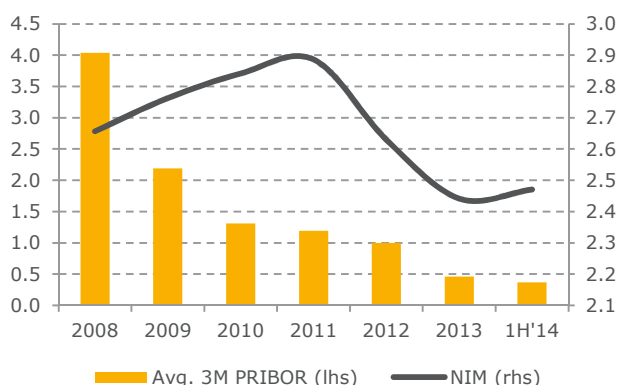


Source: Banks, Dom Maklerski mBanku

### Margin pressure persists

Czech banks earned higher net interest margins in H1 2014 (over average assets) at 2.47% than their Polish counterparts which generated 2.29% despite lower market interest with 3M PRIBOR at 0.37% vs. 3M WIBOR at 2.61%. In developed Europe, NIM averages 1.1%, potentially setting the path for CEE NIM convergence in the long term. Going forward, we anticipate NIM contraction in the Czech banking sector driven by strong competition for term deposits combined with a shift in the loan portfolio in favor of low-margin mortgages.

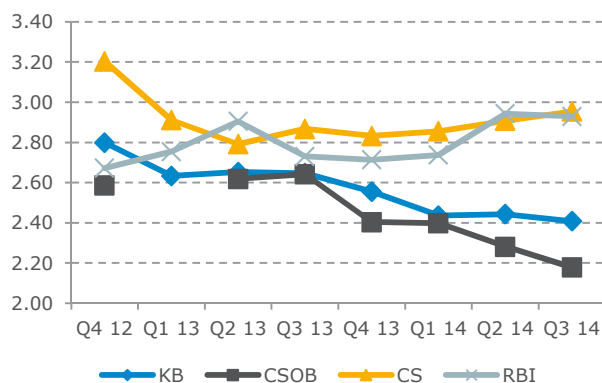
#### Czech NIM and 3M PRIBOR (%)



Source: Czech National Bank, Dom Maklerski mBanku

At Komerční Banka, NIM over average assets has been under pressure since 2011, expected to continue throughout 2015 underpinned by falling market interest rates, an increasing share of low-margin loans in the total portfolio, and deposit price pressure. Local competition is feeling pressure on interest margins as well, with CSOB posting year-on-year NIM contraction from 2.64% to 2.41% in Q3, though CS and RBI both posted improvement of respective 9bps and 20bps in the period. Going forward, on low interest rates expected to persist until 2016, bank net interest margins in the Czech Republic are set to remain tight for at least one more year. Assuming a 50bp hike in the central bank rates in 2016, in line with the Bloomberg consensus (with monetary tightening by the same amount anticipated in Poland), coupled with the deposit price war, we predict that Komerční will see NIM contraction by 14bps to 2.43% in 2014 followed by further tightening of 6bps to 2.36% in 2015 and a small rebound by 4bps to 2.40% in 2016.

### NIM comparison for Czech banks (%)

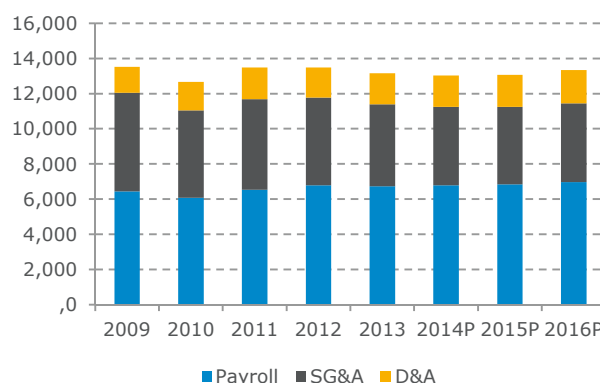


Source: Banks, Dom Maklerski mBanku

## Tight Cost Control

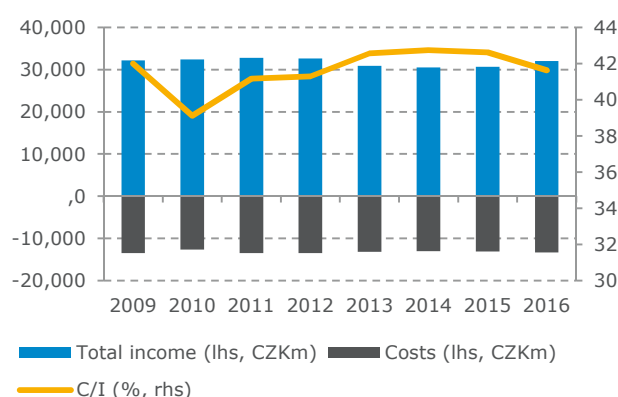
A 1.8% contraction in the first nine months of 2014 in total income forced Komerční to exercise stricter cost discipline in the period, with costs brought down 1.0% compared to 9M 2013 after a 5.3% reduction in administrative expenses accompanied by expansion of 0.7% in payroll costs and 3.8% in D&A expenses. Komerční reduced FTEs by 85 (1%) in the 12 months through September while the number of branches increased 1% to 414. The cost/income ratio averaged 41.9% in 9M 2014, at as such it stood slightly above the 37.6% average (H1 2014) for the very effective local market. The cuts in administrative expenses affected mainly infrastructure and communications, with marketing costs virtually unchanged. Komerční intends to keep a tight lid on costs throughout 2015 depending on the pace of revenue growth. For our part, we anticipate that the Bank's costs will edge up some 0.3% in 2015 and in 2016 they will accelerate to 1.9%. As a result, the costs/income ratio will remain steady at 43% in 2014-2015 and improve slightly to 42% in 2016.

### Cost breakdown at Komerční Banka



Source: Komerční Banka, Dom Maklerski mBanku

### C/I ratio at Komerční Banka

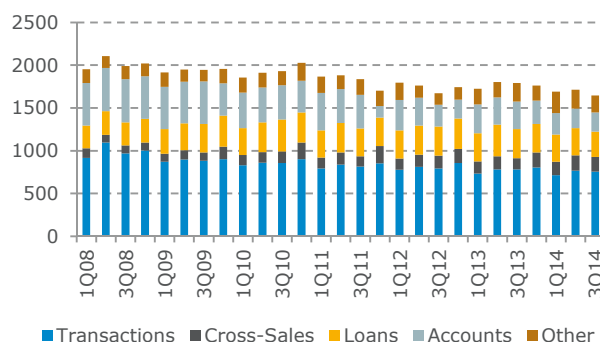


Source: Czech National Bank, Dom Maklerski mBanku

## Fee Income Under Pressure

Komerční's fee income logged a sharp, 5% deterioration in the first nine months of 2014 compared to the same period in 2013. As a counter-measure against low interest rates combined with downward pressure on deposit prices, the Bank decided to launch a deposit rewards program for retail customers called 'MojeOdmeny' offering bonuses such as free accounts and cashback deals and free ATM withdrawals. While helping to stem the outflow of clients, MojeOdmeny has put pressure on the Bank's deposit fee income which in 9M 2014 fell by a staggering 28% relative to 9M 2013. At the same time, on weaker volumes, Komerční also reported falling fee income from loans (-11% y/y) and transactions (-3%).

### Fee income at Komerční Banka (CZK m)

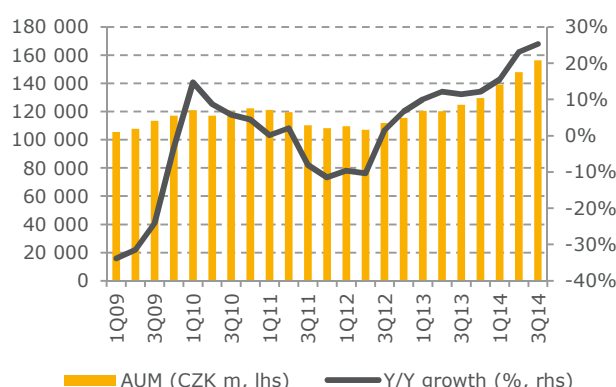


Source: Komerční Banka, Dom Maklerski mBanku



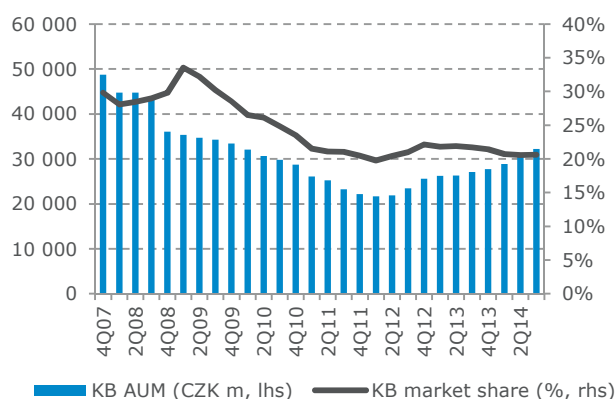
The flip side of low market interest rates is that clients seeking high-yield alternatives to deposits are driving up the assets under management of investment funds. According to the Czech Capital Market Association AKAT, the AUM of Czech funds were up 25.3% y/y at 30 September after rising at a three-year CAGR of 12.3%. Komerční as well has benefitted from this trend, with AUMs expanding at a high annual double-digit rate of 19.0%. That said, we must note that the Bank has been relentlessly losing market share in AUMs since Q4 2012, though at the moment it still controls a big, 21% chunk of the market. On growing AUM, Komerční saw its cross-selling fee income, which includes client assets in mutual funds and life insurance, soar 21% at 30 September 2014 compared to the same time last year. In 2015, persistently low interest rates should continue to drive investment sales for the Bank.

### AUM of Czech investment funds



Source: AKAT, Dom Maklerski mBanku

### AUM of Komerční investment funds



Source: AKAT, Dom Maklerski mBanku

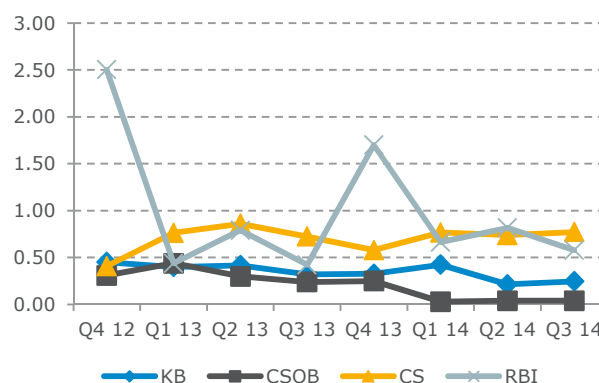
According to our forecasts, after falling 5% in 2014, the 2015 fee income of Komerční will post a small gain of 1% in 2015 (an effect of deposit discounts on the one hand and rising AUM on the other hand) followed by a bigger gain of 1.8% in 2016. Note that the Czech central bank is expected to reduce the interchange fee in 2016 to match the EU levels of 0.2%-0.3% expected to be in force at the time from today's 1%.

## Cost of Risk and Quality of Assets

The non-performing loan ratio in the Czech lending market increased from 6.6% to 6.9% in the nine months through September 2014 led by a deteriorating quality of corporate loans (with NPL up from 8.9% to 10.0%); NPL in the retail segment in the period remained unchanged at 4.8%. Overall, loan quality at the major Czech banks has either

improved or remained stable relative to 2013 with NPL ratios down 10bps ytd to 5.6% at Komerční Banka, and 20bps each at CS (5.2%) and SCOB (4.45%). Regardless of rising NPL, the market cost of risk (to average loans) fell to 48bps at 30 June from 70bps in 2013. Of the three leaders, CSOB and KB reported low CoR at respective 13bps and 30bps at 30 September while the cost of risk of CS was relatively high at 76bps. At the same time, the ratio of provisioning to NPL exceeded 70% at CS and CSOB while at KB it was less than 68%.

### Cost of risk comparison (%)



Source: Banks, Dom Maklerski mBanku

### NPL comparison for Polish and Czech banks (%)

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14
<b>Czech R.</b>							
CS	5.2	5.2	4.7	4.6	4.6	4.6	4.7
RBI	6.7	6.8	6.6	6.8	6.5	6.4	6.1
KB	5.8	5.7	5.8	5.6	5.7	5.5	5.5
CSOB	5.1	5.1	4.9	4.7	4.6	4.4	4.5
<b>Poland</b>							
RBI	9.3	9.7	10.3	10.0	10.0	10.1	10.2
PKO BP	9.2	9.1	8.6	8.2	8.1	7.2	7.1
Pekao	7.5	7.5	7.3	7.3	7.1	7.0	6.9
Handlowy	8.2	7.4	7.2	7.6	6.3	6.2	6.4
ING BSK	4.4	4.8	4.4	4.6	4.6	4.4	4.6
Millennium	5.0	4.6	4.5	4.4	4.3	4.3	4.3
GNB	13.5	13.3	13.4	13.6	12.9	13.7	13.7

Source: Banks, Dom Maklerski mBanku

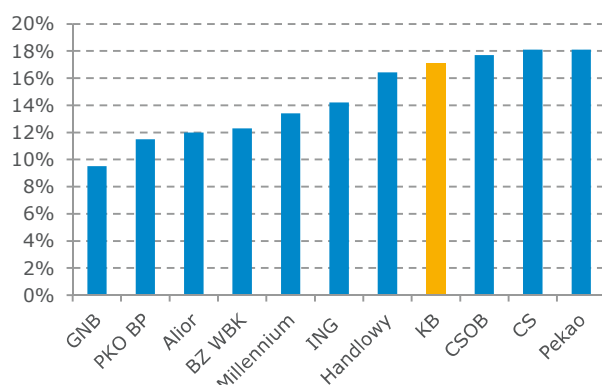
Komerční owes its low risk reserves to the corporate lending business where CoR (to average loans) averaged 22bps in 9M 2014 vs. 34bps in 9M 2013. In retail, cost of risk in the period improved as well to 36bps from 44bps the year before. In 2015, Komerční anticipates CoR normalization to 35-40bps but looking at the Czech Republic's recovering economy we have a more optimistic view on the future quality of loan assets at the Bank and we anticipate an increase in CoR from 27bps in 2014 to 31bps in 2015 and 36bps in 2016.

## Capital Position, Dividends

Komerční Banka boasts one of the strongest capital bases in the CEE region with the Tier-1 ratio at 30 September 2014 exceeding the internal target of 15-16% at 17.1%. As for dividends, the Bank presented an updated policy on the occasion of the Q4 2014 earnings announcement, putting the annual payout ratio in the range of 70-100%. In our view, Komerční will want to keep shareholder distributions as high as possible in the years ahead while maintaining internal solvency requirements intact, and so we project the 2015-2016 payout ratios at 90-91%,

implying dividend yields of about 6% – a level which is very attractive but comparable to the yields offered by Polish banks like Pekao or Bank Handlowy.

### Tier-1 comparison (%)

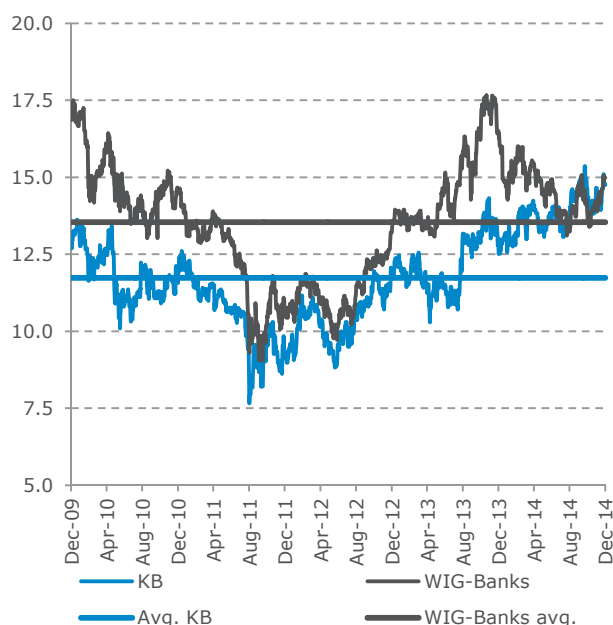


Source: Banks, Dom Maklerski mBanku

## Valuation

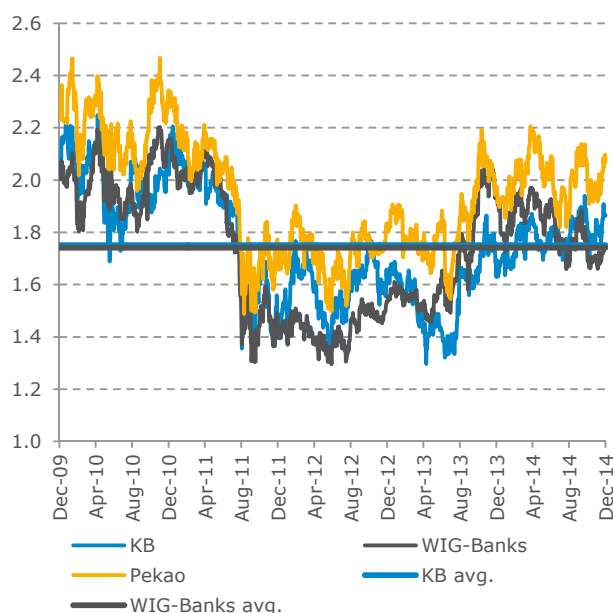
On our forecasts, Komerční Banka is valued at 15.1x 2015E P/E and 14.4x 2016E P/E showing respective premiums of 5% and 17% relative to the Polish WIG-Banks index. Historically, KOMB was trading on an average five-year 12-month forward P/E of 11.7x, i.e. at a 13% discount to the Polish P/E average of 13.5x, today shrunken to just 2%. Similarly, on 12-month forward P/Bv, KOMB was historically trading at a premium of just 1% to its Polish peers vs. 7% today.

### 12M forward P/E



Source: Bloomberg, Dom Maklerski mBanku

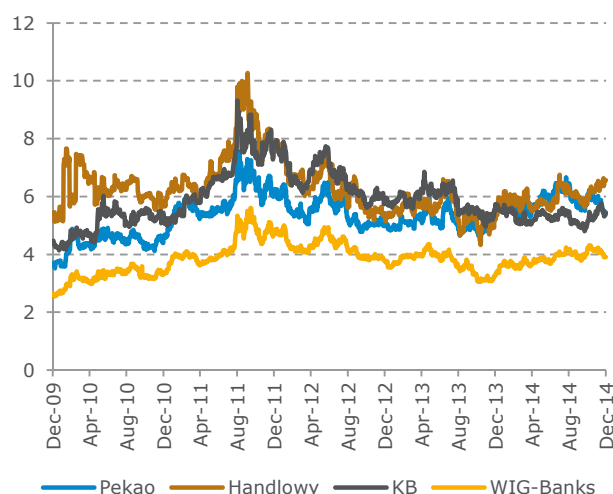
### 12M forward P/B



Source: Bloomberg, Dom Maklerski mBanku

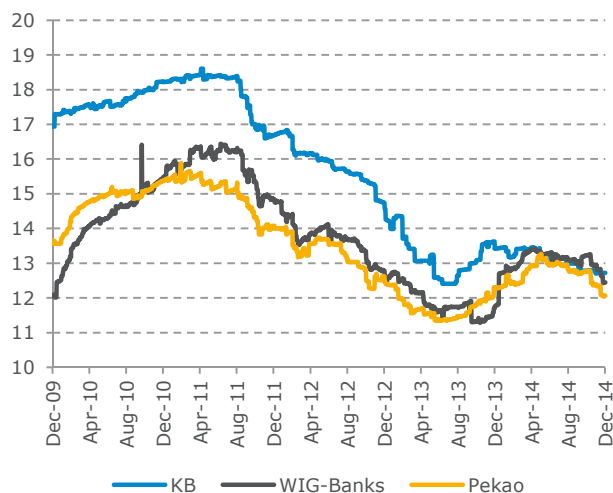
At the same time, note that Komerční's average expected return on equity today is on a par with that displayed by the broad WIG-Banks banks index while historically its ROE was always much higher. On the other hand, the projected dividend yield offered by Komerční is higher than the average 12-month forward dividend yield of Polish banks while matching the yields offered by Pekao and Bank Handlowy.

### 12M forward dividend yield



Source: Bloomberg, Dom Maklerski mBanku

### 12M forward ROE



Source: Bloomberg, Dom Maklerski mBanku

Owing to the higher dividends, we believe the discount at which KOMB is valued relative to Polish peers is set to contract going forward from its already low level. Meanwhile, despite a tough year ahead in 2015, the Polish bank sector generates stronger loan growth and has a better profitability outlook in a longer term. Further, again, the dividend yield offered by Komerční is comparable to those offered by Pekao and Handlowy which both have less downside potential than the Czech bank in our view. We are raising our 9-month price target for KOMB to CZK 4,549 per share, showing 7.5% downside risk from the current level. Our cost-of-equity calculations assume risk-free rate at 1.5%, a risk premium of 4.5%, and a Beta of 1.



## Overview of quarterly results

(CZK m)	4Q'12	1Q'13	2Q'13	3Q'13	4Q'13	1Q'14	2Q'14	3Q'14
<b>Net interest income</b>	<b>5452</b>	<b>5259</b>	<b>5327</b>	<b>5293</b>	<b>5328</b>	<b>5279</b>	<b>5335</b>	<b>5395</b>
Fee income	1742	1725	1800	1790	1761	1690	1711	1647
Trading income	727	597	729	661	503	571	506	646
Other income, dividends	30	33	38	30	20	26	36	24
<b>Total income</b>	<b>7951</b>	<b>7614</b>	<b>7895</b>	<b>7774</b>	<b>7612</b>	<b>7566</b>	<b>7588</b>	<b>7712</b>
<b>Operating costs</b>	<b>-3643</b>	<b>-3116</b>	<b>-3293</b>	<b>-3266</b>	<b>-3473</b>	<b>-3124</b>	<b>-3201</b>	<b>-3254</b>
<b>Operating profit before provisioning</b>	<b>4308</b>	<b>4498</b>	<b>4602</b>	<b>4508</b>	<b>4139</b>	<b>4441</b>	<b>4387</b>	<b>4458</b>
<b>Cost of risk</b>	<b>-526</b>	<b>-470</b>	<b>-494</b>	<b>-380</b>	<b>-395</b>	<b>-518</b>	<b>-262</b>	<b>-305</b>
<b>Operating profit</b>	<b>3782</b>	<b>4027</b>	<b>4108</b>	<b>4128</b>	<b>3744</b>	<b>3923</b>	<b>4125</b>	<b>4154</b>
Equity in profits (losses) of subsidiaries	31	35	40	23	110	40	55	48
Pension benefits	-62	-133	-126	-113	-112	-121	-127	-115
<b>Pre-tax profit</b>	<b>3751</b>	<b>3929</b>	<b>4022</b>	<b>4038</b>	<b>3742</b>	<b>3843</b>	<b>4053</b>	<b>4087</b>
Tax	-634	-705	-753	-710	-657	-666	-638	-729
Minority interests	83	78	105	80	114	95	109	90
<b>Net profit</b>	<b>3035</b>	<b>3146</b>	<b>3164</b>	<b>3248</b>	<b>2970</b>	<b>3081</b>	<b>3305</b>	<b>3268</b>

## Balance Sheet

(CZK m)	4Q'12	1Q'13	2Q'13	3Q'13	4Q'13	1Q'14	2Q'14	3Q'14
Net loans	451,547	454,052	457,551	457,301	473,090	466,168	472,929	475,522
Other interest-bearing assets	288,874	311,777	301,061	308,886	352,673	363,760	358,832	392,982
Other non-interest-bearing assets	46,415	45,203	37,196	37,938	38,217	39,638	45,832	46,120
<b>Total assets</b>	<b>786,836</b>	<b>811,032</b>	<b>795,808</b>	<b>804,125</b>	<b>863,980</b>	<b>869,566</b>	<b>877,593</b>	<b>914,624</b>
Deposits	579,067	598,735	606,859	609,284	649,158	658,896	656,518	679,002
Other interest-bearing obligations	78,114	76,412	68,635	71,548	89,627	76,623	84,498	91,988
Other non-interest-bearing obligations	29,117	33,274	30,400	29,463	28,657	32,050	36,239	39,484
<b>Total liabilities</b>	<b>686,298</b>	<b>708,421</b>	<b>705,894</b>	<b>710,295</b>	<b>767,442</b>	<b>767,569</b>	<b>777,255</b>	<b>810,474</b>
Minority interests	2,769	2,848	2,683	2,764	2,879	2,975	2,959	3,049
<b>Equity</b>	<b>97,769</b>	<b>99,763</b>	<b>87,230</b>	<b>91,065</b>	<b>93,659</b>	<b>99,021</b>	<b>97,379</b>	<b>101,101</b>

## Trading Multiples

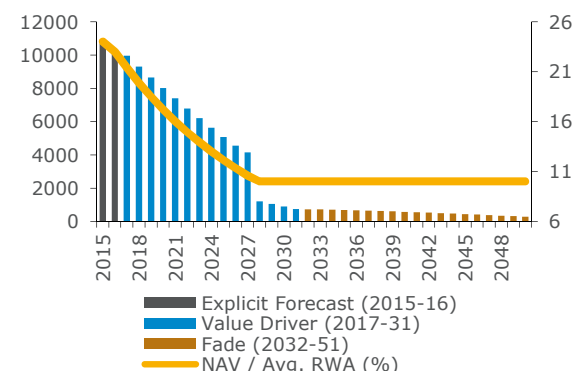
(%)	4Q'12	1Q'13	2Q'13	3Q'13	4Q'13	1Q'14	2Q'14	3Q'14
Loan growth (y/y)	4.0	4.6	4.2	2.7	4.8	2.7	3.4	4.0
Deposit growth (y/y)	3.3	6.0	4.2	7.2	12.1	10.0	8.2	11.4
Net interest margin	2.8	2.6	2.7	2.6	2.6	2.4	2.4	2.4
Costs / Income	45.8	40.9	41.7	42.0	45.6	41.3	42.2	42.2
NPL ratio (%)	5.8	5.8	5.7	5.8	5.6	5.7	5.5	5.5
Reserves/NPL (%)	62.7	64.1	64.0	64.0	64.2	65.5	66.7	67.9
Reserves / Gross loans	0.5	0.4	0.4	0.3	0.3	0.4	0.2	0.2
Effective tax rate (%)	16.9	17.9	18.7	17.6	17.6	17.3	15.7	17.8
ROE	12.8	12.7	13.5	14.6	12.9	12.8	13.5	13.2
Tier-1 ratio	14.7	14.9	16.2	16.7	15.8	16.2	16.7	17.1
Capital adequacy ratio	14.7	14.9	16.2	16.7	15.8	16.2	16.7	17.1

## Valuation

### Dividend Discount Model

	(CZK m)	%
Explicit forecast (2015-16)	20,775	12.6
Adjustment for time value of money	5,188	3.2
Value driver (2017-31)	79,634	48.5
Fade (2032-51)	10,920	6.6
Terminal value	47,771	29.1
<b>Fair value of equity</b>	<b>164,288</b>	<b>100.0</b>
Number of shares (millions)	37,8	
<b>Fair value per share (CZK)</b>	<b>4,350</b>	
Cost of equity (%)	6,0	
<b>9M target price (CZK)</b>	<b>4,545</b>	

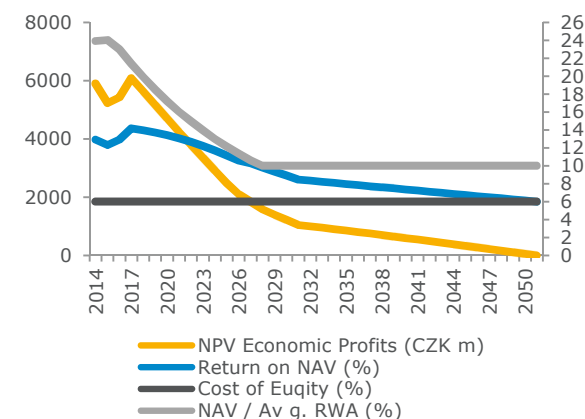
### Dividend Discount Model



### Economic Profits Model

	(CZK m)	%
Opening tangible NAV	81,528	49.5
Explicit forecast (2014-16)	16,556	10.1
Adjustment for time value of money	8,794	5.3
Value driver (2017-31)	47,518	28.9
Fade (2032-51)	10,177	6.2
<b>Fair value of equity</b>	<b>164,573</b>	<b>100.0</b>
Number of shares (millions)	37.8	
<b>Fair value per share (CZK)</b>	<b>4,357</b>	
Cost of equity (%)	6.0	
<b>9M target price (CZK)</b>	<b>4,553</b>	

### Economic Profits Model



### Key financial ratios

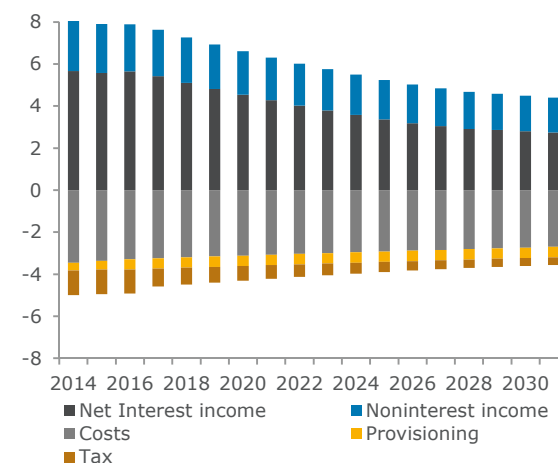
(%)	2014	2015	2016	Avg.*
Net interest income / Average RWA	5.7	5.6	5.6	3.7
Non-interest income / Average RWA	2.4	2.3	2.3	1.9
Costs / Average RWA	-3.5	-3.4	-3.3	-3.0
Costs / Income	42.7	42.6	41.6	53.5
Provisioning / Average RWA	-0.4	-0.4	-0.5	-0.5
Effective tax rate	-17.2	-18.2	-18.2	-18.2
Other / RWA	-1.2	-1.2	-1.1	-0.6
Net profit / Average RWA	3.1	3.0	3.0	1.7
NAV / Average RWA	<b>23.9</b>	<b>24.0</b>	<b>23.0</b>	<b>13.9</b>
Tangible return on NAV	<b>12.9</b>	<b>12.3</b>	<b>12.9</b>	<b>11.4</b>
Net profit growth	1.1	-1.6	4.8	-1.9

Average RWA (CZK m)	377,260	388,123	405,963	775,100
Growth in average RWA	2.0	2.9	4.6	7.5

\*2017-31E avg.

### Costs/Income as pct. of RWA



### Sensitivity Analysis

		Fade Period		
		20	25	30
<b>Market Risk Premium</b>	4.0	4,672	4,775	4,857
	4.5	<b>4,353</b>	4,342	4,506
	5.0	4,097	4,147	4,196

### Valuation Summary

	(PLN)
DDM	4,350
Economic Profits	4,357
<b>Average fair value</b>	<b>4,353</b>
<b>9M target price (CZK)</b>	<b>4,549</b>

**Income Statement (IFRS consolidated figures)**

(CZK m)	2010	2011	2012	2013	2014E	2015E	2016E
<b>Net interest income</b>	<b>21,431</b>	<b>22,190</b>	<b>21,969</b>	<b>21,207</b>	<b>21,396</b>	<b>21,642</b>	<b>22,904</b>
Fee income	7,725	7,305	6,971	7,077	6,724	6,592	6,626
Trading income	3,135	3,158	3,598	2,489	2,240	2,307	2,377
Other	95	111	125	121	122	128	135
<b>TOTAL INCOME</b>	<b>32,386</b>	<b>32,764</b>	<b>32,663</b>	<b>30,894</b>	<b>30,483</b>	<b>30,669</b>	<b>32,041</b>
<b>Operating costs</b>	<b>-12,666</b>	<b>-13,489</b>	<b>-13,484</b>	<b>-13,148</b>	<b>-13,026</b>	<b>-13,069</b>	<b>-13,335</b>
<b>Operating profit before provisioning</b>	<b>19,720</b>	<b>19,275</b>	<b>19,179</b>	<b>17,746</b>	<b>17,456</b>	<b>17,601</b>	<b>18,706</b>
Credit risk allowance	-3,115	-1,988	-1,846	-1,733	-1,365	-1,574	-1,960
Allowance for financial instruments	8	-5,355	0	0	0	0	0
Other reserves	7	18	-25	-6	-27	-28	-29
<b>Cost of risk</b>	<b>-3,100</b>	<b>-7,325</b>	<b>-1,871</b>	<b>-1,739</b>	<b>-1,392</b>	<b>-1,602</b>	<b>-1,989</b>
<b>Net operating profit</b>	<b>16,620</b>	<b>11,950</b>	<b>17,308</b>	<b>16,007</b>	<b>16,065</b>	<b>15,999</b>	<b>16,717</b>
Equity in profits (losses) of subsidiaries	75	81	121	208	223	234	245
Pension benefits	-620	-575	-489	-484	-480	-480	-480
<b>Pre-tax profit</b>	<b>16,075</b>	<b>11,456</b>	<b>16,940</b>	<b>15,731</b>	<b>15,807</b>	<b>15,752</b>	<b>16,482</b>
Tax	-2,665	-1,738	-2,708	-2,825	-2,766	-2,914	-3,049
Minority interests	80	243	278	378	374	370	367
<b>Net profit</b>	<b>13,330</b>	<b>9,475</b>	<b>13,954</b>	<b>12,528</b>	<b>12,667</b>	<b>12,468</b>	<b>13,066</b>

**Balance Sheet (IFRS consolidated figures)**

(CZK m)	2010	2011	2012	2013	2014E	2015E	2016E
Cash and central bank balances	13,689	16,980	28,057	44,405	59,947	62,944	66,091
Interbank loans	112,180	101,393	64,111	125,735	132,022	133,342	134,675
Loans	384,593	434,386	451,547	473,089	483,310	504,255	531,783
Debt securities	157,160	164,261	196,706	182,533	184,076	191,439	199,096
Fixed assets and intangible assets	14,379	14,534	15,659	15,396	15,270	15,093	14,862
Other assets	16,013	23,256	30,756	22,822	23,963	25,161	26,419
<b>Total assets</b>	<b>698,014</b>	<b>754,810</b>	<b>786,836</b>	<b>863,980</b>	<b>898,588</b>	<b>932,234</b>	<b>972,927</b>
Interbank deposits	29,075	37,455	38,903	49,681	63,734	74,169	89,467
Deposits	538,051	560,701	579,067	649,158	662,307	682,254	702,854
Securities issued	31,104	42,399	39,213	39,947	43,143	45,300	47,565
Subordinated loans	6,001	6,002	0	0	0	0	0
Other liabilities	17,705	26,403	29,115	28,656	29,797	30,618	32,253
<b>Equity</b>	<b>74,779</b>	<b>79,217</b>	<b>97,769</b>	<b>93,659</b>	<b>96,584</b>	<b>96,720</b>	<b>97,455</b>
Minority interests	1,299	2,633	2,769	2,879	3,023	3,174	3,333
<b>Total equity and liabilities</b>	<b>698,014</b>	<b>754,810</b>	<b>786,836</b>	<b>863,980</b>	<b>898,588</b>	<b>932,234</b>	<b>972,927</b>

## Key Ratios

%	2010	2011	2012	2013	2014E	2015E	2016E
<b>Y/Y growth</b>							
Loans	3.3	12.9	4.0	4.8	2.2	4.3	5.5
Deposits	-2.5	4.2	3.3	12.1	2.0	3.0	3.0
Equity	10.7	5.9	23.4	-4.2	3.1	0.1	0.8
ASSETS	0.4	8.1	4.2	9.8	4.0	3.7	4.4
Net profit	21.1	-28.9	47.3	-10.2	1.1	-1.6	4.8
Net interest income	0.9	3.5	-1.0	-3.5	0.9	1.2	5.8
<b>Balance-sheet ratios</b>							
Loans / Deposits	71.5	77.5	78.0	72.9	73.0	73.9	75.7
Deposits / Assets	77.1	74.3	73.6	75.1	73.7	73.2	72.2
Loans / Assets	55.1	57.5	57.4	54.8	53.8	54.1	54.7
Equity / Assets (incl. minority inter.)	10.9	10.8	12.8	11.2	11.1	10.7	10.4
Capital adequacy ratio	15.3	14.6	14.7	15.8	16.3	15.7	15.0
Tier 1 ratio	14.0	13.4	14.7	15.8	16.3	15.7	15.0
<b>Asset quality</b>							
NPL / Loans	6.5	5.7	5.8	5.6	6.0	5.9	5.9
Provisioning / Loans	3.8	3.7	3.8	3.8	3.7	3.7	3.7
Provisioning / NPL	59.3	64.6	65.8	67.4	62.9	64.0	64.0
Net provisioning / Average loans	0.8	0.5	0.4	0.4	0.3	0.3	0.4
<b>Profitability</b>							
Net interest margin*	3.2	3.2	3.0	2.7	2.5	2.5	2.5
Interest income / Average assets	3.1	3.1	2.9	2.6	2.4	2.4	2.4
Non-interest income / Average assets	1.6	1.5	1.4	1.2	1.0	1.0	1.0
Costs / Average assets	1.8	1.9	1.7	1.6	1.5	1.4	1.4
Costs / Income	39.1	41.2	41.3	42.6	42.7	42.6	41.6
Net provisioning / Average assets	0.4	1.0	0.2	0.2	0.2	0.2	0.2
Pre-tax profit / Average assets	2.3	1.6	2.2	1.9	1.8	1.7	1.7
Effective tax rate	16.6	15.2	16.0	18.0	17.5	18.5	18.5
ROA	1.9	1.3	1.8	1.6	1.5	1.4	1.4
ROE	18.7	12.3	15.8	13.1	13.3	12.9	13.5
<b>Valuation multiples</b>							
Number of shares outstanding (eop, millions)	38.0	37.8	37.8	37.8	37.8	37.8	37.8
Average number of shares outstanding (millions)	38.0	37.9	37.8	37.8	37.8	37.8	37.8
EPS (CZK)	351.2	250.2	369.4	331.7	335.4	330.1	345.9
BVPS (CZK)	1,970.2	2,097.3	2,588.5	2,479.6	2,557.1	2,560.7	2,580.1
P/E (x)	14.0	19.7	13.3	14.8	14.7	14.9	14.2
P/BV (x)	2.5	2.3	1.9	2.0	1.9	1.9	1.9
DPS (CZK)	170.0	270.0	160.0	230.0	230.0	300.0	300.0
Dividend Yield (%)	3.5	5.5	3.3	4.7	4.7	6.1	6.1

\*over average assets

**List of abbreviations and ratios contained in the report:****EV** – net debt + market value**EBIT** – Earnings Before Interest and Taxes**EBITDA** – EBIT + Depreciation and Amortisation**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**Recommendations of Dom Maklerski mBanku:**

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Recommendations are updated at least once every nine months.

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rating	Sell
rating day	2014-10-07
price on rating day	5000.00
WIG on rating day	53992.31

**Michał Marczak**  
member of the management board  
tel. +48 22 438 24 01  
[michal.marczak@mdm.pl](mailto:michal.marczak@mdm.pl)  
strategy, resources, metals

## Research Department:

**Kamil Kliszczyk**  
deputy director  
tel. +48 22 438 24 02  
[kamil.kliszczyk@mdm.pl](mailto:kamil.kliszczyk@mdm.pl)  
energy, chemicals, power generation

**Michał Konarski**  
tel. +48 22 438 24 05  
[michal.konarski@mdm.pl](mailto:michal.konarski@mdm.pl)  
banks

**Jakub Szkopek**  
tel. +48 22 438 24 03  
[jakub.szkopek@mdm.pl](mailto:jakub.szkopek@mdm.pl)  
industrials

**Paweł Szpigel**  
tel. +48 22 438 24 06  
[pawel.szpigel@mdm.pl](mailto:pawel.szpigel@mdm.pl)  
media, IT, telco

**Piotr Zybała**  
tel. +48 22 438 24 04  
[piotr.zybala@mdm.pl](mailto:piotr.zybala@mdm.pl)  
construction, real-estate development

**Piotr Bogusz**  
tel. +48 22 438 24 08  
[piotr.bogusz@mdm.pl](mailto:piotr.bogusz@mdm.pl)  
retail

## Sales and Trading:

**Piotr Gawron**  
director  
tel. +48 22 697 48 95  
[piotr.gawron@mdm.pl](mailto:piotr.gawron@mdm.pl)

**Piotr Dudziński**  
deputy director  
tel. +48 22 697 48 22  
[piotr.dudzinski@mdm.pl](mailto:piotr.dudzinski@mdm.pl)

**Marzena Łempicka-Wilim**  
deputy director  
tel. +48 22 697 48 95  
[marzena.lempicka@mdm.pl](mailto:marzena.lempicka@mdm.pl)

## Foreign Institutional Sales:

**Łukasz Wójtowicz, CAIA**  
tel. +48 22 697 48 47  
[lukasz.wojtowicz@mdm.pl](mailto:lukasz.wojtowicz@mdm.pl)

**Dom Maklerski mBanku S.A.**  
Research Department  
ul. Senatorska 18  
00-075 Warszawa  
[www.mDomMaklerski.pl](http://www.mDomMaklerski.pl)

## Traders:

**Krzysztof Bodek**  
tel. +48 22 697 48 89  
[krzysztof.bodek@mdm.pl](mailto:krzysztof.bodek@mdm.pl)

**Michał Jakubowski**  
tel. +48 22 697 47 44  
[michal.jakubowski@mdm.pl](mailto:michal.jakubowski@mdm.pl)

**Tomasz Jakubiec**  
tel. +48 22 697 47 31  
[tomasz.jakubiec@mdm.pl](mailto:tomasz.jakubiec@mdm.pl)

**Szymon Kubka, CFA, PRM**  
tel. +48 22 697 48 16  
[szymon.kubka@mdm.pl](mailto:szymon.kubka@mdm.pl)

**Anna Łagowska**  
tel. +48 22 697 48 25  
[anna.lagowska@mdm.pl](mailto:anna.lagowska@mdm.pl)

**Paweł Majewski**  
tel. +48 22 697 49 68  
[pawel.majewski@mdm.pl](mailto:pawel.majewski@mdm.pl)

**Adam Mizera**  
tel. +48 22 697 48 76  
[adam.mizera@mdm.pl](mailto:adam.mizera@mdm.pl)

**Adam Prokop**  
tel. +48 22 697 47 90  
[adam.prokop@mdm.pl](mailto:adam.prokop@mdm.pl)

**Michał Roźmiej**  
tel. +48 22 697 49 85  
[michal.rozmiej@mdm.pl](mailto:michal.rozmiej@mdm.pl)

## "Private Broker"

**Jarosław Banasiak**  
director, active sales  
tel. +48 22 697 48 70  
[jaroslaw.banasiak@mdm.pl](mailto:jaroslaw.banasiak@mdm.pl)