

Friday, May 08, 2015 | special comment

Handlowy – NIM, Trading Income Top Expectations In Q1

Rating: reduce | target price: PLN 95.35 | current price: PLN 111.90

BHW PW; BHW.WA | Banks, Poland

Analyst: Michał Konarski +48 22 438 24 05

At PLN 217.0m the Q1 2015 net profit of Handlowy showed 5.9% growth from the previous quarter and a 12.4% drop from Q1 2014, and it came 6.1% ahead of a PLN 204.5m consensus estimate and topped our PLN 204.9m forecast. The upside surprise was owed to a 19% quarter-on-quarter increase in trading income and a surprising lack of downward pressure on NIM after a drop of 43bps posted in Q4 2014. After being unaffected in Q1 we believe NIM will show the impact of the March interest rate cuts in Q2. The first-quarter profit accounts for 25.6% of the full-year consensus estimate which may be set for a downward adjustment if Handlowy does not generate high trading income in the coming quarters and if NIM indeed comes under pressure in Q2. We expect neutral market reactions today to the Q1 announcement.

Net interest income fell 3.0% q/q and 12.4% y/y to PLN 256.8m in Q1 2015, in line with market expectations. NIM (over average assets) remained flat at the quarter-before level of 2.12%.

Net loans increased 2.6% relative to Q1 2014 but they did not change compared to Q4 2014 as an 0.8% expansion in corporate loans was offset by an 0.9% contraction in retail loans (with card volumes down 5.1%, cash loan volumes up 0.9%, mortgage volumes rising 2.3%, and other retail loans up 5.8%).

Deposits posted a 11.8% drop in Q1 after a seasonal upturn of 12.1% in Q4 2014. The ratio of loans to deposits was 60.4% at 31 March, far exceeding the sector average.

Fee income rose 0.7% q/q in Q1, and it slightly missed analysts' expectations. Despite continuing interchange cuts Handlowy managed to improve card fees by 19.9% and custody fees by 11.4%, however at the same time it experienced a 17.4% q/q drop in fees from insurance and investment product distribution and a 9.7% decrease in fees from payment orders.

Operating costs fell 0.5% y/y and 4.4% q/q in Q1 2015, as a 14.4% reduction in payroll costs was canceled out by an 18.7% surge in SG&A. Handlowy reduced costs of external services related to distribution of banking products by 80.1% in Q1 2015 after a surge of 96.1% recognized in Q4 2014, as well as cutting rental costs by 30.5%.

Handlowy set aside PLN 3.5m **loan-loss reserves** in Q1 after reversals of PLN 12.0m recognized in Q4 2014 and PLN 2.4m in Q1 2014. This was a result of PLN 3.1m provisioning raised for corporate loans, combined with PLN 0.4m charge-offs on retail loans. The quality of assets improved in Q1, with the NPL ratio down to 4.7% from 4.9% the quarter before. The coverage ratio remained unchanged at 85%.

2015 Q1 results vs. expectations

(PLN m)	1Q'15	consensus	differ.	mDM	differ.
Net interest income	256.8	254.3	1.0%	254.9	0.7%
Fee income	151.4	154.2	-1.8%	147.4	2.7%
Total income	591.1	574.6	2.9%	560.1	5.5%
Operating costs	312.9	316.6	-1.2%	304.4	2.8%
Provisioning	3.5	4.0	-12.3%	2.4	45.7%
Net profit	217.0	204.5	6.1%	204.9	5.9%

Source: Bank Handlowy, Consensus estimates provided by PAP, mDM - estimates by Dom Maklerski mBanku

Summary of 2015 Q1 results

(PLN m)	1Q'14	4Q'14	1Q'15	pct. change Y/Y	Q/Q
Net interest income	293.1	264.6	256.8	-12.4	-3.0
Fee income	157.0	150.4	151.4	-3.6	0.7
Trading income	167.2	154.7	184.1	10.2	19.0
Other	3.4	4.2	-1.3	n.m.	n.m.
Non-interest income	327.6	309.3	334.3	2.0	8.1
Total income	620.7	574.0	591.1	-4.8	3.0
Operating costs	314.4	327.3	312.9	-0.5	-4.4
Operating profits	306.2	246.6	278.1	-9.2	12.8
Provisioning	-2.4	-12.0	3.5	n.m.	n.m.
Pre-tax profit	308.6	258.7	274.6	-11.0	6.2
Tax	60.9	53.4	57.6	-5.5	7.9
Equity in profits/losses of associates	0.0	-0.3	0.0	n.m.	n.m.
Net profit	247.7	205.0	217.0	-12.4	5.9

Source: Bank Handlowy, 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**Recommendations of Dom Maklerski mBanku S.A.:**

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Michał Marczak

member of the management board

tel. +48 22 438 24 01

michal.marczak@mdm.pl

strategy, resources, metals

Research Department:**Kamil Kliszc**

director

tel. +48 22 438 24 02

kamil.kliscz@mdm.pl

energy, chemicals, power generation

Michał Konarski

tel. +48 22 438 24 05

michal.konarski@mdm.pl

banks

Jakub Szkopek

tel. +48 22 438 24 03

jakub.szkopek@mdm.pl

industrials

Paweł Szpigiel

tel. +48 22 438 24 06

pawel.szpigiel@mdm.pl

media, IT, telco

Piotr Zybała

tel. +48 22 438 24 04

piotr.zybala@mdm.pl

construction, real-estate development

Piotr Bogusz

tel. +48 22 438 24 08

piotr.bogusz@mdm.pl

retail

Sales and Trading:**Piotr Gawron**

director

tel. +48 22 697 48 95

piotr.gawron@mdm.pl**Marzena Łempicka-Wilim**

deputy director

tel. +48 22 697 48 82

marzena.lempicka@mdm.pl**Foreign Institutional Sales:****Łukasz Wójtowicz, CAIA**

deputy director, international markets

tel. +48 22 697 48 47

lukasz.wojtowicz@mdm.pl**Dom Maklerski mBanku S.A.**

Research Department

ul. Senatorska 18

00-075 Warszawa

www.mDomMaklerski.pl**Traders:****Krzysztof Bodek**

tel. +48 22 697 48 89

krzysztof.bodek@mdm.pl**Michał Jakubowski**

tel. +48 22 697 47 44

michal.jakubowski@mdm.pl**Tomasz Jakubiec**

tel. +48 22 697 47 31

tomasz.jakubiec@mdm.pl**Szymon Kubka, CFA, PRM**

tel. +48 22 697 48 16

szymon.kubka@mdm.pl**Anna Łagowska**

tel. +48 22 697 48 25

anna.lagowska@mdm.pl**Paweł Majewski**

tel. +48 22 697 49 68

pawel.majewski@mdm.pl**Adam Mizera**

tel. +48 22 697 48 76

adam.mizera@mdm.pl**Adam Prokop**

tel. +48 22 697 47 90

adam.prokop@mdm.pl**Michał Roźmiej**

tel. +48 22 697 49 85

michal.rozmiej@mdm.pl**"Private Broker"****Jarosław Banasiak**

director, active sales

tel. +48 22 697 48 70

jaroslaw.banasiak@mdm.pl