



Thursday, September 29, 2016 | update

Komerční Banka: buy (upgraded)

KOMB CP; BKOM.PR | Banks, Czech Republic

Still A Generous Dividend Payer

We are upgrading our investment rating for Komerční Banka from accumulate to buy, and we set our updated price target for the stock at CZK 980 per share, implying 17% upside potential. Komerční is operating in an increasingly favorable market environment as a low unemployment rate, strong economic momentum, and upcoming interest rate hikes in the Czech Republic make for a buoyant earnings outlook for the coming years. Despite having to scale back future distributions in the wake of more stringent capital requirements, Komerční remains one of the highest-yield dividend stocks in the CEE region with dividend yield at 4.8%. KOMB stock is currently valued at a 10% discount to the Polish WIG-Banks peers on 12M forward P/E, higher than the average five-year discount of 5%, which we find unwarranted given that the Czech bank achieves higher ROE (11% vs. 7%) and offers higher dividend yield (5% vs. 4%) than the Polish competition. We would take advantage of the recent price decline to buy shares in Komerční.

Facing one more challenging year in 2017

We have raised our 2016 net income estimate for Komerční Banka by 5.8% after factoring in the CZK 1.0bn one-time gain earned on Visa shares. At the same time, we lowered our 2017 forecast by 19% to reflect the expected interest rate reduction by 50bps in the Czech Republic. The revised 2016 estimate matches the current consensus, while our 2017 projection is 7.0% lower than the average market projection and the 2018 forecast is 6.7% higher. On an adjusted basis, we expect Komerční's net income for 2017 to show y/y contraction of just 0.3%, followed by a 16.3% rebound in 2018.

Offering high dividends

Komerční announced it would have to "normalize" its annual dividend payments sooner than planned (i.e. starting with next year's payout) to meet the new, more stringent capital requirements (CET1 15.5%) imposed by the Czech National Bank. Based on a conversation with CNB representatives, we think it is safe to assume the Bank's CET1 requirement will be raised by another 50 bps, and we believe the Bank will take this into account in the updated dividend policy, set for release together with the financial results for Q3 2016. According to our calculations, Komerční can maintain CET1 at or over 16% even if it offers per-share dividends of CZK 40 in 2017 and CZK 42 in 2018, implying respective dividend yields of 4.8% and 5.1% - levels which far exceed the averages seen in the CEE banking sector (the DY for MSCI EME Financials is 3.9%).

Deserving of premium to Polish banks

Komerční Banka is trading at 12.2x 2016E P/E and 13.4x 2017E P/E, showing respective discounts of 14% and 22% to the Polish bank sector (14.2x and 17.2x) which we consider undeserved as we believe KOMB should be valued at a premium to WIG-Banks given that it offers higher dividend yields (5.0% vs. 3.9% WIG-Banks), higher returns on equity (11% in 2017E vs. 7% WIG-Banks), and safer market conditions (no special tax, no CHF loan exposure).

(CZK m)	2014	2015	2016E	2017E	2018E
Net interest income	21,423	21,357	20,512	20,477	22,947
Noninterest income	9,254	9,687	11,113	10,020	10,297
Operating costs	13,065	14,352	13,767	13,799	13,967
Operating income	17,612	16,692	17,859	16,698	19,277
Net income	12,954	12,759	12,880	11,788	13,711
Costs/Income (%)	42.6	46.2	43.5	45.2	42.0
ROE (%)	13.0	12.2	12.4	11.0	12.1
P/E (x)	12.2	12.4	12.2	13.4	11.5
P/B (x)	1.5	1.5	1.5	1.4	1.4
DPS	46.0	62.0	62.0	40.0	42.0
Dividend yield (%)	5.5	7.4	7.4	4.8	5.0

Current Price	CZK 834.90
Target Price	CZK 980.00
MCap	CZK 157.7bn
Free Float	CZK 62.4bn
ADTV (3M)	CZK 423.15m

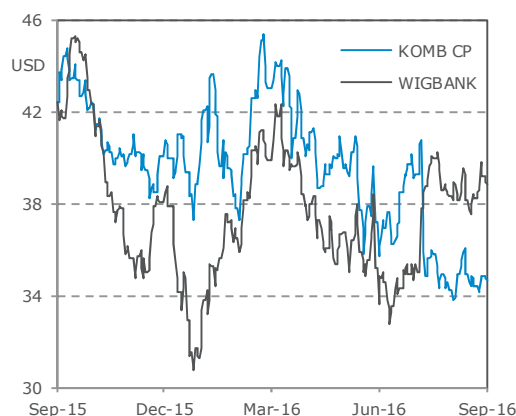
Ownership

Société Générale S.A.	60.4%
Others	39.6%

Business Profile

Komerční Banka is one of the largest banks in the Czech Republic. It offers universal banking services to corporate as well as retail clients. Komerční Banka's loan portfolio consists 41% of mortgages, 6% consumer loans, and 53% corporate loans. The Bank maintains a high capital surplus while generating high returns on equity approximating 12%, moreover it records extremely low cost of risk thanks to favorable market conditions in the Czech Republic.

KOMB CP vs. WIG-Banks (US\$)



Company	Target Price		Rating	
	new	old	new	old
Komerční Banka	980.00	1,085.60	buy	accumulate

Company	Current Price	Target Price	Upside
Komerční Banka	834.90	980.00	+17.4%

Forecast revision since last update		2016E	2017E
Total income		+3.9%	-8.3%
Pre-tax income		+5.6%	-18.1%
Net income		+5.8%	-18.6%

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Investment Case

We are upgrading Komerční Banka from accumulate to buy, with the 9-month price target lowered to CZK 980 per share. Komerční is trading at a discount to the Polish bank sector, which we consider unwarranted given the regulatory pressures that have weighed on banks in Poland for the last twelve months. While financial institutions both in Poland and in the Czech Republic are benefitting from positive economic momentum, in case of Poland this is overshadowed by unfavorable regulation, including an additional tax levied on assets (which is having a negative impact on profits and lending) and the plans to force banks to convert Swiss franc mortgages into zlotys at historical exchange rates, potentially causing a deep economic crisis. Meanwhile, Czech banks are enjoying an accelerating lending growth and the prospect of an earnings boost in the near future from expected hikes in the local central bank interest rates.

Komerční has recently announced it will have to scale back future dividend payments to comply with more stringent local capital requirements, however even if the annual payout ratio is cut from 90% to a projected 60%, the Bank will still be able to offer dividend yield well above the average payout by WIG-Banks companies. With all factors considered, we would take advantage of any price weakness to buy shares in Komerční Banka.

Komerční FY2016 guidance vs. our projections

Y/Y pct. change	2016	
	Guidance*	Our Estimate
Net interest income	-	-4.0%
NIM (bps)	-0.10-0.15	-0.10
Loan growth	<10%	11.0%
Fees and commissions	-1%-2%	-1.1%
Trading income	+	+43.6%
Total income	~0	+0.7%
Total costs	-	-4.1%
Cost of risk (bps)	30-40	30
Dividend payout ratio	50-70%	69%

Source: Komerční Banka, Dom Maklerski mBanku *as given in Q2 2016

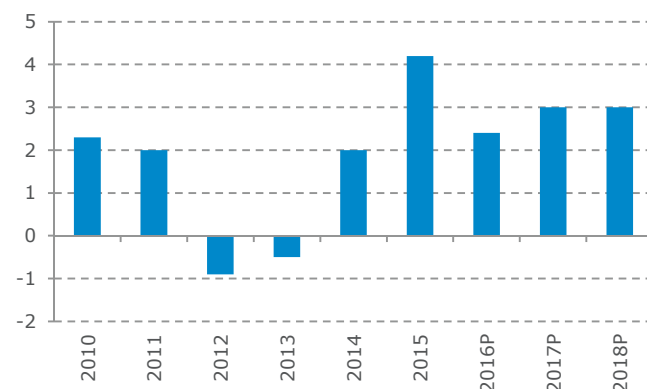
Market Outlook

Using projections by the Czech National Bank, we assume Czech GDP growth will be 2.4% in 2016, followed by an acceleration to 3.0% in 2017 (this compares to Komerční Banka's projection of 2.1% growth in 2016, and a 2.5% forecast by Ceska Sportelna ("CS")). The 2016 slowdown is due to reduced government spending as a result of lower EU subsidies. Further, according to Komerční's economists, the 'Brexit' is likely to take away up to 0.4ppts from Czech economic growth, and shave between 0.15 and 0.25 points from the EU-wide economic momentum over the next ten years. Without UK contributions into the EU budget, the Czech Republic is expected to receive CZK 9.5bn less per year in subsidies from 2017 to 2020 (equivalent to 0.8% of the 2016 government budget).

When it comes to interest rates, we expect they will be kept stable in 2016, and in 2017 they may be temporarily lowered as the CNB prepares to end the currency cap on the koruna (at the moment the CZK/EUR exchange rate is capped at 27 under a weak currency policy), only to be raised by a projected 50bps in 2018. The Czech inflation rate as per central bank forecasts is set for a gradual

acceleration to over 2ppts in 2017. The average 3M PRIBOR is not likely to drop below 0% in 2017, and, to complete the economic outlook for the coming months, decreasing unemployment (at 5.4% in July, -80bps ytd) means Czech banks will be able to maintain high-quality assets.

Annual GDP growth in Czech Republic (%)

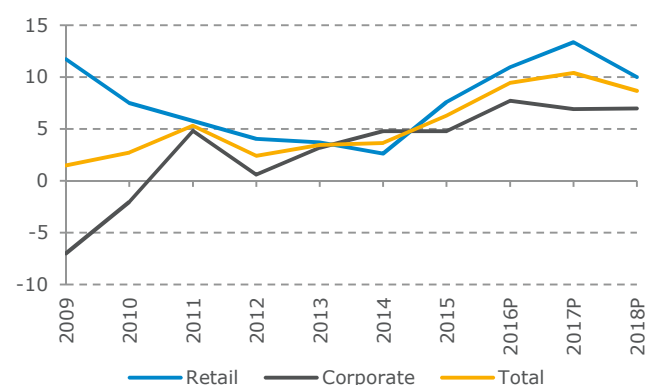


Source: Czech National Bank, Dom Maklerski mBanku

Loans

We expect that Czech bank lending will grow at an increasingly faster pace in the coming years. According to the local central bank statistics, total lending in the year to July 2016 was up 5.2%, driven mainly by corporate borrowing (+7.2% ytd), and compared to June 2015 lending in June 2016 recorded an increase of 6.9%, fueled by 9.7% growth in corporate loans, a 7.9% jump in mortgage loans, and a 2.3% rise in consumer loans. A July survey by the CNB showed that Czech banks continue to loosen their lending policies amid low financing costs, though when it comes to higher-risk facilities the banks have tightened their standards by setting more restrictive LTV requirements and charging higher margins. The CNB survey also showed that in H1 2016 loan demand exceeded the expectations of banks, which anticipated continued interest from prospective borrowers in Q3. Based on this, we predict that lending will grow 9.4% in 2016, and accelerate to 10.4% in 2017. The growth potential, especially in retail lending, is additionally reinforced by a low loan penetration rate in the Czech Republic compared to countries in the Euro Area (56% vs. 112%).

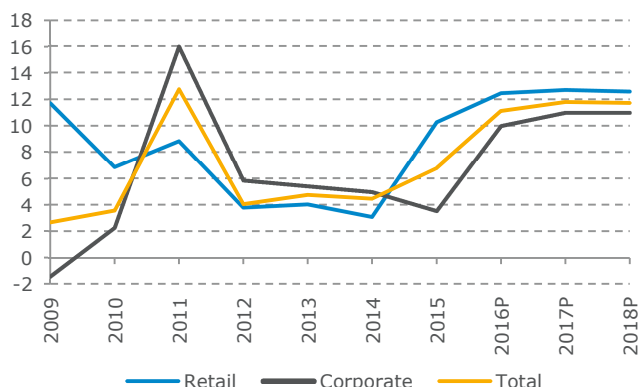
Loan growth in Czech Republic (%)



Source: Czech National Bank, Dom Maklerski mBanku

Komerční Banka's lending division is obviously among the beneficiaries of the positive Czech economic momentum, with the growth in 2016, for the first time in ten years, expected to be more robust than experienced by Polish banks. Komerční Banka saw its total loan sales jump 9.9% y/y in Q2 2016, with retail lending up 9.0% and corporate lending soaring 10.7%. Most notably, the annual rate of expansion in the mortgage portfolio in the period was an impressive 12.8%. Accordingly, we have a 11% growth prediction for Komerční Banka's net loan portfolio in 2016, and in 2017 we anticipate further growth at an annual rate of 11.9%.

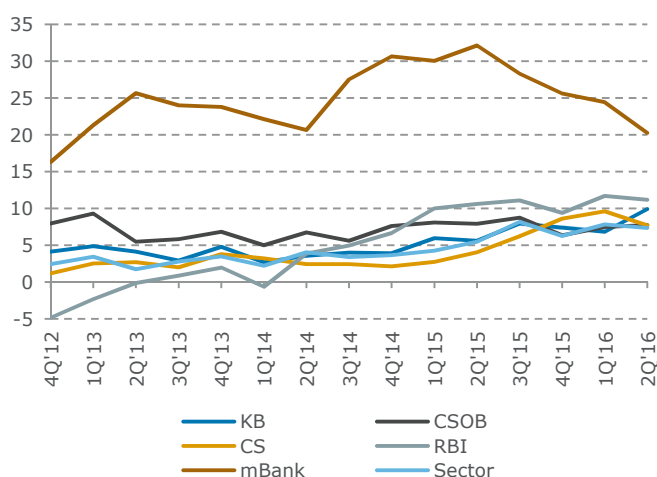
Loan growth projection for Komerční (%)



Source: Komerční Banka, Dom Maklerski mBanku

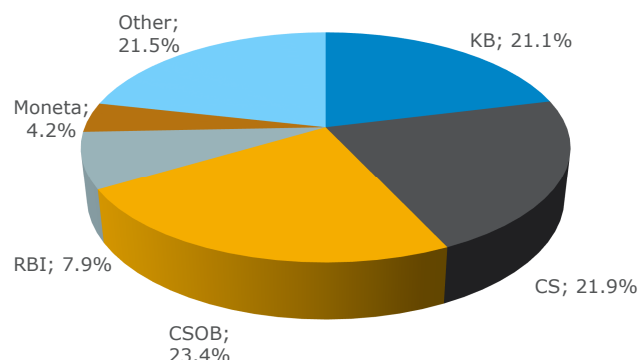
Compared to its main local top-3 rivals, SCOB and Ceska Sporitelna, who also enjoy stronger lending this year, Komerční led the way in Q2 2016 with an annual growth rate of 9.9% vs. 7.7% reported by the two other players, but it trailed behind smaller banks which are just starting to build a presence in the Czech Republic, such as Raiffeisen (+11.2%) and mBank (+20.3%). Overall, however, despite aggressive competition from newcomers, the top three 'incumbents' between them control 66% of the Czech loan market.

Y/Y pct. lending growth at Czech banks



Source: Banks, Dom Maklerski mBanku

Czech bank market shares in loans (Q2'16)

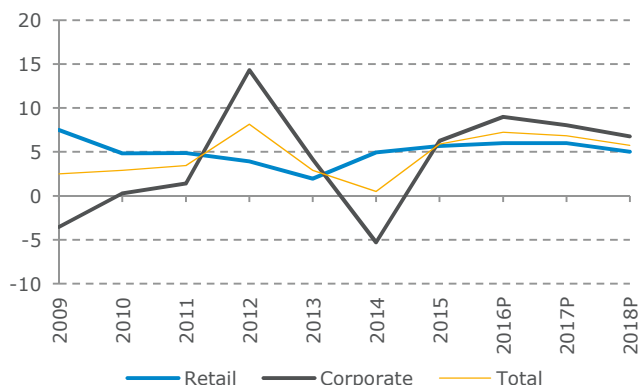


Source: Banks, Czech National Bank, Dom Maklerski mBanku

Deposits

The Czech deposit market expanded by 8.2% in the year through July 2016, driven by a steep, 7.6% rise in retail deposits and an 8.9% jump in corporate deposits. Even after considerable ytd narrowing of 80bps, the deposit interest rates in the Czech Republic remain well above the 3M PRIBOR, pointing to fierce competition. Our 2016 total Czech deposit growth projection is 7.2%, followed by continued increases of 6.9% in 2017 and 5.7% in 2018. Consequently, the average ratio of loans to deposits in the Czech banking sector is likely to increase from 70.1% at the end of 2015 to a projected 76.0% in 2018.

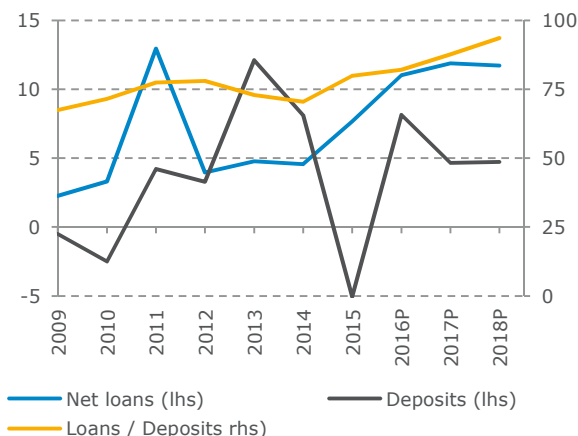
Deposit growth in Czech Republic (%)



Source: Czech National Bank, Dom Maklerski mBanku

At Komerční Banka, we predict that deposits will increase at a slower rate than loans, though with its Q2 2016 loans/deposits ratio at a safe 80%, the Bank has no need to compete for new savings in a tough market. Our prediction as to annual deposit growth for Komerční is 8.1% in 2016 and 4.7% each in 2017 and 2018.

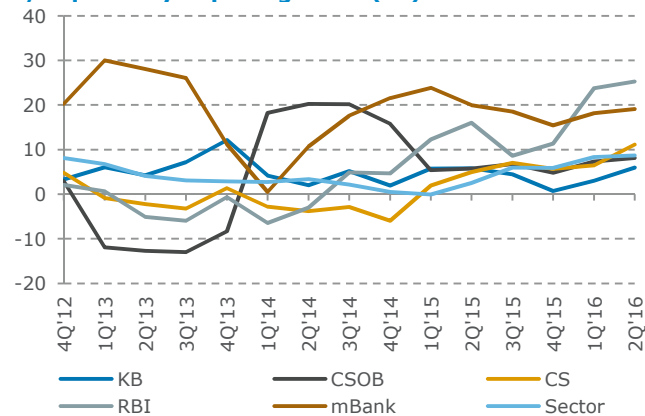
Loan and deposit growth projection for Komerční (%)



Source: Czech National Bank, Dom Maklerski mBanku

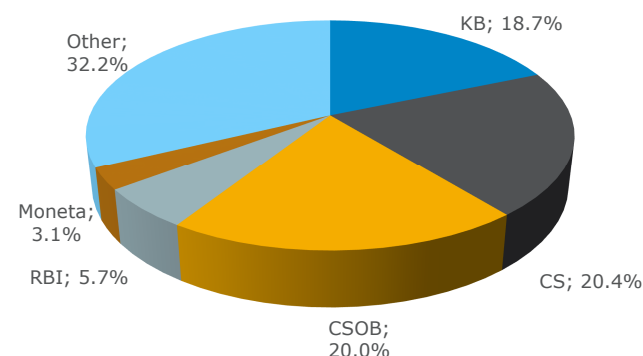
The situation in the Czech market for retail deposits remains challenging for local banks. Like in the case of loans, savings growth is driven mainly by smaller banks seeking to capture a meaningful percentage of a market controlled by three players. This is reflected in the statistics for Q2 2016, showing high deposit growth recorded by small newcomers such as mBank (19.1%) and Raiffeisen (+25.2%) compared to slower growth reported by the majors (CSOB +8.0%; CS +11.1%, KB +6.0%) which, between them, controlled 59% of the Czech deposit market as of 30 June 2016.

Y/Y quarterly deposit growth (%)



Source: Banks, Dom Maklerski mBanku

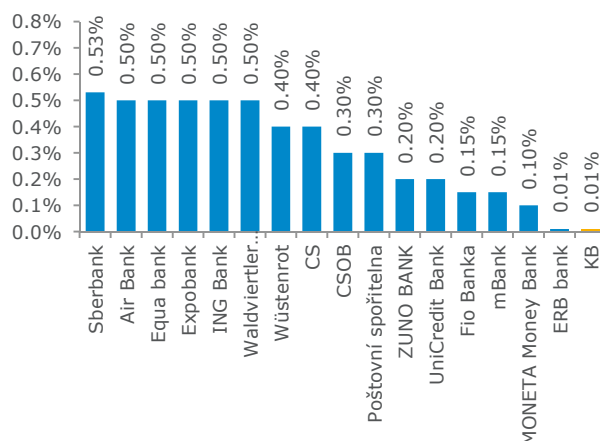
Czech bank market shares in deposits (Q2'16)



Source: Banks, Czech National Bank, Dom Maklerski mBanku

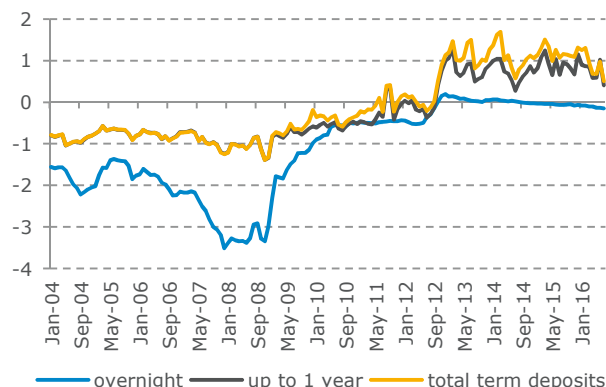
Due to intense competition, margins achieved by Czech banks on term deposits from individuals have been negative as the interest rates offered to clients at an average 0.798% are much higher than the 3M PRIBOR rate of 0.29%. The banks currently offering the highest deposit rates are Sberbank (0.53%), Air Bank and Equa Bank (0.5%), Expobank, ING, and Waldviertler. With 0.01%, Komerční's deposit rate is among the lowest on the market.

Term deposit yields in Czech Republic



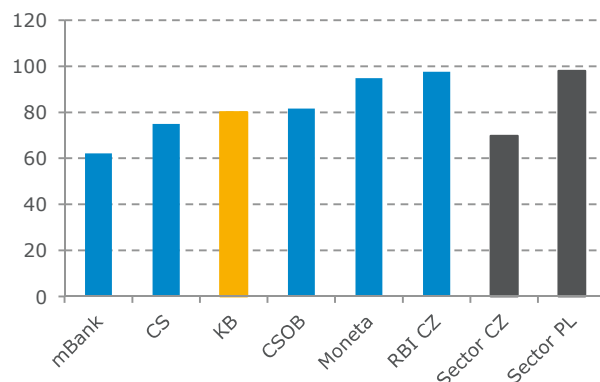
Source: Air Bank, Dom Maklerski mBanku

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



Source: Czech National Bank, Dom Maklerski mBanku

Loans/Deposits at 30 Jun. 2016 (%)

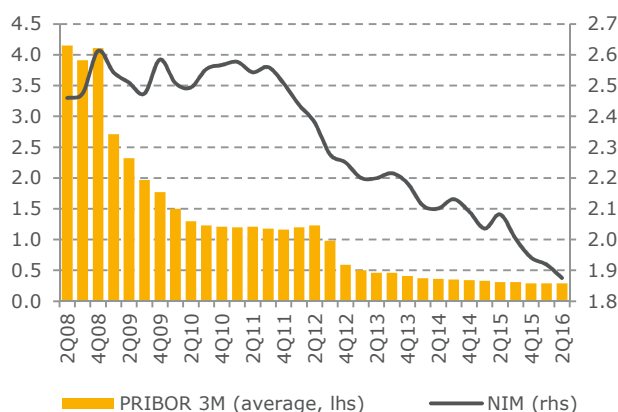


Source: Banks, Dom Maklerski mBanku

Margin Pressure Persists

Czech banks earned a net interest margin of 1.88% (over average assets) in Q2 2016, similar to the average NIM of 1.91% for the Polish counterparts, achieved despite much lower local interest rates, with 3M PRIBOR at 0.3% vs. 3M WIBOR of 1.6%. In Western Europe, NIM averages 1.1%, potentially setting the path for CEE NIM convergence in the long term. In our view, the Czech NIM will worsen further going forward, led by the interest rate cut below zero anticipated in 2017, ahead of the removal of the currency peg on the crown, and due to significant refinancing activity in the Czech loan market.

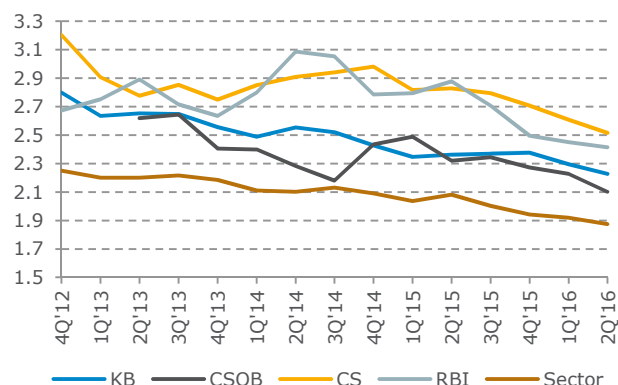
Czech NIM and 3M PRIBOR (%)



Source: Czech National Bank, Dom Maklerski mBanku

Komerční's NIM (over average assets) has been under pressure since 2011, and it is expected to continue declining throughout 2017, underpinned by falling market interest rates, an increasing share of low-margin loans in the total portfolio, loan refinancing, and deposit price pressure. NIM contraction equally affects Komerční's competition, with the interest margins in Q2 2016 compared to Q2 2015 down from 2.32% to 2.10% at CSOB, from 2.83% to 2.51% at CS, from 2.88% to 2.41% at Raiffeisen, and from 6.33% to 5.86% at Moneta Money Bank. Going forward, on low interest rates expected to persist until the end of 2017, bank net interest margins in the Czech Republic are set to remain tight for at least one more year, but in 2018 the CNB is expected to raise interest rates by 50bps (for comparison in Poland the next rate hike is anticipated one year later). Consequently, we predict that Komerční will see NIM contraction by 10bps to 2.21% in 2016 followed by a further tightening of 17bps to 2.04% in 2017, and a rebound by 12bps to 2.16% in 2018. With that said, keep in mind that the positive effects of the 2018 tightening may be short-lived due to the fact that mortgage interest rates are fixed for five-year periods.

NIM comparison for Czech banks (%)

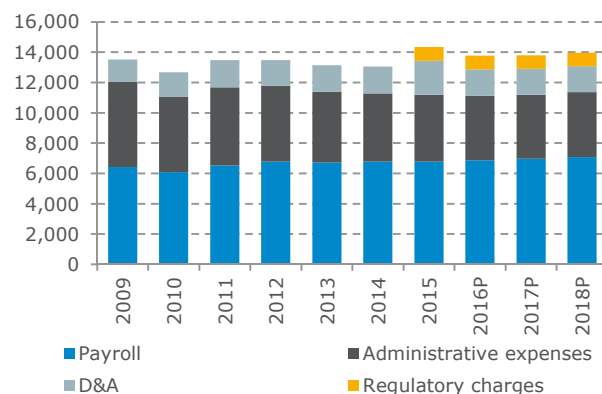


Source: Banks, Dom Maklerski mBanku

Costs Under Control

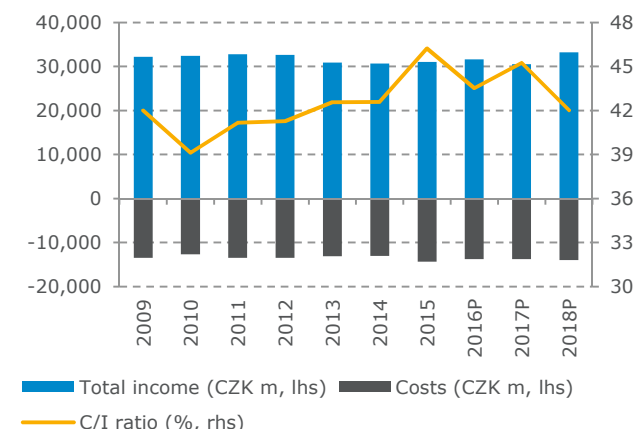
In 2015, Komerční's costs were inflated by property impairment which boosted the annual amortization costs by CZK 418m. Adjusted for the one-time event, the annual cost-to-income ratio amounted to 44.9%. In H1 2016, Komerční was able to keep operating costs flat at the year-ago level, thanks mainly to a 3.1% year-over-year reduction in administrative expenses which offset a 1.7% increase in payroll costs and 1.5% higher regulatory costs. Over the last 12 months, Komerční's employee and branch headcount has stabilized at 8.4 thousand and 396, respectively. The cost/income ratio in H1 2016 was 38.6%, supported by a one-time gain of CZK 959m from the sale of Visa shares. The reduction in administrative costs reported in H1 2016 was achieved across the whole category except marketing. Komerční expects to report lower costs this year than last, thanks mainly to lower D&A, and according to our calculations the 2016 total costs will show a drop of 4.1%, remain flat in 2017, and rise 1.2% in 2018. At the same time, the cost/income ratio will increase from an estimated 44% in 2016 to 45% in 2017, and fall to a projected 42% in 2018.

Cost breakdown at Komerční Banka (CZK m)



Source: Komerční Banka, Dom Maklerski mBanku

C/I ratio at Komerční Banka

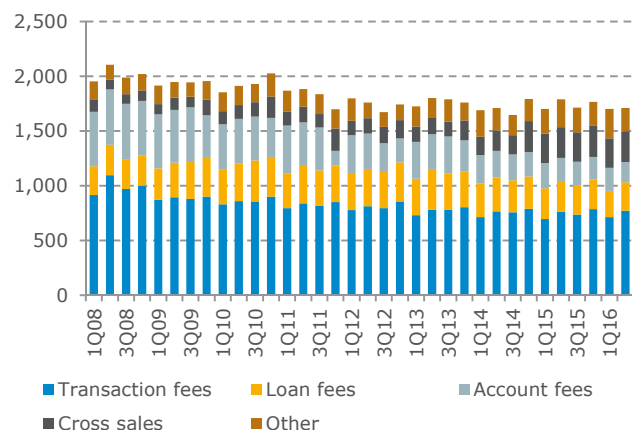


Source: Czech National Bank, Dom Maklerski mBanku

Fee Income Under Pressure

In line with Komerční's guidance, providing for flat-to-slightly negative fee income in 2016, we assume 1.1% contraction in 2016 under pressure from lower interchange fees, low interest rates, and downward pressure on deposit prices, which, combined, force Komerční to keep in place the 'MojeOdměny' loyalty reward program for customers. Komerční estimates that the reduced interchange fee will lop CZK 200m off its annual fee income. In H1 2016, the Bank logged a 10.5% year-over-year drop each in loan fees (due to strong competition) and in account fees.

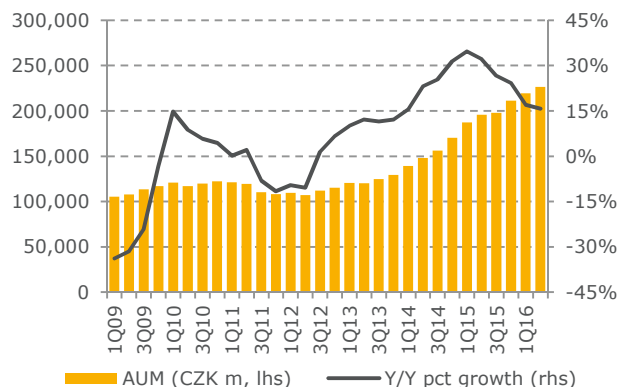
Quarterly fee income of Komerční Banka (CZK m)



Source: Komerční Banka, Dom Maklerski mBanku

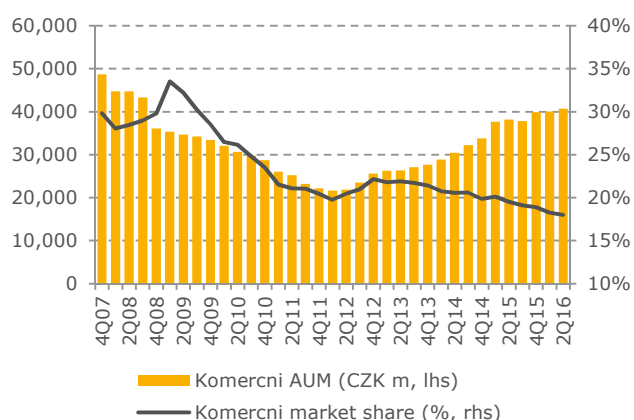
The flip side of low market interest rates is that clients seeking high-yield alternatives to deposits are helping to bolster the assets under management of investment funds. According to the Czech Capital Market Association AKAT, the AUM of Czech funds were up 15.7% y/y at 30 June 2016 after rising at a three-year CAGR of 23.5%. Komerční as well has benefitted from this trend, with its AUMs expanding at a 3-year CAGR of 15.7%. 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, 18% chunk of the market. On growing AUM, Komerční's cross-selling fee income rises at a 12-month moving average rate of 8.9%. In 2016 and 2017, 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



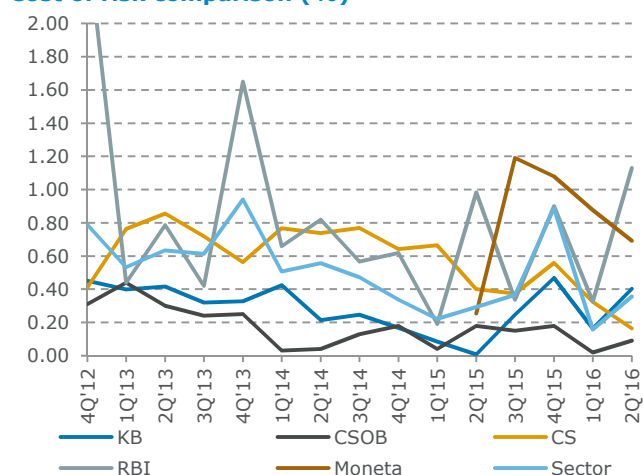
Source: AKAT, Dom Maklerski mBanku

According to our forecasts, after falling 1.1% in 2016, the 2017 fee income of Komerční will post a small gain of 1.4%, followed by a bigger gain of 2.6% in 2018. The 2016 contraction is led by low interest rates which, on the one hand, hurt fee income through intensified customer loyalty rewards, and, on the other hand, support growth in assets under management. The recovery anticipated in 2017 will be driven by positive year-ago comparable base effects, and the 2018 rebound will be fueled by interest rate hikes resulting in reduced competition.

Cost of Risk and Quality of Assets

The non-performing loan ratio in the Czech banking sector fell from 6.62% to 5.83% in the twelve months through July 2016, reflecting the improving quality of both corporate loans (where the NPL ratio decreased from 9.5% to 7.7%) and retail loans (a decline from 4.6% to 3.5%). It is worth noting the very low consumer NPL of 7.1% (vs. 12.1% in Poland), supported by a low, 5.5% unemployment rate. The general decline in borrower default is reflected in the decreasing NPL ratios of the top-3 Czech banks, down 110bps y/y to 4.0% at Komerční Banka, 65bps y/y to 4.3% at CS, and 82bps ytd to 3.0% at 30 June 2016. The improving loan quality is also driving down costs of risk in the Czech bank sector, with the local CoR at 30 June at a mere 25bps compared to 79bps in Poland, led by CSOB and CS with 9bps and 16bps, respectively. Relative to this, the CoR of Komerční was higher at 40bps, as was Moneta Money Bank's (69bps) and Raiffeisen's (113bps).

Cost of risk comparison (%)



Source: Banks, Dom Maklerski mBanku

NPL comparison for Polish and Czech banks (%)

	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16
Czech Rep.	6.9	6.7	6.8	6.5	6.2	5.9
CS	5.1	4.9	4.6	4.7	4.5	4.3
RBI	5.5	5.2	5.0	4.7	5.5	5.3
KB	5.3	5.1	4.5	4.2	4.0	4.0
CSOB	4.0	3.8	3.7	3.6	3.4	3.0
Poland	7.5	7.3	7.2	6.8	6.8	6.7
PKO BP	6.8	6.9	6.9	6.6	6.6	6.5
Pekao	7.2	7.1	6.7	6.5	6.5	6.4
BZ WBK	8.3	8.1	8.1	7.3	7.0	6.8
ING BSK	4.5	3.8	3.2	3.2	3.3	2.9
Millennium	4.2	4.3	4.6	4.6	4.5	4.6
Handlowy	5.2	5.1	4.3	3.6	3.8	3.7
Alior	9.8	8.3	8.6	9.3	9.3	10.0
GNB	16.1	16.0	14.9	13.2	13.5	13.9

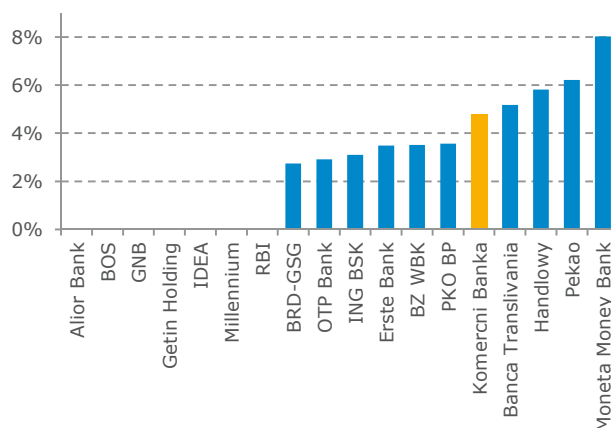
Source: Banks, Dom Maklerski mBanku

Komerční maintains low risk reserves thanks to the retail lending business, which in H1 2016 generated net reversals of CZK 14m vs. charge-offs of CZK 92m posted in H1 2015. In corporate, cost of risk increased to 54bps in H1 2016 from just 2bps in H1 2015, which the Bank explains with "a few isolated cases" of default. Komerční predicts that its 2016 yearly cost of risk will be in the range of 30-40bps, and we are confident it can reach the lower end of this range given the strong economy and falling unemployment of the Czech Republic. In the two following years, we expect cost of risk to be maintained at low levels.

Capital Position, Dividends

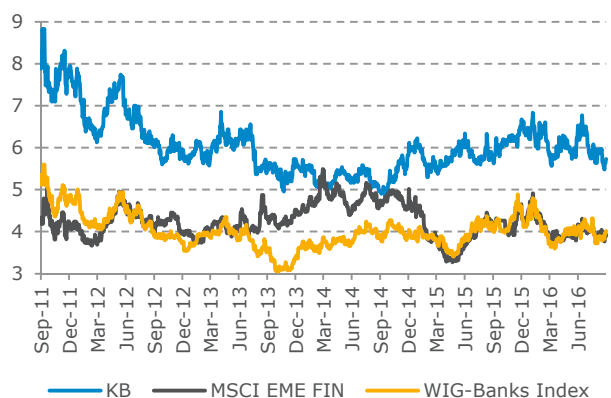
Komerční Banka had a CET 1 ratio of 15.2% as of 30 June 2016, including a 92% dividend reserve. After having the CET1 requirement raised to 15.5% by the Czech central bank in August, Komerční has had to review its dividend policy and revert to the regular dividend payout ratio of 60-70%. We learned during a meeting with CNB representatives earlier this month that the Czech counter-cyclical buffer could be raised by another 50bps if local banks maintain an intense mortgage lending activity, though the CNB officials believe they will be able to cool the mortgage market with more stringent LTV requirements. However, we expect Komerční to take this prospect into account in the updated dividend policy announcement on November 3rd, and to factor in a 50bp buffer over the minimum CET1 requirement of 15.5% when determining the size of the future distributions. As a result, we predict the Bank will offer per-share dividend of CZK 40 in 2017 and CZK 42 in 2018, implying respective dividend yields of 4.8% and 5.0% - levels which, though significantly lower than the 7.4% average offered in the last two years, are still among the highest in the EME banking sectors. According to statistics by Bloomberg, Komerční's dividend yield is second only to those offered by Moneta Money Bank, Pekao, Bank Handlowy, and Banca Transilvania. Moreover, even if it were to drop to ~5% over a longer period, looking at the 12M FWD dividend yield for the last five years, Komerční's dividend yield would still be more attractive than the 4.0% five-year average for the Polish WIG-Banks index or the 4.25% average offered by MSCI EME Financials.

Dividend Yield comparison (%)



Source: Bloomberg, Dom Maklerski mBanku

12M FWD DY comparison (%)

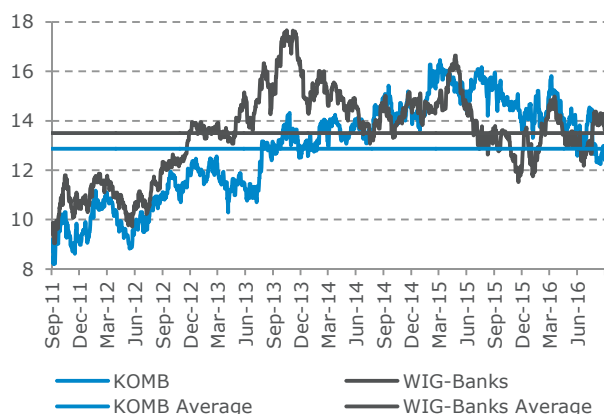


Source: Bloomberg, Dom Maklerski mBanku

Valuation

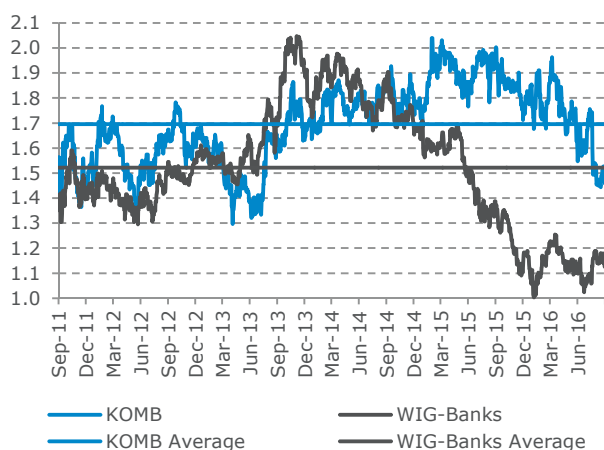
On our forecasts, Komerční Banka is valued at 12.2x 2016E P/E and 13.4x 2017E P/E, showing respective discounts of 14% and 22% relative to the Polish WIG-Banks index. Historically, KOMB was trading on 5-year average 12M-months forward P/E of 12.9x, i.e. at a 5% discount to the Polish P/E average of 13.5x, today widened to 10%.

12M forward P/E



Source: Bloomberg, Dom Maklerski mBanku

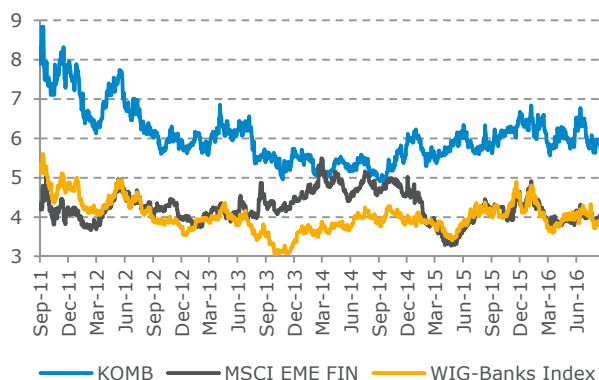
12M forward P/B



Source: Bloomberg, Dom Maklerski mBanku

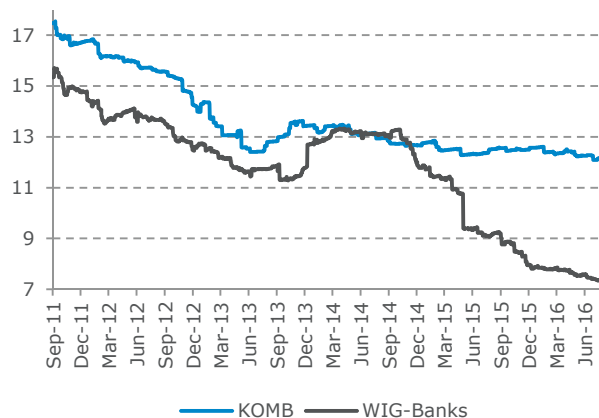
Meanwhile, note that the current 12-month-forward forecast ROE for Komerční Banka is 12.04%, a level well above the 7.31% average expected of WIG-Bank banks, warranted by a more favorable market environment, not affected by special bank taxes, political risk, or a threat of losses in the wake of forced CHF loan conversion. Moreover, the projected dividend yield of Komerční Banka exceeds the 12M forward average dividend yield of Polish banks even after the planned reduction in future shareholder distributions.

12M forward dividend yield



Source: Bloomberg, Dom Maklerski mBanku

12M forward ROE



Source: Bloomberg, Dom Maklerski mBanku

Given the higher dividends and returns on equity, underpinned by lower political risk, we believe Komerční Banka should be valued at a premium to the Polish bank sector. Compared to Poland, the future outlook for the Czech banking market is increasingly more attractive, and it includes faster lending growth, a strong economy, and likely increases in interest rates. To reiterate, the reduced shareholder distributions at Komerční are still much more generous than the dividend yields offered by most CEE banks.

We have adjusted our price target for Komerční Banka for the lower dividends, arriving at a per-share price of CZK 980, implying upside potential of 16.5%. Our cost-of-capital calculations assume a risk-free rate at 1.5%, a risk premium of 4.5%, and Beta of 1.

Quarterly Income Statement

(CZK m)	3Q'14	4Q'14	1Q'15	2Q'15	3Q'15	4Q'15	1Q'16	2Q'16
Net interest income	5,395	5,420	5,348	5,321	5,334	5,354	5,234	5,213
Fee income	1,647	1,794	1,701	1,790	1,712	1,765	1,700	1,708
Trading income	646	657	660	587	589	774	734	1,626
Other income, dividends	24	28	22	29	24	34	27	38
Total income	7,712	7,899	7,731	7,728	7,659	7,926	7,694	8,585
Operating costs	-3,254	-3,707	-3,356	-3,850	-3,423	-3,723	-3,879	-3,317
Operating income before provisioning	4,458	4,191	4,375	3,878	4,236	4,203	3,815	5,268
Cost of risk	-305	-211	-109	-9	-324	-633	-225	-563
Operating income	4,154	3,980	4,267	3,868	3,913	3,570	3,590	4,705
Equity in profits (losses) of subsidiaries	48	48	46	47	31	28	51	45
Pension benefits	-115	0	0	0	0	0	0	0
Pre-tax income	4,087	4,028	4,313	3,915	3,944	3,598	3,641	4,750
Tax	-729	-647	-738	-637	-605	-657	-653	-839
Minority interests	90	81	119	94	94	67	95	110
Net income	3,268	3,300	3,456	3,184	3,245	2,874	2,894	3,801

Quarterly Balance Sheet

(CZK m)	3Q'14	4Q'14	1Q'15	2Q'15	3Q'15	4Q'15	1Q'16	2Q'16
Net loans	475,522	494,706	495,300	502,218	517,666	532,617	534,539	555,813
Other interest-generating assets	353,078	366,765	364,319	345,261	346,231	314,280	349,573	333,910
Other non-interest-generating assets	46,367	50,358	52,569	43,159	47,405	44,658	49,179	50,059
Total assets	874,967	911,829	912,188	890,638	911,302	891,555	933,291	939,782
Deposits	640,652	661,703	659,467	655,222	669,261	666,407	679,096	694,320
Other interest-generating obligations	92,934	108,546	99,561	97,934	97,890	87,007	104,756	99,874
Other non-interest-generating obligations	38,610	33,574	40,183	39,240	40,158	31,913	38,199	42,941
Liabilities	772,196	803,823	799,211	792,396	807,309	785,327	822,051	837,135
Minority interests	3,049	3,131	3,250	3,656	3,750	3,816	3,911	3,645
Equity	99,722	104,875	109,727	94,586	100,244	102,412	107,329	99,003

Key ratios

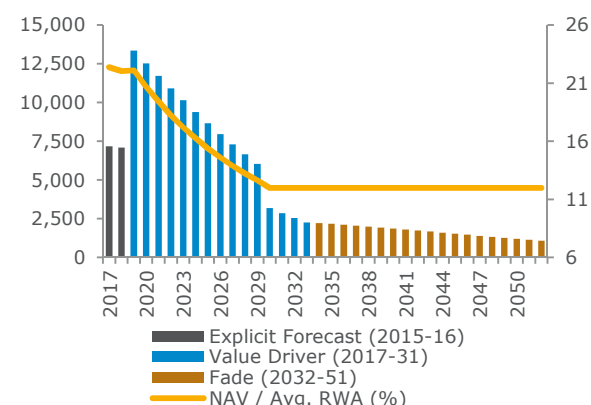
(%)	3Q'14	4Q'14	1Q'15	2Q'15	3Q'15	4Q'15	1Q'16	2Q'16
Loan growth (y/y)	4.0	4.6	6.2	6.2	8.9	7.7	7.9	10.7
Deposit growth (y/y)	5.1	1.9	5.7	5.8	4.5	0.7	3.0	6.0
Net interest margin	2.5	2.4	2.3	2.4	2.4	2.4	2.3	2.2
Costs / Income	42.2	46.9	43.4	49.8	44.7	47.0	50.4	38.6
NPL ratio (%)	5.5	5.2	5.3	5.1	4.5	4.2	4.0	4.0
Coverage ratio (%)	67.9	66.7	64.5	63.4	64.6	63.0	63.7	61.8
Provisions / Gross loans	0.2	0.2	0.1	0.0	0.2	0.5	0.2	0.4
Effective tax rate (%)	17.8	16.1	17.1	16.3	15.3	18.3	17.9	17.7
ROE	13.4	12.9	12.9	12.5	13.3	11.3	11.0	14.7
Tier-1 Ratio	17.1	16.4	16.7	16.5	16.4	16.3	16.0	15.3
Solvency ratios	17.1	16.4	16.7	16.5	16.4	16.3	16.0	15.3

Valuation

Dividend Discount Model

	(CZK m)	%
Explicit Forecast (2017-18)	14,276	7.7
Adjustment for time value of money	4,623	2.5
Value Driver (2019-2023)	115,552	62.7
Fade (2034-53)	31,907	17.3
Terminal value	18,080	9.8
Fair value of equity	184,437	100.0
Number of shares (millions)	188.9	
Fair value per share (CZK)	977	
Cost of equity (%)	6.0	
9M target price (CZK)	1,021	

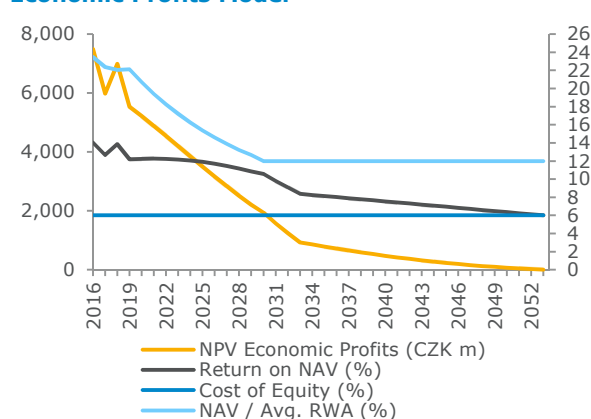
Dividend Discount Model



Economic Profits Model

	(CZK m)	%
Opening Tangible NAV	87,242	51.4
Explicit Forecast (2016-18)	20,467	12.1
Adjustment for time value of money	7,007	4.1
Value Driver (2019-2023)	48,135	28.3
Fade (2034-53)	6,945	4.1
Fair value of equity	169,797	100.0
Number of shares (millions)	188.9	
Fair value per share (CZK)	899	
Cost of equity (%)	6.0	
9M target price (CZK)	940	

Economic Profits Model

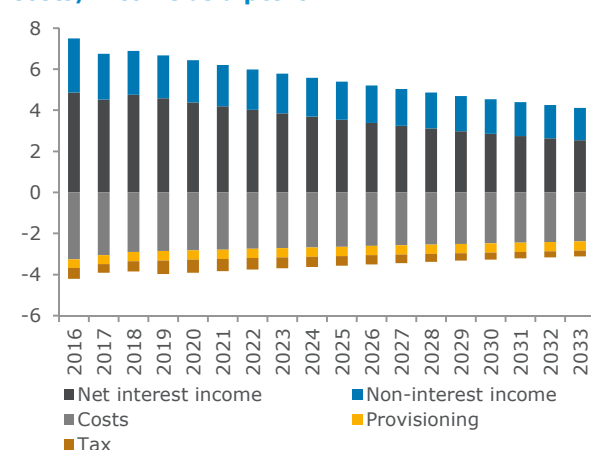


Key financial ratios

(%)	2016	2017	2018	Avg.*
Net interest income / Average RWA	4.9	4.5	4.8	3.5
Non-interest income / Average RWA	2.6	2.2	2.1	1.8
Costs / Average RWA	-3.3	-3.1	-2.9	-2.6
Costs / Income	43.5	45.2	42.0	50.2
Provisioning / Average RWA	-0.4	-0.4	-0.5	-0.5
Effective tax rate	-18.7	-18.7	-18.7	-18.7
Other / RWA	-0.5	-0.4	-0.5	-0.5
Net income / Average RWA	3.3	2.8	3.0	1.8
NAV / Average RWA	23.5	22.4	22.0	15.4
Tangible return on NAV	14.0	12.6	13.8	11.2
Net profit growth	0.9	-8.5	16.3	-2.5
Average RWA (CZK m)	421,920	452,158	482,427	722,290
Growth in average RWA	6.6	7.2	6.7	4.5

*2019-2033E average

Costs/Income as a pct. of RWA



Sensitivity Analysis

		Fade Period		
		20	25	30
Market Risk Premium	4.0%	975.8	985.8	994.5
	4.5%	937.8	945.1	951.4
	5.0%	879.6	884.5	888.7

Valuation Summary

	(CZK)
Dividend Discount Model	976.6
Economic Profits Model	899.1
Average Fair Value	937.8
9M Target Price (CZK)	980.0

Income Statement (IFRS consolidated figures)

(CZK m)	2012	2013	2014	2015	2016P	2017P	2018P
Net interest income	21,969	21,207	21,423	21,357	20,512	20,477	22,947
Fee income	6,971	7,077	6,752	6,968	6,893	6,988	7,171
Trading income	3,598	2,489	2,386	2,610	4,099	2,904	2,992
Other income	125	121	116	109	122	128	135
Total income	32,663	30,894	30,677	31,044	31,626	30,497	33,244
Operating costs	-13,484	-13,148	-13,065	-14,352	-13,767	-13,799	-13,967
Operating income before provisioning	19,179	17,746	17,612	16,692	17,859	16,698	19,277
Credit risk allowance	-1,846	-1,733	-1,271	-1,305	-1,736	-1,925	-2,155
Allowance for financial instruments	0	0	0	0	0	0	0
Other reserves	-25	-6	-25	231	-25	-27	-30
Cost of risk	-1,871	-1,739	-1,296	-1,074	-1,761	-1,952	-2,184
Net operating income	17,308	16,007	16,316	15,618	16,098	14,746	17,093
Equity in profits (losses) of subsidiaries	121	208	191	152	160	168	176
Pension benefits	-489	-484	-508	0	0	0	0
Pre-tax income	16,940	15,731	15,999	15,770	16,258	14,914	17,269
Tax	-2,708	-2,825	-2,669	-2,637	-3,008	-2,759	-3,195
Minority interests	278	378	376	374	370	367	363
Net income	13,954	12,528	12,954	12,759	12,880	11,788	13,711

Balance Sheet (IFRS consolidated figures)

(CZK m)	2012	2013	2014	2015	2016P	2017P	2018P
Cash and central bank balances	28,057	44,405	152,903	128,336	134,753	141,490	148,565
Interbank loans	64,111	125,735	59,698	47,799	48,277	48,760	49,247
Loans	451,547	473,089	494,706	532,617	591,259	661,528	739,017
Debt securities	196,706	182,533	195,927	138,145	143,671	149,418	155,394
Fixed assets and intangible assets	15,659	15,396	15,176	14,463	14,276	14,136	13,987
Other assets	30,756	22,822	34,851	30,196	31,102	32,035	32,996
Total assets	786,836	863,980	953,261	891,556	963,337	1,047,366	1,139,207
Obligations to the financial sector	38,903	49,680	61,362	56,230	69,062	111,620	158,228
Deposits	579,067	649,158	701,867	666,407	720,681	754,279	789,982
Outstanding debt securities	39,213	39,947	46,054	30,777	32,316	33,932	35,628
Subordinated loans	0	0	0	0	0	0	0
Other liabilities	29,115	28,657	34,484	31,912	32,818	33,751	34,712
Equity	97,769	93,659	106,363	102,414	104,511	109,697	116,426
Minority interests	2,769	2,879	3,131	3,816	3,950	4,088	4,231
Total liabilities	786,836	863,980	953,261	891,556	963,337	1,047,366	1,139,207



Key Ratios

%	2012	2013	2014	2015	2016P	2017P	2018P
Y/Y growth							
Loans	4.0	4.8	4.6	7.7	11.0	11.9	11.7
Deposits	3.3	12.1	8.1	-5.1	8.1	4.7	4.7
Equity	23.4	-4.2	13.6	-3.7	2.0	5.0	6.1
Assets	4.2	9.8	10.3	-6.5	8.1	8.7	8.8
Net income	47.3	-10.2	3.4	-1.5	0.9	-8.5	16.3
Net interest income	-1.0	-3.5	1.0	-0.3	-4.0	-0.2	12.1
Balance-sheet ratios							
Loans / Deposits	78.0	72.9	70.5	79.9	82.0	87.7	93.5
Deposits / Assets	73.6	75.1	73.6	74.7	74.8	72.0	69.3
Loans / Assets	57.4	54.8	51.9	59.7	61.4	63.2	64.9
Equity / Assets (incl. minority inter.)	12.8	11.2	11.5	11.9	11.3	10.9	10.6
Capital adequacy ratio	14.7	15.8	16.4	16.3	15.7	16.0	16.0
Tier 1 ratio	14.7	15.8	16.4	16.3	15.7	16.0	16.0
Asset quality							
NPL / Loans	5.8	5.6	5.2	4.2	4.5	4.5	4.5
Provisioning / Loans	3.8	3.8	3.7	2.9	3.0	2.9	2.9
Provisioning / NPL	65.8	67.4	70.7	68.7	67.0	65.1	65.5
Net provisioning / Average loans	0.4	0.4	0.3	0.2	0.3	0.3	0.3
Profitability							
Net interest margin*	3.0	2.7	2.5	2.4	2.3	2.1	2.2
Interest income / Average assets	2.9	2.6	2.4	2.3	2.2	2.0	2.1
Non-interest income / Average assets	1.4	1.2	1.0	1.1	1.2	1.0	0.9
Costs / Average assets	1.7	1.6	1.4	1.6	1.5	1.4	1.3
Costs / Income	41.3	42.6	42.6	46.2	43.5	45.2	42.0
Net provisioning / Average assets	0.2	0.2	0.1	0.1	0.2	0.2	0.2
Pre-tax profit / Average assets	2.2	1.9	1.8	1.7	1.8	1.5	1.6
Effective tax rate	16.0	18.0	16.7	16.7	18.5	18.5	18.5
ROA	1.8	1.6	1.5	1.4	1.4	1.2	1.3
ROE	15.8	13.1	13.0	12.2	12.4	11.0	12.1
Trading Multiples							
Number of shares outstanding (eop, millions)	188.9	188.9	188.9	188.9	188.9	188.9	188.9
Average number of shares outstanding	188.9	188.9	188.9	188.9	188.9	188.9	188.9
EPS (CZK)	73.9	66.3	68.6	67.6	68.2	62.4	72.6
BVPS (CZK)	517.7	495.9	563.2	542.3	553.4	580.9	616.5
P/E (x)	11.3	12.6	12.2	12.4	12.2	13.4	11.5
P/B (x)	1.6	1.7	1.5	1.5	1.5	1.4	1.4
DPS (CZK)	32.0	46.0	46.0	62.0	62.0	40.0	42.0
Dividend yield (%)	3.8	5.5	5.5	7.4	7.4	4.8	5.0

*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

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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%
REDUCE – we expect that the rate of return from an investment will range from -5% to -15%
SELL – we expect that an investment will bear a loss greater than 15%
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Strong and weak points of valuation methods used in recommendations:

DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.

Relative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

Economic profits – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

Discounted Dividends (DDM) – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.

NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

Previous ratings issued for Komerční Banka

Rating	hold	accumulate	buy	accumulate
Rating date	2016-02-02	2016-03-04	2016-05-06	2016-06-02
Price on rating day	5239.00	4942.00	4624.00	948.00
WIG on rating day	44294.89	46448.27	46430.16	44700.67

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