mBank Dom Maklerski

mBank.pl

Friday, February 01, 2019 | update

Banks

Poland

Rate hikes Off Table But Banks Press On Regardless

Taking a page out of mBank's latest economic outlook for 2019, we have revised our earnings projections for the bank sector through 2020 to reflect the change in expectations as to Poland's next interest hike, which is now seen unlikely to happen until the end of the Monetary Council's current term in mid-2022, versus a previous estimate of three hikes in 2020. The result is a reduction of an average 4% in the net income forecasts for 2020, along with a 3% downward adjustment net interest income, indicating that, even with rates holding low, the current expectations of market analysts. are very well within the reach of all rated banks. The market seems to be underestimating the lending potential of Polish banks, which are set to report record quarterly earnings for Q4 2018, generated on sustainable revenues and curbed cost of risk continuing into 2019. We have also revised our 2019 dividend forecasts to account for the extra capital buffers imposed after recent stress tests by the Polish regulator (the "ST add-on"). Under the new capital requirements, the maximum dividend payout ratios that Polish institutions are allowed to offer this year went up to 50% for PKO BP, but fell to 75% for Pekao and Bank Handlowy, and to 25% for Santander. Finally, the landscape for banks has changed with the revival of the FX borrower relief bill, with plans to put it into effect from July. The measures will not bear too heavily on the valuations of banks, but they are likely to make a major dent in profits. The FX bill has been in the pipeline since August 2017, and it is still going through changes that make it hard to quantify at this juncture, which is why it is not factored into our current earnings forecasts. With that said, the only bank whose investment rating under our methodology will probably have to be downgraded with the bill's passing is Bank Millennium. After updating our expectations, and taking into consideration share price gains since the beginning of the year, we downgrade to hold our recommendations for PKO BP, ING BSK, and Santander, and we now rate Handlowy as reduce. Pekao, Alior, and Bank Millennium are still our top picks.

Updating for canceled rate hike expectations

Recent comments coming out of Poland's Monetary Council to the effect that rate hikes might not be in the pipeline until the end of the Council's current term have prompted us to cancel the expectation for three hikes in 2020, and consequently to lower our aggregate net income forecast for the sector by 4% or PLN 0.6bn. This is a very mild adjustment based on an informed belief in continued growth in net interest income in the next two years, fueled by expanding loan portfolios. We consider flat interest rates much less of a risk than the FX mortgage bill.

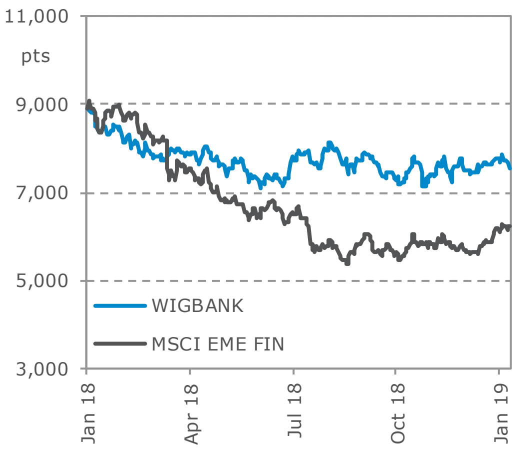
Updating for the FX bill

Head of the parliamentary sub-committee in charge of the FX borrower relief bill, Tadeusz Cymański, recently said his goal was to have the bill pass by the end of March 2019, so that it can become law from July. In the worst-case scenario, the aftermath for the bank sector could reach PLN 1 billion in 2019 and PLN 2 billion the following year. 2019 being an election year in Poland, the best-case scenario is that polling finds that the franc loan issue no longer resonates with voters.

Company	P/E			P/BV			ROE (%)		
	19E	20E	21E	19E	20E	21E	19E	20E	21E
PKO	12.0	11.4	10.9	1.2	1.1	1.0	10.2	10.1	9.8
PEO	11.3	10.2	9.3	1.2	1.1	1.1	10.7	11.4	11.7
SPL	14.4	12.1	10.7	1.4	1.3	1.2	10.3	11.4	11.9
ING	15.0	13.4	12.1	1.8	1.7	1.5	12.7	13.1	13.3
MIL	14.6	10.4	9.4	1.2	1.1	0.9	8.5	10.8	10.7
BHW	12.8	12.7	11.9	1.2	1.2	1.2	9.8	9.7	10.0
ALR	7.5	6.7	6.2	0.9	0.8	0.7	12.4	12.3	11.8

WIG-Banks	7,622.93
MSCI EME Financials	241.73
2019E P/E	12.8x
2019E P/B	1.3x

WIG-Banks vs. MSCI EME Financials



Name	9MTP		Recommendation	
	new	old	new	old
PKO	40.92	45.00	hold	accumulate
PEO	131.80	136.29	buy	buy
SPL	388.00	400.00	hold	accumulate
ING	191.80	199.63	hold	accumulate
MIL	10.00	10.10	accumulate	accumulate
BHW	65.50	76.00	reduce	accumulate
ALR	87.00	92.50	buy	buy

Name	Current Price	Target Price	Upside/ Downside
PKO	39.51	40.92	+3.6%
PEO	110.60	131.80	+19.2%
SPL	373.80	388.00	+3.8%
ING	191.40	191.80	+0.2%
MIL	8.82	10.00	+13.4%
BHW	69.10	65.50	-5.2%
ALR	57.50	87.00	+51.3%

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PKO BP: hold (downgraded)

PKO PW; PKO.WA | Banks, Poland

Unfazed By Monetary Decision-Making

After adjusting for the assumed lack of interest rate hikes through 2022, we downgrade PKO from accumulate to hold with the 9M target price lowered to PLN 40.92. We have also set our new 2020 interest income forecast 3.5% lower, and we trimmed the net income forecast by 5.1%, with the assumption that low interest rates will help maintain a strong lending momentum in the next two years which will mitigate any contraction in interest income. Interestingly, our 2020 target is only 2.1% lower than the current consensus forecast, suggesting analysts may be underestimating PKO's revenue-generating potential and capability for organic growth. We have also raised our expectations as to the 2019 dividend payout ratio to 50%. Further, without actually factoring this into our forecasts, we estimate roughly that the passing of the FX mortgage relief bill in mid-2019 would create a setback of 5.7% against PKO's net income for 2019, rising to 9.1% in 2020. In subsequent years the burden will weigh with a decreasing force. The upside of the FX law is that it would unfreeze about PLN 0.8bn of PKO's capital after a forced conversion of CHF mortgages into zlotys. All in all, we consider PKO fairly valued at the current level given all the possible scenarios of an election year.

Underestimated potential

We view the 2019 earnings consensus for PKO BP as being about 3.5% too low, while the expectations for 2020 are probably overestimated by around 2%. Our current 2020 net income estimate after adjusting for canceled interest rate hikes is PLN 234m lower than the original. With that said, we believe analysts are not giving enough credit to PKO's strong lending momentum, reflected in loan book growth of an average of PLN 7.3bn in the last three quarters.

FX bill not weighing on valuation

Without incorporating it into our forecasts while the legislative process is in progress, assuming banks are told to set aside 1% of the value of their CHF mortgage portfolios (the better-case scenario relative to the worst-case 2% charge), the total cost to PKO BP according to our calculations would come up to PLN 822m, an amount equivalent to a one year's tax. That is why ultimately, not counting an inevitable initial overreaction, the bill's passing is not likely to hurt PKO's valuation by more than PLN 0.54 per share.

Fairly valued

PKO is currently trading at a discount of just 3% on 12M forward P/E relative to the historical ratio for the last three years. Valued by the market at a Fair P/E of 13.25%, the stock offers limited upside. Neither the passing of the FX bill, nor the expected lack of interest rate hikes, is likely to cause a re-rating of PKO in the near future. We find rival Pekao to be offering more upside potential at the moment.

(PLN m)	2017	2018E	2019E	2020E	2021E
Net interest income	8,606.0	9,301.7	10,081.2	10,730.2	11,384.9
Noninterest income	4,197.0	4,359.2	4,467.2	4,586.0	4,795.8
Total costs	6,024.0	6,211.6	6,431.4	6,639.5	6,894.3
Operating income*	6,779.0	7,449.3	8,117.0	8,676.7	9,286.4
Net income	3,104.0	3,732.9	4,132.3	4,343.9	4,551.3
Costs/Income (%)	47.1	45.5	44.2	43.3	42.6
ROE (%)	9.0	9.9	10.2	10.1	9.8
P/E (x)	15.9	13.2	12.0	11.4	10.9
P/B (x)	1.4	1.3	1.2	1.1	1.0
DPS	0.00	0.55	1.49	1.65	1.74
Dividend yield (%)	0.0	1.4	3.8	4.2	4.4

*before provisioning

Current Price	PLN 39.51
Target Price	PLN 40.92
MCap	PLN 49.39bn
Free Float	PLN 34.85bn
ADTV (3M)	PLN 224.0m

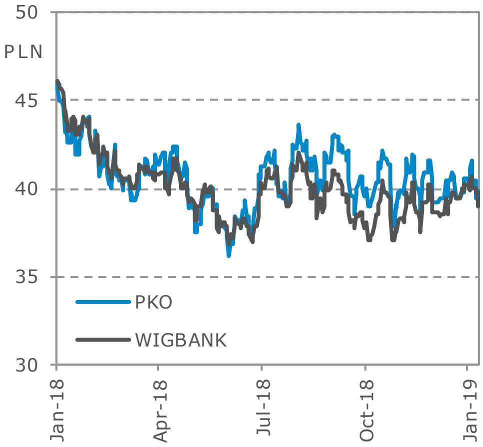
Ownership

State Treasury	29.43%
NN OFE	7.65%
Aviva OFE	7.14%
Others	55.78%

Business Profile

PKO has the largest portfolios of retail deposits and loans, and the second-largest (after Pekao) portfolios of corporate loans and deposits, in Poland. The Bank manages a balanced balance sheet and has an adequate solvency ratio. It has a 99.6% stake in the Ukrainian Kredobank, which accounts for about 1% of its assets.

PKO vs. WIG Banks



	9MTP		Rating	
	new	old	new	old
PKO BP	40.92	45.00	hold	accumulate

Company	Current Price	Target Price	Upside
PKO BP	39.51	40.92	+3.6%

Forecast Update	2018E	2019E	2020E
Total income	+0.0%	+0.1%	-2.4%
Pre-tax income	+0.9%	+1.6%	-4.2%
Net income	-1.7%	+2.0%	-5.1%

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Pekao: buy (reiterated)

PEO PW; PEO.WA | Banks, Poland

Solid Growth Prospects & Respectable Dividends

We maintain a buy rating for Pekao and we lower the 9-month price target to PLN 131.80. A lack of interest rate hikes assumed through 2020 has knocked only 2.8% off our original net income forecast for the year. We have also had to trim the expected 2019 dividend payout ratio from 90% to 75% in the wake of the new ST add-on capital buffer, but we assume this will be followed by a hike in the payouts the Bank has planned for subsequent years from 70% to 75%. At these levels, Pekao's shareholders can still expect to receive payments not match by many others, with 2021 DPS likely to top that offered in 2018 (at an 84% payout ratio) after an acceleration in ROE growth to 11.7% from 9% in 2019. On top of that, the capital retained through lower dividends can be used to extend loan growth at an annual rate of 9% into future years. PEO is a relatively low-risk investment thanks to its minimal sensitivity to changes (or lack thereof) in interest rates, and to the planned FX borrower relief measures. For all these reasons, from our point of view, Pekao deserves a premium valuation relative to its peers, most notably the top rival PKO BP.

Reduced dividend payout ratio

The extent of the ST add-on's impact on Pekao's dividend-paying capability is that it brings forward by one year a dividend cut which the Bank was planning to make anyway. The decision by the market regulator KNF to impose an extra buffer on Pekao after the Bank came in the top 3 of stress tests conduced by the EBA was something of a surprise, but on the upside, by cutting distributions early, Pekao will be able to offer higher payout ratios than it was originally planning for in subsequent years. Our current expectations for 2019-2021 DPS are in the range of PLN 6.32 to PLN 8.14.

Consensus due for a raise

Our updated 2019 and 2020 earnings forecasts for Peako stand 5% and 4%, respectively, higher than the corresponding consensus forecasts. This despite a 2.5% cut to interest income estimates after factoring in zero rate hikes. Pekao has potential for substantial cost savings in the years ahead, including through downsizing, reflected in our assumption of C/I ratio drop to 43% in 2021 from 49% in 2018.

A low-risk play deserving of premium valuation

Historically, Pekao has traded at P/E ratios in the vicinity of 15.4x compared to 11.3x today. To expect a return to the old multiples would not be realistic given that the Bank has transformed from a dividend stock to more of a growth play, after a change of ownership. However we do see a narrow premium forming over the average looking at the Bank's safe profile, low exposure to CHF loans, and high dividends.

(PLN m)	2017	2018E	2019E	2020E	2021E
Net interest income	4,593.5	4,997.2	5,559.0	6,051.7	6,523.1
Noninterest income	2,684.6	2,787.8	2,770.1	2,863.0	2,970.2
Total costs	3,534.9	3,715.1	3,728.1	3,842.9	3,967.3
Operating income*	3,743.2	4,070.0	4,601.0	5,071.7	5,526.0
Net income	2,475.1	2,210.8	2,571.0	2,850.1	3,110.3
Costs/Income (%)	49.8	48.9	46.0	44.3	42.9
ROE (%)	10.7	9.5	10.7	11.4	11.7
P/E (x)	11.7	13.1	11.3	10.2	9.3
P/B (x)	1.2	1.2	1.2	1.1	1.1
DPS	8.68	7.90	6.32	7.35	8.14
Dividend yield (%)	7.8	7.1	5.7	6.6	7.4

*before provisioning

Current Price	PLN 110.60
Target Price	PLN 131.80
MCap	PLN 29.03bn
Free Float	PLN 19.51bn
ADTV (3M)	PLN 168.6m

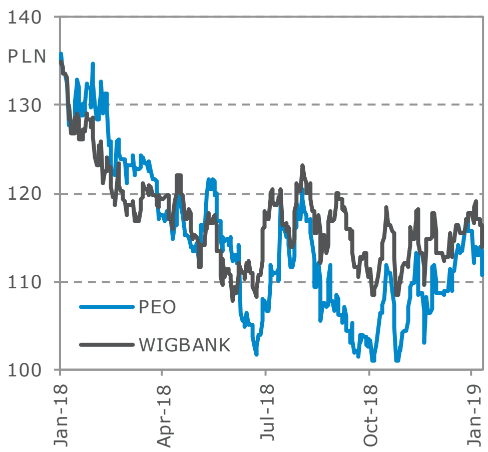
Ownership

PZU	20.00%
PFR	12.80%
UniCredit S.p.A.	6.26%
Others	60.94%

Business Profile

Pekao has the largest portfolios of corporate deposits and loans, the second-largest portfolio of retail deposits, and the third-largest portfolio of retail loans in Poland. The Bank also has the strongest capital base of all listed banks, reflected in a Tier 1 ratio exceeding 17%. Pekao plans to use its capital surplus toward organic growth and acquisitions.

PEO vs. WIG Banks



Name	9MTP new	9MTP old	Rating new	Rating old
Pekao	131.80	136.29	buy	buy

Name	Current Price	Target Price	Upside
Pekao	110.60	131.80	+19.2%

Forecast Update	2018E	2019E	2020E
Total income	0.8%	-0.5%	-1.7%
Pre-tax income	6.7%	-0.1%	-2.2%
Net income	6.0%	-0.1%	-2.8%

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Santander Bank Polska: hold (downgraded)

SPL PW; SPL1.WA | Banks, Poland

Closing In On Record-High Dividends

We downgrade Santander Bank Polska ("Santander") from accumulate to hold, and we lower our target price to PLN 388.00 per share after adjusting cost-of-risk expectations for the next three years to 80bp, resulting in a trimmed 2020 net income estimate, and after taking into account the disappointing fee income generated in 2018. The expected lack of changes in interest rates through mid-2022 in our view will not affect Santander's future interest income. The Bank says it can grow NIM by 30bp this year by reducing financing costs, but we would say a 10bp rise is more realistic. The FX mortgage law is still the biggest source of downside risk to our forecasts; its estimated toll on Santander in the worst-case-scenario might reach PLN 760m in total, which would imply a need to knock PLN 6.19 off our per-share valuation, but not a need to downgrade of our neutral view on the Bank. In the near future the pain of the FX loan issue should be eased by a record-high dividend promised this year, with the regular distribution at 25% of 2018 earnings beefed up by a payout of the whole of undistributed earnings accumulated in prior years, i.e. PLN 1,470m total or PLN 20.21 per share.

Underestimated earnings potential

Our outlook on Santander assumes 5%-7% higher earnings in 2020-2021 than are currently expected by market analysts. This based on more optimistic expectations as to net interest income and an anticipation for a 10bp boost in the net interest margin for 2019 provided by gradual withdrawal from expensive and excessive external financing entered into before the acquisition of Deutsche Bank Polska (DBPL).

Record dividends hinge only on regulator's approval

After being slapped with an unexpected extra capital buffer in the form of the ST add-on, Santander has had to cut the planned 2019 dividend payout ratio from 50% to 25%. On a brighter note, however, the Bank is currently waiting for permission from the financial regulator to also distribute the whole retained earnings, coming in at PLN 1,470m, as dividends this year. After adjusting for the halved payout ratio, our 2019 DPS estimate at PLN 20.24 stands at twice the figure forecast by market consensus.

Impact of the FX bill

The FX bill continues to loom large over Santander, however its potential impact has diminished with each month since the measures were announced as the franc-denominated mortgages get repaid, and it now stands at a worst-case total of PLN 760m, implying 4%, 6%, and 5% cuts, respectively, to the net income consensus forecasts for 2019, 2020, and 2021, and suggesting a need for us to take PLN 6.2 away from the current per-share valuation.

(PLN m)	2017	2018E	2019E	2020E	2021E
Net interest income	5,276.9	5,742.4	6,792.2	7,487.2	8,030.8
Noninterest income	2,486.8	2,606.3	2,864.5	2,929.7	3,019.3
Total costs	3,372.4	3,769.0	4,117.2	4,116.4	4,110.2
Operating income*	4,391.2	4,579.7	5,539.5	6,300.5	6,940.0
Net income	2,213.1	2,365.2	2,648.1	3,155.2	3,556.8
Costs/Income (%)	43.4	45.1	42.6	39.5	37.2
ROE (%)	10.6	10.1	10.3	11.4	11.9
P/E (x)	16.8	15.9	14.4	12.1	10.7
P/B (x)	1.7	1.5	1.4	1.3	1.2
DPS	5.40	3.10	20.24	12.98	15.47
Dividend yield (%)	1.4	0.8	5.4	3.5	4.1

*before provisioning

Current Price	PLN 373.80
Target Price	PLN 388.00
MCap	PLN 38.12bn
Free Float	PLN 12.09bn
ADTV (3M)	PLN 38.0m

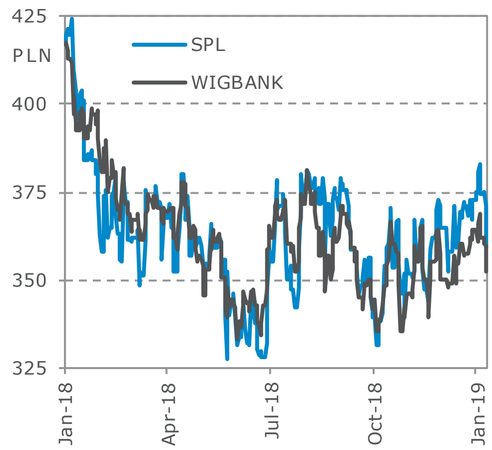
Ownership

Banco Santander S.A.	68.13%
Others	31.87%

Business Profile

Santander is a universal lender with a slight bias toward the corporate sector, though the merger with Santander Consumer Bank raised the share in the loan portfolio of consumer debt. The Bank has a solvency ratio of 15.6%. The main priority of its strategic investor, Banco Santander, is to create value for shareholders by controlling costs and increasing market share to 12%.

SPL vs. WIG Banks



Name	9MTP new	9MTP old	Rating new	Rating old
SPL	388.00	400.00	hold	accumulate

Name	Current Price	Target Price	Upside
SPL	373.80	388.00	+3.5%

Forecast Update	2018E	2019E	2020E
Total income	-1.3%	2.3%	0.2%
Pre-tax income	3.6%	0.2%	-3.3%
Net income	7.9%	1.1%	-2.8%

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ING BSK: hold (downgraded)

ING PW; INGP.WA | Banks, Poland

Profit Expectations Off Base But ROE Reigns Supreme

We downgrade ING BSK from accumulate to hold, with the 9-month price target at PLN 191.80 per share. We have updated our view on the Bank to account for the fact that we no longer expect interest rates in Poland to increase through to the end of 2020, and to adjust for the upcoming acquisition of a 45% stake in the asset manager NN TFI (45%). After also adopting a more conservative outlook on future provisioning, we have reduced our 2019 and 2020 net income forecasts by 1.8% and 3.6%, respectively. We feel the analysts' consensus for 2019 should also shift about 4% lower even after already being cut by 8% over the last 12 months. The forecasts for 2020 look right. Our valuation model for ING indicates that the Bank should be traded at a higher premium to the sector than most of its peers, owing to minimal exposure to CHF loan risk, fast-paced growth, consistent dividends, and one of the region's highest ROE, expected to come in at 12.8% in 2019. Ehen it comes to upside catalysts, however, we see none coming this year either from earnings or from dividends.

2019 earnings potential slightly overestimated

After downward revisions of a total of 8% over the last 12 months, the current consensus expectations for ING BSK's net income in 2019 still look about 4% too high to us given higher-than-forecast cost of risk posted in 2018 (+7bp y/y) and flat NIM growth anticipated in the coming years. With that said, the 12% likely earnings rebound this year, supported by contributions from NN TFI to the tune of PLN 13m before taxes, and a ROE of 13%, though already fully priced in, are nothing to be sniffed at.

Negligible effect of flat rates

We expect ING BSK to post 11% growth in net interest income in 2019, followed by 10% expansion in 2020, driven by projected growth in loan volumes at an annual rate of 13% in 2019 and 11% in 2020. At the same time, the Bank's NIM will probably stay flat in the next three years, meanwhile there is expectation for an 8bp rise in the average industry NIM in 2019. With interest rate hikes no longer expected in 2020, we applied a minor, 1.8% trim to the NII forecast for the year.

No more upside left

ING is trading at high earnings multiples fully justified by superior profitability offered alongside consistent dividends. At 15.5x consensus estimates, the P/E ratio currently shows a discount of just 5% to the average for the last 5 years. The P/B ratio carries a premium over 30% over the historical average. We do not see another re-rating of ING, especially after the expected consensus revisions. A more promising pick among CEE banks with similar profiles is Komercni Banka, offering 10% upside potential.

(PLN m)	2017	2018E	2019E	2020E	2021E
Net interest income	3,452.8	3,743.1	4,139.2	4,570.1	4,980.0
Noninterest income	1,303.1	1,473.3	1,480.8	1,521.2	1,593.1
Total costs	2,122.6	2,336.9	2,429.3	2,524.0	2,613.0
Operating income*	2,633.3	2,879.5	3,190.7	3,567.3	3,960.0
Net income	1,403.1	1,477.6	1,658.2	1,856.4	2,062.4
Costs/Income (%)	44.6	44.8	43.2	41.4	39.8
ROE (%)	12.6	12.2	12.7	13.1	13.3
P/E (x)	17.7	16.9	15.0	13.4	12.1
P/B (x)	2.1	2.0	1.8	1.7	1.5
DPS	0.00	3.20	3.41	3.82	4.28
Dividend yield (%)	0.0	1.7	1.8	2.0	2.2

*before provisioning

Current Price	PLN 191.40
Target Price	PLN 191.80
MCap	PLN 24.90bn
Free Float	PLN 6.22bn
ADTV (3M)	PLN 5.2m

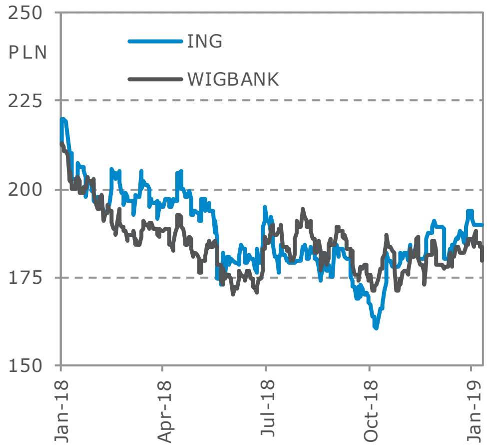
Ownership

ING Bank N.V.	75.00%
Aviva OFE	8.35%
Others	16.65%

Business Profile

ING BSK has a well-diversified sales mix for retail and corporate clients. Its loans/deposits ratio is one of the lowest in the sector at ca. 84%. The Bank invests surplus capital in debt securities, mainly Polish government bonds. Its deposits are mainly retail and its loans are mainly corporate, ,though the share of consumer credit, in particular mortgage loans, is constantly increasing.

ING vs. WIG Banks



Name	9MTP new	9MTP old	Rating new	Rating old
ING BSK	191.80	199.63	hold	accumulate

Name	Current Price	Target Price	Upside
ING BSK	191.40	191.80	+0.2%

Forecast Update	2018E	2019E	2020E
Total income	-0.3%	-0.2%	-1.3%
Pre-tax income	-2.0%	-1.5%	-2.7%
Net income	-2.5%	-1.8%	-3.6%

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Millennium: accumulate (reiterated)

MIL PW; MILP.WA | Banks, Poland

FX Loans Still the No.1 Worry

We maintain a buy rating for Millennium, with the target price clipped to PLN 10.00 per share. The cancellation of the original three -hike 2020 scenario for interest rates has had a negligible effect on our earnings outlook for the year since it had already assumed slow NIM growth after the acquisition of Eurobank. On the upside, by buying the smaller local lender, Millennium made good use of the high capital surplus accumulated under increasingly more stringent dividend restrictions. With that said, the dip into the excess cash stockpile means the Bank will probably not make a distribution to its shareholders for at least three more years. Eurobank is set to boost Millennium's market share in retail lending by an estimated 1.6%, and add 0.9% to the share in total loans. The need to integrate operations at an estimated cost of PLN 200m, while Eurobank's contributions to the consolidated earnings will not start until around mid-year at the earliest, means 2019 will be a challenging year for Millennium in terms of earnings, which are expected to remain flat this year against a 14% rebound forecast for the whole sector. Lastly, when it comes to FX mortgage relief, its passing this year at worst will wipe out the current upside potential offered by MIL, estimated at 13%.

Earnings potential boosted by Eurobank merger

After an initial fall of a projected 12% in 2019 due to high post-merger integration costs, estimated at PLN 200m, while the period of consolidation will be shorter, we predict that Millennium's EPS after the merger with Eurobank will increase 14% in 2020 and 17% in 2021. This compares to Millennium's own guidance, which assumes 15% EPS shrinkage next year followed by a rebound of 23% in 2020 and 26% in 2021. Further, the Eurobank deal prompted us to raise our 2020 ROE forecast from 9.8% to 10.8%, and to assume that the net profit for year will cross the billion-zloty mark. When it comes to the market consensus, the expected 2019 net income estimate, which partly prices the Eurobank merger, looks about 8% too high at the current level.

FX loans still the No.1 worry

Once passed, the measures planned under the FX mortgage relief bill might cost Millennium between PLN 0.4bn and PLN 1.1bn total in future profits, which means the Bank could see between 0.7 and 0.2 zlotys knocked off the value of its shares. The franc-denominated mortgage loans acquired with Eurobank have guarantees under a risk-sharing arrangement with the seller, Societe Generale. The potential FX loan burden is not a concern from a solvency standpoint, however in the worst-case scenario it could diminish Millennium's annual earnings by as much as 25% in 2020E and 18% in 2021E.

(PLN m)	2017	2018E	2019E	2020E	2021E
Net interest income	1,696.5	1,803.9	2,282.3	2,783.0	2,949.7
Noninterest income	953.1	950.0	1,039.4	1,129.7	1,164.7
Total costs	1,280.6	1,337.2	1,803.1	1,893.9	1,886.6
Operating income*	1,368.9	1,416.8	1,518.5	2,018.9	2,227.8
Net income	681.2	732.8	735.3	1,026.2	1,144.2
Costs/Income (%)	48.3	48.6	54.3	48.4	45.9
ROE (%)	9.3	9.1	8.5	10.8	10.7
P/E (x)	15.7	14.6	14.6	10.4	9.4
P/B (x)	1.4	1.3	1.2	1.1	0.9
DPS	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

*before provisioning

Current Price	PLN 8.82
Target Price	PLN 10.00
MCap	PLN 10.70bn
Free Float	PLN 5.34bn
ADTV (3M)	PLN 19.5m

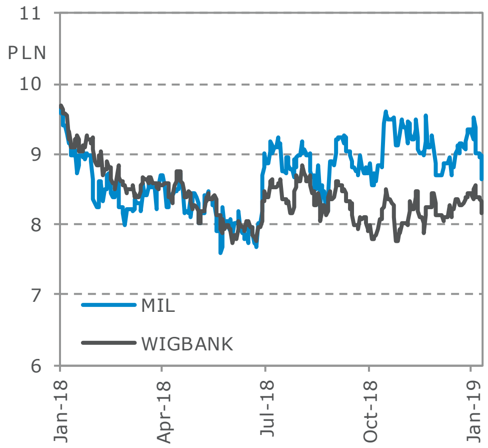
Ownership

Millennium BCP	50.10%
NN OFE	8.66%
Aviva OFE	6.29%
PZU OFE	5.61%
Others	29.34%

Business Profile

Millennium is the seventh-largest bank in Poland with a market share of ca. 4%. Its assets are mostly retail. About 59% of the loan portfolio are mortgages, including about 66% foreign-currency loans.. Due to the high FX exposure relative to regulatory requirements, Millennium is not expected to pay dividends until 2019.

MIL vs. WIG Banks



Symbol	9MTP new	9MTP old	Rating new	Rating old
MIL	10.00	10.10	accumulate	accumulate

Name	Current Price	Target Price	Upside
Millennium	8.82	10.00	+13.4%

Forecast Update	2018E	2019E	2020E
Total income	0%	-1.15%	-0.28%
Pre-tax income	0%	-3.17%	-0.76%
Net income	0%	-0.87%	-0.17%

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Friday, February 01, 2019 | update

Handlowy: reduce (downgraded)

BHW PW; BHW.WA | Banks, Poland

A Compelling Acquisition Target

We downgrade Handlowy from accumulate to reduce, and we lower our price target from PLN 76.00 to PLN 65.50 after accounting for the expected lack of interest rate hikes originally forecast in 2020, which forced us to slash the net profit projection for the year by 10% - the largest cut we have had to make of all rated banks. What makes Handlowy's profits so sensitive to interest rates is its large portfolio of consumer loans, equivalent to 37% of the total loan book. Handlowy used to be traded at a premium to peers which is no longer applicable since the Bank's transformation from a dividend to a growth stock after it came up short of the TCR requirement for a 100% dividend payout in Q3 2018, with the shortfall worsened by the imposition of a hefty stress-test add-on of 4.44pp earlier this year. Handlowy has an ambition to accelerate its expansion in retail banking, but we question that it can given the poor track record so far: since 2007, the Bank has grown its market share in mortgage loans from 0.1% to 0.4%, and at the same time it shrunk its presence in NMLs from 3.5% to 2.0%. A small branch network is also not helpful in furthering the sales ambitions. With all this in mind, we see Handlowy, or at least its retail business, as being put up for sale in the near future.

Slashed NII forecasts

Our 2020 net interest income forecast for Handlowy had to be slashed by 9% after accounting for the lack of interest rate hikes, which is also expected to result in a 6bp fall in NIM while assets grow by a projected 5%. At the same time, we see the 2019 market consensus for Handlowy as underestimated.

Earmarked for sale

The exit of Handlowy' owner, Citigroup, from consumer banking in 11 countries in 2014 did not include Poland, but back then the market conditions here were very different, with no special bank levy in place, and with higher interest rates. Since 2014, Handlowy' ROE has decreased from 13% to an estimated 9.5% in 2018, and ROA is down from 2.0% to 1.5%. At the same time, the Polish banking industry is in a consolidation phase through M&A deals as well as organic expansion of large players who are edging out smaller rivals. Handlowy, to date viewed as catering mostly to the affluent segment, is already taking steps to defend market share by creating a more universal appeal, but its reputation as a bank for the well-to-do might be hard to overcome. Meanwhile an attractive client base and quality assets make Handlowy a perfect acquisition target.

Current Price	PLN 69.10
Target Price	PLN 65.50
MCap	PLN 9.03bn
Free Float	PLN 2.26bn
ADTV (3M)	PLN 4.8m

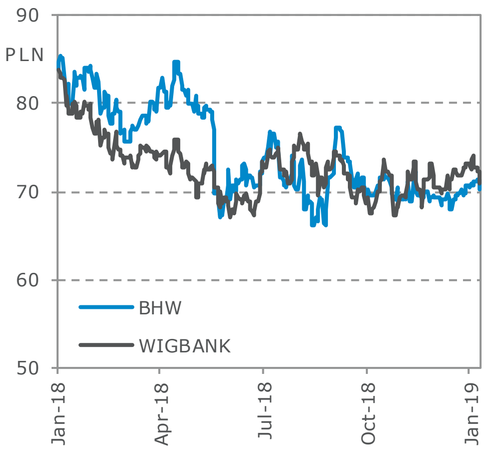
Ownership

Citibank Overseas Investment Corporation	75.00%
Others	25.00%

Business Profile

Handlowy's main customer target are large international corporate clients, reflected in the portfolios of deposits and loans. In retail the Bank focuses on card products and HNW banking.Handlowy has one of the strongest capital bases of all listed banks reflected in a CET ratio of 17.3%. In addition, it has a low ratio of loans to deposits at 55.91% as of September 2017.

BHW vs. WIG-Banks



Name	9MTP new	9MTP old	Rating new	Rating old
Handlowy	65.50	76.00	reduce	accumulate

Name	Current Price	Target Price	Downside
Handlowy	69.10	65.50	-5.2%

Forecast Update	2018P	2019P	2020P
Total income	0.4%	0.5%	-4.4%
Pre-tax income	1.3%	1.6%	-9.3%
Net income	1.6%	1.9%	-10.4%

(PLN m)	2017	2018E	2019E	2020E	2021E
Net interest income	1,082.1	1,118.4	1,187.8	1,220.6	1,283.0
Noninterest income	1,028.8	1,103.8	1,139.8	1,173.1	1,207.6
Total costs	1,223.3	1,211.2	1,245.9	1,277.5	1,305.0
Operating income*	887.7	1,010.9	1,081.7	1,116.2	1,185.5
Net income	535.6	661.7	705.3	712.1	760.9
Costs/Income (%)	57.9	54.5	53.5	53.4	52.4
ROE (%)	7.8	9.5	9.8	9.7	10.0
P/E (x)	16.9	13.6	12.8	12.7	11.9
P/B (x)	1.3	1.3	1.2	1.2	1.2
DPS	4.53	4.11	3.80	4.05	4.09
Dividend yield (%)	6.6	5.9	5.5	5.9	5.9

*before provisioning

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Friday, February 01, 2019 | update

Alior Bank: buy (reiterated)

ALR PW; ALR.WA | Banks, Poland

New Chapter Under New Leadership

We maintain a buy rating for Alior Bank, with the 9-month price target trimmed to PLN 87.00 per share after a downward revision to our earnings estimates to reflect the expected lack of interest rate hikes through 2020. At the updated levels, our forecasts still sit 9%-12% higher than the consensus forecasts. The estimate for 2019 might look overly ambitious at first glance at PLN 986m, but relative to the 2018 target of PLN 873m before one-offs it is no longer as much of a stretch. Alior may incur a setback as high as PLN 50m this year depending on the outcomes of the ongoing misselling probe by the financial regulator. From the market's standpoint, an equally crucial catalyst aside from increasing profits is the stability restored in Alior's top management ranks after several reshuffles over the past year. Alior's owner, PZU, seems to have given a nod to the new Board by sending sent its CFO, who also serves as the Bank's Supervisory Board Chair, to sit in at a recent conference call. In our eyes ALR remains grossly undervalued relative to its bullish prospects.

Unrivaled growth

We have cut our 2020 net income forecast for Alior by 6% to reflect the expected lack of rate hikes, and we made a 3% adjustment to the 2019 forecast for the potential misselling fine. Our updated outlook assumes growth in lending volumes by PLN 5bn in 2019 and PLN 4.6bn in 2020, and predicts stable cost of risk of 1.6%-1.7% over the next 3-year period. Even at the downgraded levels, the new earnings estimates indicate 2017-2020 earnings CAGR of 23% - other banks can only dream of that kind of growth.

New Board looks set to stay

We hope Alior has no more management board reshuffles lined up for the near future. After receiving a nod from PZU, and after reportedly signing off on statutory executive pay caps, the current board members look settled in their positions, and are not likely to move anywhere unless the KNF has objections or PZU itself undergoes some kind of major reshuffle.

Attractively priced

At 7.5x 209E P/E and 0.9x P/B, ALR is trading at respective discounts of 42% and 34% to the market averages. The Bank should have a hefty discount to its peers given its relatively weak capital position, but at the current level the gap is much too steep looking, among others, at ROE, which remains among the highest in the sector. It is also worth noting that, as the cheapest WIG20 company with state ownership, Alior is among the potential major beneficiaries of Poland's new pension savings scheme.

(PLN m)	2017	2018E	2019E	2020E	2021E
Net interest income	2,841.1	3,086.9	3,416.5	3,654.1	3,872.8
Noninterest income	956.0	1,025.6	1,052.9	1,076.5	1,100.0
Total costs	1,930.3	1,836.1	1,895.0	1,903.0	1,940.1
Operating income*	1,866.8	2,276.4	2,574.4	2,827.7	3,032.7
Net income	515.2	709.3	985.9	1,112.8	1,207.3
Costs/Income (%)	50.8	44.6	42.4	40.2	39.0
ROE (%)	8.0	10.0	12.4	12.3	11.8
P/E (x)	14.4	10.5	7.5	6.7	6.2
P/B (x)	1.1	1.0	0.9	0.8	0.7
DPS	0.00	0.00	0.00	0.00	0.00
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

*before provisioning

Current Price	PLN 57.50
Target Price	PLN 87.00
MCap	PLN 7.43bn
Free Float	PLN 5.26bn
ADTV (3M)	PLN 39.4m

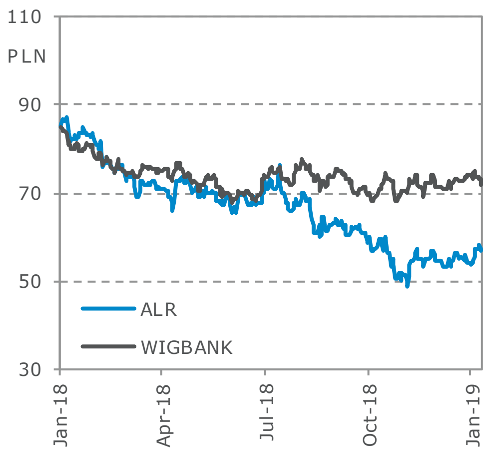
Ownership

PZU SA. PZU SFIO UNIVERSUM	31.91%
Aviva OFE	7.26%
NN OFE	7.15%
BlackRock Inc.	5.28%
Others	48.40%

Business Profile

Alior Bank is the fastest-growing bank in Poland achieving asset growth at an average annual rate of 24% in the last three years. Alongside organic growth, the Bank is aiming to build its presence through acquisitions (Meritum Bank, Bank BPH). Thanks to a high, 39% share of consumer loans in its portfolio, Alior continued to generate high net interest margins of >4%. On the other hand, through a high share of high-risk loans, it incurs very high costs of risk (195bps at year-end 2016). We expect Alior to maintain the strong growth momentum in the years ahead.

ALR vs. WIG Banks



Name	9MTP new	9MTP old	Rating new	Rating old
Alior Bank	87.00	92.50	buy	buy

Name	Current Price	Target Price	Upside
Alior Bank	57.50	87.00	+51.3%

Forecast Update	2018P	2019P	2020P
Total income	0.31%	0.08%	-2.14%
Pre-tax income	-4.70%	0.44%	-2.66%
Net income	-7.60%	-2.50%	-6.13%

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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

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%
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%
Recommendations are updated at least once every nine months.

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The production of this recommendation was completed on February 1, 2019, 8:48 AM.
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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.

mBank issued the following recommendations for Alior Bank in the 12 months prior to this publication:

recommendation	buy	buy	buy
date issued	2018-12-05	2018-10-04	2018-02-01
target price (PLN)	92.50	96.00	109.00
price on issue date	56.65	62.90	85.50

mBank issued the following recommendations for Bank Handlowy in the 12 months prior to this publication:

recommendation	accumulate	buy	buy	accumulate
date issued	2018-12-05	2018-10-04	2018-04-06	2018-02-01
target price (PLN)	76.00	90.00	94.00	94.00
price on issue date	71.10	76.90	77.50	84.70

mBank issued the following recommendations for Bank Millennium in the 12 months prior to this publication:

recommendation	accumulate	hold	reduce	sell	reduce	sell
date issued	2018-11-14	2018-11-05	2018-10-04	2018-08-02	2018-04-06	2018-02-01
target price (PLN)	10.10	8.40	8.40	7.00	7.00	7.00
price on issue date	9.49	8.85	9.27	9.12	8.35	9.59

mBank issued the following recommendations for Bank Pekao in the 12 months prior to this publication:

recommendation	buy	buy	buy
date issued	2018-12-05	2018-10-04	2018-02-01
target price (PLN)	136.29	138.70	157.00
price on issue date	113.25	107.20	135.90

mBank issued the following recommendations for Bank Millennium in the 12 months prior to this publication:

recommendation	accumulate	buy	accumulate	hold	reduce	sell
date issued	2018-12-05	2018-11-05	2018-10-04	2018-04-06	2018-03-05	2018-02-01
target price (PLN)	45.00	47.00	47.00	38.00	38.00	38.00
price on issue date	41.96	40.39	42.55	39.74	42.20	45.66

mBank issued the following recommendations for ING BSK in the 12 months prior to this publication:

recommendation	accumulate	buy	accumulate	accumulate	buy	accumulate	hold
date issued	2018-12-05	2018-11-05	2018-10-04	2018-08-02	2018-07-04	2018-03-05	2018-02-01
target price (PLN)	199.63	200.00	200.00	212.00	212.00	212.00	212.00
price on issue date	183.60	166.00	181.00	190.00	178.40	198.00	220.00

mBank issued the following recommendations for Santander Bank Polska in the 12 months prior to this publication:

recommendation	accumulate	buy	accumulate	accumulate	buy	hold
date issued	2018-12-05	2018-11-05	2018-10-04	2018-09-03	2018-03-05	2018-02-01
target price (PLN)	400.00	400.00	400.00	430.00	430.00	430.00
price on issue date	364.80	353.80	367.00	376.00	357.80	420.00

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