

Thursday, May 30, 2019 | update

Pekao: buy (reiterated)

PEO PW; PEO.WA | Banks, Poland

It's just getting started

We are lowering our target price to PLN 121.00 per share, but we leave the buy rating unchanged. The price of Bank Pekao shares has decreased by 5.6% vs. the decline of WSE Banks by 1.9%. Pekao's discount partly results from the expected correction of the consensus caused by over double increase of the BFG fee, and partly from rumors indicating the possibility of Pekao's takeover of Idea Bank. In fact, the increase in the BFG contribution and the reserve for collective redundancies, in our opinion, will result in a 4% decrease in consensus for 2019 and 3% & 6% for 2020-21. Nevertheless, it should be emphasized that the BFG contribution should decrease next year due to the change in the structure of deposits, and collective redundancies will cause a significant decrease in the C/I ratio, which will result in a 14% increase in net profit. In addition, Bank Pekao, likewise Bank Handlowy, is still to payout a good dividend in the amount of PLN 6.60 per share (DY >6%), which date was set for July 10th. On the 2020/21 P/E index, Bank Pekao is listed at 7% % 5% discount to the average and with 4% & 5% discount to PKO BP. Taking into account the upcoming dividend, good outlook for results, post-election stabilization, low probability of acquiring banks in trouble and an attractive valuation, we believe it is a very good moment to invest in Pekao.

The results and the dividend will rebound

We expect Bank Pekao's net income in 2019 to remain flat (4% below consensus), and to grow in 2020 by as much as 14% (3% below consensus). The 2020 results will be supported by falling operating costs (collective redundancies) and further dynamic growth of net loans (+ 9% y/y). The flat dynamics of results in 2019 will result in flat DPS (PLN 6.52 per share), which will then rise with the results up to PLN 7.46 per share (7.2% of DY). At the same time, we note that the bank is still ahead of the dividend payment (PLN 6.60 per share, the third-highest DYield in the sector) for 2018, and the dividend day is set for July 10th, 2019.

Idea acquisition not as bad as it looks

Despite numerous denials of the Management Board, Bank Pekao is invariably associated with acquisitions of banks of Leszek Czarnecki Group. We believe that the probability of such scenario is low, and the scenario of forced restructuring is much more likely (more: <https://tinyurl.com/y44przi8>). Nevertheless, if we were to consider such scenario, the conclusions could be surprising. By replacing the financing cost at Idea for Pekao in 2018, the estimated interest result would increase by PLN 318 million, and Idea would generate a net profit of PLN 100 million (excl. one-off). What's interesting, 93% of Idea deposits expire up to 6 months, which makes restructuring easier. Additionally, the acquisition of Idea Bank's TREA does not result in the loss of the dividend payment capacity @75%. We believe that, as in the case of SKOKs, the acquiring entity could count on BFG's financial support.

(PLN m)	2017	2018	2019E	2020E	2021E
Net interest income	4,593.5	4,994.0	5,493.0	5,880.6	6,270.9
Non-interest income	2,684.6	2,836.2	2,844.0	2,926.0	3,011.9
Total costs	3,534.9	3,709.8	4,093.5	3,971.1	4,088.7
Operating income*	3,743.2	4,120.4	4,243.4	4,835.5	5,194.1
Net income	2,475.1	2,287.2	2,282.3	2,609.2	2,771.5
Costs/Income (%)	49.8	48.3	49.9	46.0	44.9
ROE (%)	10.7	9.9	9.9	10.9	11.2
P/E (x)	11.0	11.9	11.9	10.4	9.8
P/B (x)	1.2	1.2	1.2	1.1	1.1
DPS	8.68	7.90	6.60	6.52	7.46
Dividend yield (%)	8.4	7.6	6.4	6.3	7.2

*before provisioning

Current Price	PLN 103.75
Target Price	PLN 121.00
Market Cap	PLN 27.23bn
Free Float	PLN 18.30bn
ADTV (3M)	PLN 133.93m

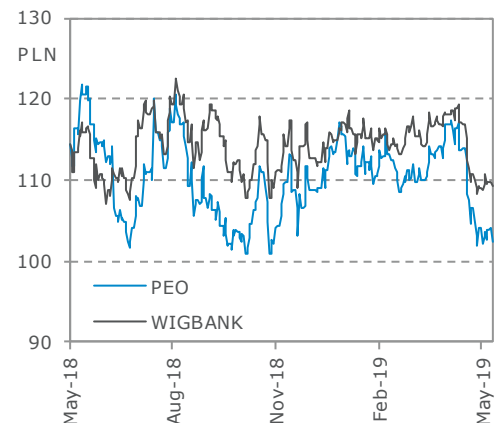
Ownership

PZU S.A.	20.00%
PFR S.A.	12.80%
UniCredit S.p.A	6.26%
Others	67.20%

Business Profile

Pekao has the second largest portfolios of corporate deposits and loans and the third-largest portfolio of retail loans in Poland. The Bank also has a strong capital base which will allow it to offer 75% dividend payout in the next two years, one of the highest on the market. Going forward Pekao plans to accelerate organic growth.

PEO vs. WIG-Banks



Company	Target Price		Rating	
	new	old	new	old
Pekao	121.00	131.80	buy	buy

Company	Current Price	Target Price	Upside/Downside
Pekao	103.75	121.00	+16.6%

Forecast revision since last update	2019E	2020E	2021E
Total income	+0.1%	-1.2%	-2.2%
Pre-tax income	-6.1%	-4.6%	-6.6%
Net income	-11.2%	-8.5%	-10.9%

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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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BUY – we expect that the rate of return from an investment will be at least 15%
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HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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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.

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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 investment recommendations for Company in the 12 months prior to this publication

Rating	buy	buy	buy
Rating date	2019-02-01	2018-12-05	2018-10-04
Target price (PLN)	131.80	136.29	138.70
Price on rating day	110.60	113.25	107.20

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