mBank Dom Maklerski

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PKO BP – Strategy Update for 2020-2022

Rating: buy | target price: 47.17 PLN | current price: 38.30 PLN

PKO PW; PKO.WA | Banks, Poland

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Top Highlights:

- PKO is eyeing flat earnings growth in 2020 in the wake of the CJEU rulings on Polish FX mortgages and early loan repayment fees, coupled with the implementation of MREL. Next year's growth will also be curbed by a high 2019 comparable base, boosted by a number of one-time gains. After an acceleration in 2021-22, net income in 2022 is set to top PLN 5bn. Our own forecasts for PKO assume net income of PLN 4.78bn in 2020 and PLN 4.94bn in 2021.
- The pursuit of financial sector consolidation in Poland entails a high risk of failure given limited room for synergy and considering corporate governance.
- NIM is set for long-term contraction. On the one hand, there is potential to reduce financing costs, but on the other hand the expected cost reimbursement to early loan payers, combined with a need to issue MREL bonds, and downward pressure on credit pricing, in the end will produce a negative effect.
- PKO will have to issue PLN 20bn MREL bonds assuming a requirement of about 30% RWA (the current official requirement is 23%, but PKO assumes it will be raised to 25%). MREL is a challenge for the financial sector and its regulators.
- PKO expects a gradual rise in cost of risk in both the retail and the corporate segment, but emphasizes that it will put in place advanced risk assessment tools to keep CoR well below the market averages. In case of retail, the rise in CoR will go hand in hand with the planned customer base expansion, and in case of corporate loans it will be driven by the deteriorating financial standing of business clients. We assume CoR will reach 75 bps in 2021 after a gradual rise.
- Despite slower economic expansion (with 2020-22E GDP CAGR at 3.6%), PKO expects average household income in Poland to increase at an annual rate of 6.7% in the 2020-2022 period (vs. 5.7% CAGR in 2016-19), indicating sustained consumer strength. The Bank wants to capitalize on this with consumer lending beyond the forecast average growth of 7.3%.
- PKO's updated strategy plan does not offer a quick solution to the FX mortgage issue.
- **PKO's strategic targets are consistent with our current outlook for the Bank. A 2020 CoR range of 60-75bps, which we consider the main downside risk, is an ambitious but not impossible challenge.**

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

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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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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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.

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