Thursday, January 23, 2020 | special comment

Banks – Forecast of 2019 Q4 Results

Banks, Poland

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Our expectation as the Polish financial sector prepares to kick of the fourth-quarter reporting season next week is that earnings will fall on a comparable basis, with the reported figures weighed down by large one-time write-offs associated with CHF loan risk. We predict that the sector's combined net income will show a 21% drop from the same quarter a year earlier and 18% contraction from the quarter before (with the respective declines on a recurring comparable basis estimated at 6% and 12%). If this is correct, this would imply a need for analysts to revise their current consensus for FY2019 as much as 19% lower. At the same time, we do not expect much negative impact of the earnings announcements on bank stock prices since most of the write-offs should be priced in at this point following pre-reporting profit warnings from the sector.

What analysts might have not fully accounted for are additional charges related to consumer loan fee refunds upon early repayment that are set to drag on interest income and margins. Similarly, current cost-of -risk forecasts probably do not fully adjust for Poland's decelerating economic growth.

Against this backdrop, we see Millennium as one of the worst fourth-quarter underperformers potentially facing more charges in 2020 due to its liberal provisioning policy. At PKO BP, we anticipate massive write-offs greater than PLN 0.5bn for FY2019, demonstrating that the Bank is no longer the safe haven it was once thought to be in the face of potential FX loan related lawsuits.

Summing up, the Polish financial sector might be seen to pull back slightly on fourth-quarter earnings while analysts adjust their future expectations to reflect weaker-than-expected FY2019 performance. For alternatives, we would look toward Czech institutions like Moneta and Komercni, and consider Erste Group in Austria.

Summary of 2019 Q4 earnings estimates by rated bank

(PLN m)	mBank	Q/Q	Y/Y	consensus*	differ.
PKO BP	789	-36%	-22%	1,145	-31%
Pekao	672	2%	-10%	755	-11%
Santander	464	-26%	-40%	678	-32%
ING	455	10%	1%	481	-5%
Millennium	78	-61%	-63%	188	-58%
Handlowy	161	42%	6%	184	-12%
Alior Bank	151	21%	-17%	191	-21%

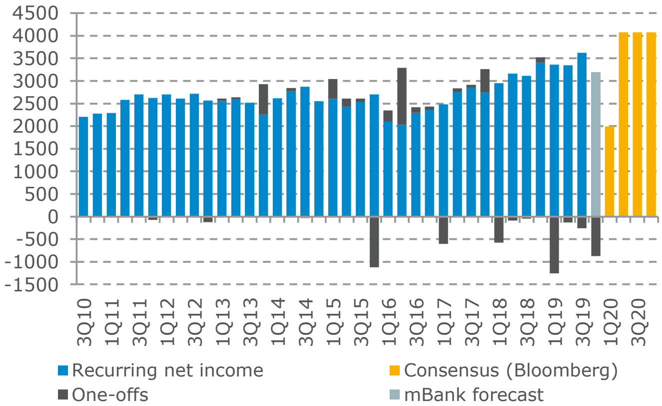
Source: mBank, Bloomberg, *Estimate implied by full-year market consensus

Bank earnings calendar

	Prelim. Results	Final results
Santander	2020-01-29	2020-02-20
Millennium	2020-02-03	2020-02-14
mBank	2020-02-06	2020-02-28
ING	2020-02-06	2020-03-06
Handlowy	2020-02-13	2020-03-26
PKO BP		2020-02-12
Pekao		2020-02-27
Alior Bank		2020-02-28
BNP Paribas		2020-03-03
BOŚ		2020-03-17

Source: Banks

Quarterly aggregate earnings of Polish banks - historical figures and estimates through Q3 2020 (PLN m)



Source: Banks, mBank, Bloomberg

No Clear Winner This Earnings Season

The write-offs taken by banks in Q4 2019 hurt bottom lines as well as, in some cases, the 2020 dividend prospects. After booking first-ever provisions for loan fee refunds to early payers, net interest income in the sector most likely fell 1% from the previous quarter even as loan portfolios continued to expand. There are banks where one-time charges were not as huge in Q4, such as ING BSK, Bank Handlowy, Pekao, and Alior, but overall the fourth-quarter and FY2019 results are set to miss expectations and most likely prompt downward revisions to the forecasts for FY2020.

When it comes to the biggest potential letdowns, it is worth pointing out that Millennium uses a more liberal approach to CHF loan risk management than most of its competition (with provisions equivalent to 1% of NPLs vs. 2% at SPL and 2.5% at ING), as well as being the only lender who uses effective interest rates rather than stated rates to calculate loan fee refunds.

At PKO BP, the recurring fourth-quarter profit will be solid, but the huge write-offs that will accompany it will bring to light the true scale of the CHF-related risk.

Lower DPS

We have adjusted our dividend expectations for rated banks based on expected 2019 Q4 earnings, reducing the DPS forecasts for PKO, PEO, and SPL, and raising them for ING and BHW. At PKO BP and Santander, a weak fourth quarter means 2020 DPS cuts by 5% and 6%, respectively.

Nevertheless some banks are still able to offer attractive dividend yields at the current share price levels; for example, the 2020E dividend yield of PKO BP is currently 8.5%, Handlowy can offer 7.3%, and Pekao can deliver 6.1%. ING and Santander both have dividend yields below 2%. For PKO, a high dividend yield is the single biggest potential value driver as its earnings momentum slows.

Minimum capital requirements for dividend distributions by banks

	Min. Req. to offer 75% Payout Ratio		Min. Req. to offer 100% Payout ratio		Actual Ratios as of 30 Sep.'19		
	Tier 1	TCR	Tier 1	TCR	Tier 1	TCR	DPS*
PKO BP	14.3%	16.4%	14.4%	16.5%	16.7%	18.0%	2.98
Pekao	13.8%	15.8%	16.0%	18.0%	15.5%	17.2%	6.15
Santander	13.8%	15.8%	15.0%	17.0%	14.3%	16.1%	5.01
ING	13.5%	15.5%	13.5%	15.5%	14.2%	15.5%	3.84
Millennium	16.7%	19.9%	20.1%	23.3%	17.1%	20.2%	0.00
Handlowy	13.3%	15.3%	14.6%	16.6%	16.3%	16.3%	3.93
Alior Bank	13.0%	15.0%	14.5%	16.5%	13.4%	16.2%	0.00

Source: Banks, mBank, *implied by fourth-quarter estimates

Consequences of Early Loan Refund Rules

The fourth quarter of 2019 was the first full quarter of banks expensing refunds owed to early loan payers against net interest income, with negative effects on interest margins. Nevertheless these refunds do not seem to be fully accounted for yet in analysts' expectations for FY2020.

Based on warnings filed to date, the refunds can be expected to have the biggest impact on core net earnings at Santander, PKO BP, and Alior. At Millennium, the use of the effective rate method to calculate the reimbursable fees in the long run might prove problematic (note that Millennium increased its consumer loan book by acquiring Eurobank). Interestingly, Handlowy is the only rated bank to not have yet set aside any extra reserves for refund risk – in fact, the bank has not even issued a comment on the matter as of this writing. With that said, looking at its small consumer loan book, we can probably assume the refunds risk in case of Handlowy is less severe than for others; some banks might have to continue to increase the reserves dedicated to this purpose during 2020.

Estimated impact of early loan refunds on annual net interest income of Polish banks

(PLN m)	expected impact on annual net interest income (PLN m)	Provisioning made to date (PLN m)
PKO BP	320	68.5
Pekao	123	29.5
Santander	404	83
ING	30	17
Millennium	84	53
Handlowy	0	0
Alior Bank	316	57

Source: Banks, mBank

Alior Bank

- Alior will report its fourth-quarter results on February 28th, 2020.
- We expect net income to come in at PLN 150.7m after rising 21% from the third quarter and falling 17% on the year, an estimate 21% below the Q4 market consensus implied by the average of the full-year forecasts tracked by Bloomberg.
- The difference is because the consensus estimate does not fully account for the effect of loan fee refunds (PLN 80m per quarter).
- Despite additional refund costs, Alior should be able to curb the fall in 2019 Q4 net interest income to about 3% on a q/q basis with organic growth.
- Operating expenses will most likely rise above PLN 400m even after a 1% decline relative to a year earlier.
- We expect a 3% q/q reduction to PLN 316m in risk reserves, with cost of risk coming in at 200bp.
- Our 2019 Q4 outlook for Alior is consistent with the Bank's own guidance on recurring results. We believe Alior is capable of fulfilling the FY2020 expectations of analysts even at their current challenging levels.

2019 Q4 forecast for Alior Bank

(PLN)	4Q'19E	3Q'19	Q/Q	Y/Y
Net interest income	775.3	802.3	-3%	-3%
Fee income	170.1	172.5	-1%	48%
Total income	1004.6	1033.5	-3%	-6%
Operating expenses	-403.2	-372.0	8%	-1%
Provisioning	-315.9	-324.8	-3%	5%
Net income	150.7	124.5	21%	-17%

Source: mBank

Santander Bank Polska

- Santander Bank Polska will report its fourth-quarter results on January 29th, 2020.
- We anticipate a quarterly net income of PLN 464m after a 26% fall from the previous quarter and a 40% slump from the year before.
- Note that, compared to the median market forecast, our FY2019 full-year net income estimate for Santander BP is 9% lower, probably because it takes into account one-time charges not envisioned by other analysts.
- Santander BP warned that it would recognize additional charges in Q4, including a PLN 173m provision for legal risk associated with the CHF loan portfolio, and a PLN 184m provision for refunds of borrowing costs to consumers paying off their loans early. The total amount of the charges is estimated at PLN 357m, of which PLN 101m carried through net interest income and the balance recognized as other operating costs.
- On an adjusted basis, the 2019 fourth-quarter net income is likely to show a rebound of 23% from the comparable year-ago base at roughly PLN 752m.
- Net interest income at PLN 1,671m is set to show a 1.8% decline from the previous quarter, accompanied by a 12bp fall in NIM to 3.20, alongside an 8.9% increase from the year before. The expected quarterly decline in NII was led by early loan refunds in the amount of PLN 101m.
- Fee income in Q4 might post a small, 1.2% decline from Q3 due to lower loan fees.
- We anticipate a slower, 4.8% y/y growth to PLN 961m in operating costs. Keep in mind that Santander began carrying DB on its consolidated financial statements in November 2018.

- We anticipate risk reserves of PLN 277.5m as of 31 December 2019, implying quarterly cost of risk of 74bp (over average loans) and FY cost of risk of 84bp, consistent with guidance.
- Based on FY2019 estimates, we see the current FY2020 market consensus as overestimated by about 9% depending on the pace of organic growth and cost synergy on the one hand, and on whether Santander will be forced to increase CHF risk provisions during 2020 on the other hand. With that said, Santander is set to deliver one of its highest quarterly profits in history in Q4 2019.

Earnings Call details:
Date & Time: 29 January, 11:00 a.m. CET
Place: Al. Jana Pawła II 17, 5th floor.
Phone: +48 22 100 14 91
PIN: 9514

2019 Q4 forecast for Santander Bank Polska

(PLN)	4Q'19E	3Q'19	Q/Q	Y/Y
Net interest income	1670.7	1701.0	-2%	9%
Fee income	537.5	544.0	-1%	8%
Total income	2375.1	2453.6	-3%	12%
Operating expenses	-961.1	-946.8	2%	5%
Provisioning	-277.5	-336.6	-18%	-34%
Net income	463.6	625.7	-26%	-40%

Source: mBank

Bank Handlowy

- Handlowy will report its fourth-quarter results on February 13th, 2020.
- At PLN 161.1m, we expect net income to rebound 42% over the previous quarter and rise 6% from the same quarter the year before.
- Compared to the consensus estimate implied by 2019 FY analysts' forecasts, our fourth-quarter estimate stands 12% lower because it factors in the write-offs recognized in Q3, not incorporated into the consensus.
- Net interest income will most likely rise 3.6% year over year, but edge 0.8% lower relative to Q3, due probably to a seasonal deposit boost.
- Operating costs in Q4 2019 will show a quarterly increase of 1.6% and an annual rise of 1%.
- Cost of risk should decrease to 69bp after two quarters spent above the usual average, with the corporate loan CoR at 62bp and the consumer loan CoR at 80bp.
- Summing up, Handlowy's 2019 Q4 results will probably miss the expectations of analysts, but with strong bottom-line growth and few major one-time charges the announcement should meet with the market's approval.

2019 Q4 forecast for Bank Handlowy

(PLN)	4Q'19E	3Q'19	Q/Q	Y/Y
Net interest income	1134.7	1120.0	1.3%	14.0%
Fee income	347.0	340.4	1.9%	4.9%
Total income	1503.6	1469.3	2.3%	10.6%
Operating expenses	-590.2	-604.4	-2.4%	4.2%
Provisioning	-186.5	-180.2	3.5%	89.4%
Net income	455.6	414.8	9.8%	0.7%

Source: mBank

ING BSK

- ING BSK is scheduled to report 2019 Q4 results on February 6th, 2020.
- We expect net income to come in at PLN 455.6m after rising 10% from the previous quarter and increasing 1% year-over-year, an estimate which sits 6% below the average of analysts' expectations implied by the FY2019 consensus.
- We are anticipating slight contraction in NIM and other income due to charges related to early loan refunds and CHF loan risks (PLN 5m).
- On the other hand, operating costs and fee income will have improved over the previous quarter.

2019 Q4 forecast for ING BSK

(PLN)	4Q'19E	3Q'19	Q/Q	Y/Y
Net interest income	289.2	291.6	-1%	4%
Fee income	139.1	141.7	-2%	3%
Total income	555.1	552.7	0%	8%
Operating expenses	-280.5	-276.1	2%	1%
Provisioning	-36.7	-91.2	-60%	212%
Net income	161.1	113.7	42%	6%

Source: mBank

Bank Millennium

- Millennium will release preliminary fourth-quarter results on February 3rd, 2020.
- We anticipate quarterly net income at PLN 78m after a 61% fall from Q3 and a 63% drop from the year before.
- Compared to the consensus estimate implied by 2019 FY analysts' forecasts, our fourth-quarter estimate stands 58% lower, we are guessing because it factors in write-offs booked in the period, not yet incorporated into the consensus.
- Millennium took a PLN 150m charge related to CHF loan cases in Q4, most likely expensed as other costs.
- Net interest income in Q4 might show a 1% q/q rise and a 42% y/y rebound at a projected PLN 692m. The slow quarterly expansion can be blamed on loan refunds, and the fast-paced annual growth is owed to the Eurobank acquisition.
- As a result, fourth-quarter NIM is set to shrink by 7bp to 2.80%.
- We anticipate a 15% fall in noninterest income relative to Q3 2019, when Millennium recognized a big one-time gain. Fee income will have rebounded by 2% q/q and 12% y/y.
- Operating expenses at PLN 502m will be 4.5% higher than in Q3 and 57% higher than in Q4 2018, driven by expenses related to the acquisition of Eurobank (ca. PLN 60m).
- Risk reserves are estimated to have dropped by 20% q/q in Q4 to a projected PLN 107.4m, resulting in cost of risk (to average gross loans) at 60bp.
- MIL stock might pull back slightly on the fourth-quarter announcement, which will probably expose the current FY2020 consensus as overestimated at ca. PLN 918m, with additional downside risk generated by Millennium's effective-rate approach to calculating early loan fee refunds.

2019 Q4 forecast for Bank Millennium

(PLN)	4Q'19E	3Q'19	Q/Q	Y/Y
Net interest income	691.9	687.6	1%	42%
Fee income	181.7	178.3	2%	12%
Total income	964.2	1008.3	4%	32%
Operating expenses	-501.7	-480.1	5%	57%
Provisioning	-107.4	-133.8	-20%	84%
Net income	78.0	200.1	-61%	-63%

Source: mBank

Bank Pekao

- Pekao will report its fourth-quarter results on February 27th, 2020.
- We expect net income to come in at PLN 671.9m after rising 2% q/q and falling 10% y/y.
- Compared to the consensus estimate implied by 2019 FY analysts' forecasts tracked by Bloomberg, our estimate stands 11% lower.
- One-time events influencing the fourth-quarter bottom line will have included profit from an NPL sale on the positive side, and additional CHF risk reserves on the negative side, with the net effect coming in at a negative PLN 20m.
- In terms of core business, we expect to see net interest income growth at a quarterly rate of 0.8% and an annual rate of 8.4%, and we anticipate 4bp lower quarterly NIM of 2.76% (over average assets). The flat NII is due to loan fee refunds, which totaled PLN 100m net for the full FY2019.
- Operating costs in Q4 should be kept in check at an estimated PLN 882m thanks to earlier job cuts.
- Risk reserves will have an ending balance of ca. PLN 181m, and cost of risk will be 50pp.
- Investors might feel disappointed by Pekao's fourth-quarter performance given lower one-time charges than suffered by most competition, nevertheless the current earnings consensus for FY2020 looks feasible and is not in need of downward adjustments.

2019 Q4 forecast for Bank Pekao

(PLN)	4Q'19E	3Q'19	Q/Q	Y/Y
Net interest income	1402.9	1391.4	1%	8%
Fee income	647.3	642.8	1%	1%
Total income	2225.1	2062.5	8%	6%
Operating expenses	-882.3	-883.3	0%	0%
Provisioning	-180.9	-176.5	2%	72%
Net income	671.9	656.2	2%	-10%

Source: mBank

PKO BP

- PKO BP will report its fourth-quarter results on February 12th, 2020.
- We expect net income to come in at PLN 789.4m after falling 36% from the third quarter and 22% on the year.
- Compared to the consensus estimate implied by 2019 FY analysts' forecasts tracked by Bloomberg, our estimate stands 31% lower because it takes into account the PLN 503m of write-offs for CHF loan risk and fee refunds recognized in Q4.
- The additional refund charges were responsible for an expected 1% decline vs. Q3 in the fourth-quarter net interest income, with NIM down by 11bp.
- At the same time, payroll (specifically annual bonuses) was the main driver behind the bulk of the expected 7.0% seasonal surge in operating expenses.
- We expect to see flat provisioning in Q4 (not counting the new CHF reserves), resulting in cost of risk at 50bp – with the CHF provisions added in, CoR will be more than twice as high at 113bp.
- The effective tax rate for Q4 will be seasonally high at 26%.
- Investors will most likely feel disappointed by PKO's fourth -quarter announcement, in particular the expected huge write-offs which will serve as a reminder of the bank's massive exposure to CHF loan risk. With that said, we believe PKO is capable of fulfilling the high expectations of analysts for FY2020, when the annual net income is forecast to come in at PLN 4.6bn.

2019 Q4 forecast for PKO BP

(PLN)	4Q'19E	3Q'19	Q/Q	Y/Y
Net interest income	2641.8	2662.0	-1%	6%
Fee income	775.3	770.0	1%	1%
Total income	3855.1	3831.0	1%	8%
Operating expenses	-1572.3	-1470.0	7%	8%
Provisioning	-678.7	-294.0	131%	61%
Net income	789.4	1229.0	-36%	-22%

Source: mBank

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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

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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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