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Monday, March 30, 2020 | update

Banks

Poland

Fear Itself

A coronavirus recession is looming, and so we are compelled to adjust the earnings expectations for our Polish banking universe to a new economic reality, with the aggregate FY2020-2021 forecasts revised 44% and 32%, respectively, lower. A base-case scenario adopted by us assumes that the current state-mandated quarantine measures will remain in place until mid-May, and each month over the base-case period will warrant a new revision. There is no historical precedent for simultaneous, pandemic-induced, shocks to both supply and demand to help us assess the potential negative impacts on the banking sector. The single biggest factor that we can identify, which accounts for the bulk of the changes to our models, is an assumed doubling of risk costs to 155bp (+PLN 6.5bn in 2020) – a forecast which pessimists might consider too low, but which is backed by the wide range of emergency measures implemented by both Polish and European regulators and industry stakeholders. Under their guidance, banks have been given more flexibility in creating loan loss provisions under relief debt moratoria agreements, and have been offered incentives to help crisis-struck businesses to stay afloat. However the greater supervisory tolerance for provisioning flexibility probably has an expiration date – that is why it would be so important to know how long the current lockdown will last. Another major adjustment, which prompted a further PLN 1bn cut to our aggregate earnings estimate for FY2020, is the 50bp March 17th cut in the NBP's benchmark interest rate. When it comes to capital adequacy, however, it is worth pointing out that the standing of Polish banks is much more comfortable today (with TCR of 19%) than it was in 2008 (TCR=11%). The WIG-Banks lost 25% of its capitalization in the span of two weeks after being sent into an uncertainty-fueled tailspin, but we still see compelling opportunities in the sector, even in our conservative base-case scenario. In order to give a range of possible outputs in the face of extreme uncertainty and volatility, we also opt to provide best- and worst-case scenarios for the banking sector based on each bank's perceived sensitivity to risk costs and rate cuts.

Our Runaway Favorite: Pekao

Pekao is our top pick for the next nine months, owing to its resilience in the face of the impending crisis, combined with an attractive all-time low valuation at 0.6x 2021E price to book. Our other favorite choices with considerable upside potential are Alior Bank, Santander Bank Polska, Millennium, and PKO BP. We would steer clear of ING BSK, trading 19% lower than this time last year ahead of what we expect to be a 40% cut in consensus earnings forecasts. Our view on Bank Handlowy has been downgraded to hold.

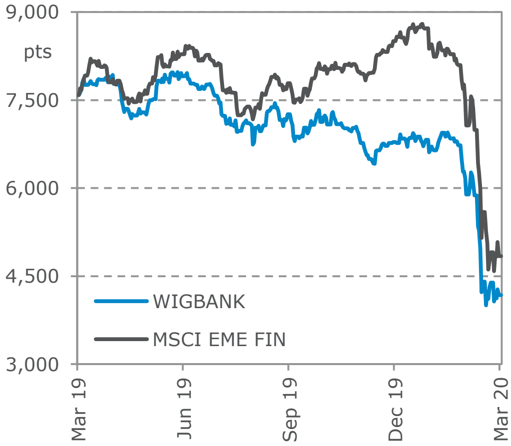
The Worst-Case Scenario

Our worst-case scenario for the Polish bank sector assumes another 50bp rate cut in 2021 and adds 50bp to the base-case costs of risk applicable to 2020 consumer and corporate portfolios. The result is a 6% cut in the expected total income for FY2021, provisioning levels relative to the base case 24% higher in 2020 and 30% higher in 2021, and annual net income reduced by 33% in 2020 and 52% in 2021. In terms of valuation effects, the biggest loser of the worst-case scenario is Alior, with its per-share value knocked down to 9.28, together with Millennium, which would be valued at PLN 1.72. The impact on Pekao is relatively mild, with the valuation trimmed to PLN 79.85.

Stock	P/E 20E	P/E 21E	P/E 22E	P/BV 20E	P/BV 21E	P/BV 22E	ROE (%) 20E	ROE (%) 21E	ROE (%) 22E
PKO	12.0	9.3	7.9	0.6	0.6	0.6	5.5	6.9	8.1
PEO	8.2	7.6	6.0	0.6	0.6	0.5	7.3	7.5	9.0
SPL	12.8	9.9	8.0	0.7	0.6	0.6	5.3	6.5	7.5
ING	19.6	16.5	12.3	1.3	1.2	1.1	6.6	7.5	9.5
MIL	20.0	10.3	10.1	0.5	0.5	0.4	2.3	4.4	4.4
BHW	14.8	13.3	10.9	0.8	0.8	0.8	5.4	5.8	7.0
ALR	78.1	4.2	2.9	0.2	0.2	0.2	0.3	5.8	7.6

WIG-Banks	4,181
MSCI EME Financials	149
2020E P/E	14.9x
2020E P/B	0.8x

WIG-Banks vs. MSCI EME Financials



Name	9MTP new	9MTP old	Recommendation new	Recommendation old
PKO	26.90	39.69	buy	buy
PEO	83.51	115.20	buy	buy
SPL	229.52	287.90	buy	hold
ING	126.36	170.00	sell	sell
MIL	4.06	5.47	buy	hold
BHW	45.66	63.46	hold	accumulate
ALR	24.72	30.50	buy	buy

Name	Current Price	Target Price	Upside/ Downside
PKO	22.75	26.90	+18.2%
PEO	55.32	83.51	+50.9%
SPL	173.90	229.52	+32.0%
ING	153.80	126.36	-17.8%
MIL	3.30	4.06	+23.4%
BHW	44.00	45.66	+3.7%
ALR	13.00	24.72	+90.1%

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PKO BP: buy (reiterated)

PKO PW; PKO.WA | Banks, Poland

Long Road To Recovery

The coronavirus crisis is expected to take a massive toll on PKO BP's bottom line, reflected in respective cuts of 45% and 33% to our forecasts for FY2020 and 2021. We anticipate a sharp, 17bp fall in this year's NIM in the wake of the March rate cut, alongside a surge from 55 to 161bp in annual cost of risk – a conservative forecast modeled on the levels registered during the 2008 and 2012 crises, which disregards the fact that the Bank's current portfolio is much more robust than back then (delta Cor 2012/11 was 17bp vs. 106bp 2019/20) and can take twice the charge-offs before pre-tax profit gets wiped out. We anticipate elevated risk costs to last through FY2021 as PKO continues to grow its loan book, albeit at a very modest pace, amid a general sector-wide contraction. Nevertheless looking at an assumed slump in ROE to 5%, and expectations of longer-than-average recovery from the coronavirus crisis, in our view PKO deserves to trade at a discount to its own book value and the book value of its next closes rival, Pekao. That being said, at 0.8x P/B, we view the stock as a buy.

Slashing Forecasts

We had to cut our 2020 and 2021 earnings expectations for PKO by 45% and 33%, respectively, to account for the Bank's huge sensitivity to low interest rates: the latest 50bp cut in March is set to squeeze quarterly NIM this year by a projected 20bp, with the full-year margin sinking by 17bp. This will most likely be accompanied by a risk cost surge to a FY2020 average of 161bp after peaking at 230bp in Q2. This leads us to expect lower ROE of 5.6% in 2020 and 7.2% in 2021, and assume a freeze on dividends this year, with a distribution from 2020 earnings set to follow in 2021, facilitated by PKO's supreme solvency ratios (Tier1 >17%).

Lowest Valuation in Years

PKO is trading at 0.8x 2021E P/B on our 2021 estimates and at 0.6x on consensus estimates, compared to a 2008 and 2012 crisis level range of 1.4x-1.6x – a discount which looks disproportionately large considering the size of the Bank's current surplus capital, enough to navigate even the bleakest economic scenario while paying regular dividends.

A Worst-Case Earnings Scenario for FY2020

In our worst-case scenario, PKO BP would generate net income of PLN 1,536m in 2020, rising to PLN 1,614m in 2021, followed by a boost to PLN 2,959m in 2022. This scenario also assumes another rate cut, which would reduce expected total income by 5% relative to the base case scenario. Further, the indicated risk reserves are PLN 4,977m in 2020, a 27% higher amount than in the base case, and in 2021 they register a decrease to PLN 4,002m (+35% to base case). PKO's per-share value in the worst-case scenario shrinks to PLN 21.02.

(PLN m)	2018	2019	2020E	2021E	2022E
Net interest income	9,353.0	10,279.0	10,118.2	10,136.4	10,740.3
Noninterest income	4,307.0	4,759.0	4,702.3	4,806.7	5,033.6
Total costs	6,218.0	6,967.0	6,557.5	6,725.0	7,024.6
Operating income*	7,442.0	8,071.0	8,262.9	8,218.0	8,749.3
Net income	3,741.0	4,031.0	2,364.3	3,050.4	3,604.2
Costs/Income (%)	45.5	46.3	44.2	45.0	44.5
ROE (%)	9.9	10.0	5.5	6.9	8.1
P/E (x)	7.6	7.1	12.0	9.3	7.9
P/B (x)	0.7	0.7	0.6	0.6	0.6
DPS	0.55	1.33	0.00	2.28	2.66
Dividend yield (%)	2.4	5.8	0.0	10.0	11.7

*before provisioning

Current Price	PLN 22.75
Target Price	PLN 26.90
MCap	PLN 28.4bn
Free Float	PLN 20.1bn
ADTV (3M)	PLN 185.7m

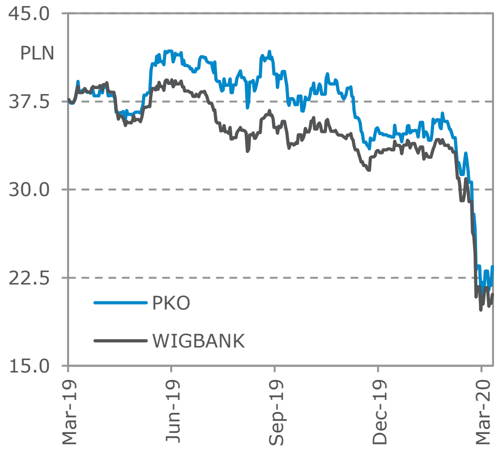
Ownership

State Treasury	29.43%
NN OFE	7.56%
Aviva OFE	7.04%
Others	55.97%

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	26.90	39.69	buy	buy

Company	Current Price	Target Price	Upside
PKO BP	22.75	26.90	+18.2%

Forecast Update	2020E	2021E	2021E
Total income	-5.9%	-9.5%	-
Pre-tax income	-37.1%	-28.2%	-
Net income	-45.2%	-33.2%	-

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Pekao: buy (reiterated)

PEO PW; PEO.WA | Banks, Poland

Shelter From the Storm

We maintain a buy rating for Pekao after lowering the 9-month price target to PLN 83.51. We view the Bank as a good safe-haven-type asset to own in a crisis, based on a solid track record of low risk costs, which never crossed 75bp over the last fifteen years – a mark of a high-quality loan portfolio. Lately Pekao has concentrated its sales efforts on the home loan market, characterized by low default rates, increasing the share of mortgages in the total loan book by 6pp over the last six years, while at the same time reducing the proportion of the high-risk SME and NML sectors to one of the lowest levels in the industry. That being said, as a precaution we make the assumption for our 2020 base-case scenario that Pekao's cost of risk this year will register a surge to 96bp after peaking at 130bp in the second quarter. Being relatively less sensitive to interest rate changes than most other banks, we further anticipate contraction of just about 15bp in Pekao's NIM after a 50bp rate cut. After factoring all this into our models, we arrived at downward earnings revisions of 29% in FY2020E and 28% in FY2021 for Pekao, representing much less dramatic cuts than in the case of other rated banks. To reiterate, PEO ranks high on our top pick list on our updated estimates, especially now that its share price has dropped 38% since the end of February.

Revising Earnings Expectations

We cut our 2020 and 2021 net income estimates for Pekao by 29% and 28%, respectively, in the face of an expected economic crisis. The assumptions for the current year include flat loan growth alongside 3% expansion in deposits, combined with a reduction in NIM of 8bp to 2.69% (over average assets), cost of risk raised to 96bp (130bp for commercial loans), a lower C/I ratio of 47%, and ROE of 8% after a decline from 9.4% in 2019.

Risk-Proofing The Loan Book

Pekao decided to dial back its risk appetite as a mitigating measure against recession impacts. Historically, the Bank's loan portfolio necessitated lower charge-offs than those of an average lender, reflected in low cost of risk of just 63bp in 2009 as well as 2012. Recently Pekao ran a campaign targeted mainly at the home loan market, but this is not going to compromise NIM sensitivity given low delinquency rates for mortgage loans. At the same time, the high-risk SME sector has a low share in the total loan book at an estimated 16% compared to an industry average of ca. 27%.

A Worst-Case Earnings Scenario for FY2020

In our worst-case scenario, Pekao would generate net income of PLN 1,462m in 2020, falling to PLN 1,146m in 2021 before a 2022 rebound to PLN 1,927m. This scenario also assumes another rate cut which would reduce expected total income by just under 7% a year in the two-year period relative to the base case scenario. Further, the indicated risk reserves are PLN 1,826m in 2020, a 28% higher amount than in the base case, and in 2021 they decrease to PLN 1,563m (+34% to base case). PEO's per-share value in the worst-case scenario would be slashed to PLN 79.85.

(PLN m)	2018	2019	2020E	2021E	2022E
Net interest income	4,994.0	5,468.0	5,473.9	5,579.9	6,020.5
Noninterest income	2,836.2	2,813.7	2,963.1	2,818.3	2,877.0
Total costs	3,709.8	3,991.8	3,926.9	3,953.2	4,077.2
Operating income*	4,120.4	4,289.9	4,510.1	4,445.0	4,820.3
Net income	2,287.2	2,165.0	1,772.0	1,910.4	2,409.4
Costs/Income (%)	48.3	48.8	47.2	47.8	46.5
ROE (%)	9.9	9.4	7.3	7.5	9.0
P/E (x)	6.3	6.7	8.2	7.6	6.0
P/B (x)	0.6	0.6	0.6	0.6	0.5
DPS	7.90	6.60	0.00	5.06	5.46
Dividend yield (%)	14.3	11.9	0.0	9.2	9.9

*before provisioning

Current Price	PLN 55.32
Target Price	PLN 83.51
MCap	PLN 14.5bn
Free Float	PLN 9.8bn
ADTV (3M)	PLN 132.2m

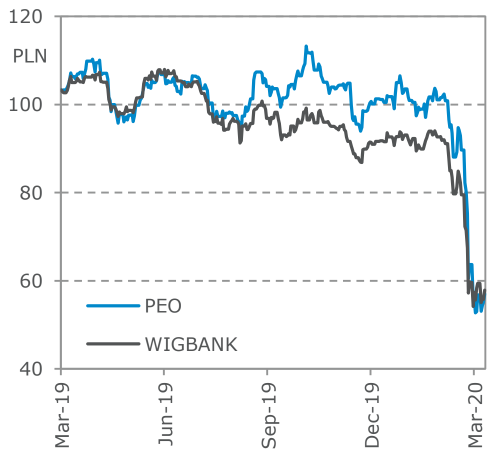
Ownership

PZU	20.00%
PFR	12.80%
Others	67.20%

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		Rating	
	new	old	new	old
Pekao	83.51	115.20	buy	buy

Name	Current Price	Target Price	Upside
Pekao	55.32	83.51	+50.9%

Forecast Update	2020E	2021E	2022E
Total income	-3.2%	-8.5%	-
Pre-tax income	-23.1%	-23.7%	-
Net income	-28.6%	-28.0%	-

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Santander Bank Polska: buy (upgraded)

SPL PW; SPL1.WA | Banks, Poland

Overstressed Downside Risk

We revised our 2020 net income forecast Santander Bank Polska ("Santander") 43% downward, and we cut the 2021 projection by 32%, to reflect an updated risk cost estimate of 167bp (x2 Y/Y), and after incorporating the March interest rate cut, set to weight through high NIM sensitivity (ca. 40%). Santander incurred comparatively high risk costs of approximately 80bp even in times of economic prosperity. Unlike in past recessions, today the Santander Group includes a Consumer Bank, which we see as struggling amid the impending crisis. On the upside, Santander still has unrealized synergies from the merger with Deutsche Bank Poland in an estimated amount of PLN 50m expected in FY2020. Furthermore, after a year of curtailed lending activity, the Bank should be able to accumulate surplus capital which will support shareholder distributions in the following years. Lastly, we updated our models to assume that the CHF loan court cases, currently adjourned amid a coronavirus lockdown, will not restart until next year; accordingly we carried the expected resulting provisioning over to 2021. Trading at 0.9x P/B on our estimates, SPL stock shows upside potential of 32% at the current level.

Revising Earnings Expectation

We cut Santander's FY2020-2022 earnings estimates by 43%, 32%, and 26%, respectively, after reducing the 2020 NIM forecast by 9bp to reflect its high sensitivity (c.40%) to interest rate reductions. At the same time, we doubled our original risk cost estimate for the year to 167bp, decreasing to 136bp by 2022. This is predicated on the assumption of little to no new loan originations in 2020, and a 6% rebound in 2022.

CHF Loan Losses Laid Over to FY2021

The coronavirus outbreak has disrupted the Polish court system, and we assume for modeling purposes that the cases against Santander pursued by CHF mortgage holders will be delayed by about a year, and in some cases dropped altogether. Under these circumstances, it is likely that the regulator will excuse the Bank from recognizing provisions for these loans in 2020. Nevertheless these provisions, which we estimate at PLN 4.6bn, will come up again in 2021.

A Worst-Case Earnings Scenario for FY2020

In our worst-case scenario, Santander would generate net income of PLN 1,1021m in 2020, rising to PLN 1,121m in 2021, followed by a boost to PLN 1,895m in 2022. This scenario also assumes another rate cut which would reduce expected total income by 4% relative to the base case scenario. Further, the indicated risk reserves are PLN 2,954m in 2020, a 19% higher amount than in the base case, and in 2021 they decrease to PLN 2,643m (+21% to base case). SPL's per-share value in the worst-case scenario amounts to PLN 192.10.

(PLN m)	2018	2019	2020E	2021E	2022E
Net interest income	5,742.4	6,580.2	6,434.3	6,630.3	7,007.2
Noninterest income	2,553.7	2,904.3	2,868.6	2,870.3	3,030.0
Total costs	3,769.0	4,488.7	3,995.4	3,986.3	4,027.8
Operating income*	4,527.2	4,995.8	5,307.5	5,514.3	6,009.4
Net income	2,363.4	2,138.3	1,388.7	1,799.6	2,223.0
Costs/Income (%)	45.4	47.3	42.9	42.0	40.1
ROE (%)	10.1	8.5	5.3	6.5	7.5
P/E (x)	7.4	8.3	12.8	9.9	8.0
P/B (x)	0.7	0.7	0.7	0.6	0.6
DPS	3.10	19.72	0.00	3.40	4.41
Dividend yield (%)	1.8	11.3	0.0	2.0	2.5

*before provisioning

Current Price	PLN 173.90
Target Price	PLN 229.52
MCap	PLN 17.7bn
Free Float	PLN 5.6bn
ADTV (3M)	PLN 40.2m

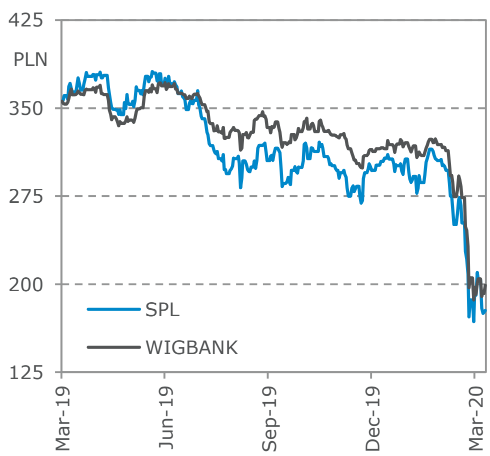
Ownership

Banco Santander S.A.	68.30%
Others	31.70%

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	229.52	287.90	buy	hold

Name	Current Price	Target Price	Upside
SPL	173.90	229.52	+32.0%

Forecast Update	2020E	2021E	2022E
Total income	-6.0%	-8.8%	-8.2%
Pre-tax income	-32.4%	-25.3%	-20.9%
Net income	-43.3%	-32.3%	-25.7%

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ING BSK: sell (reiterated)

ING PW; INGP.WA | Banks, Poland

More Downside Ahead

We cut of FY2020-21 earnings estimates for ING BSK ("ING") by 42%-37% – a considerable downward revision based on expectations of a 1.4-fold ramp-up in 2020 risk reserves which might push cost of risk upward to 123bp. At this level, the risk costs would be lower than the CoR anticipated at comparably-sized banks like PKO BP and Santander, but they would exceed those of Pekao if numbers recorded during the 2009 and 2012 crises are anything to go by. ING is expected to have to boost reserves due to a substantial credit risk exposure stemming from commercial loans alone (52%) and combined with consumer loans (66%). On the other hand, the March interest rate cut is not likely to affect NIM by more than 6bp. Furthermore, after a year of slow loan growth, we believe ING's solvency ratios will improve to a point where it will be able to increase the annual dividend payout ratio to 50% of profit. ING BSK is not going to come out of the crisis unscathed, but nevertheless on our estimates the Bank's valuation comes out relatively high at 1.0x price to book, the highest ratio in our coverage universe. That being said, with estimated downside potential to our target price of over 17%, in our book ING remains a sell.

Cutting Forecasts

We cut our 2020 net income estimate for ING BSK by 29% to PLN 1,022m after factoring in an expected increase to 123bp in the year's cost of risk, implying a boost to risk reserves to a projected PLN 1.5bn. Note that at this level the anticipated CoR value would still be lower than the estimated sector average of 153bp. Further, we see ING BS as posting NIM contraction of 8bp in FY2020, accompanied by a 1% decline in loan volumes.

Anticipating Higher Dividends

After a decline in loan originations in 2020, accompanied by estimated ROE of 7% this year and 8% in 2021, ING should see its Tier 1 ratio firm to 17%, and the total capital ratio brought upward to 20%. Based on this assumption, we raise our expectations for shareholder distributions in the next two years by revising the original dividend payout ratio upward from 30% to 50%. That being said, at 2.6%-3.1% ING's dividend yield range is far from being the most attractive in the sector.

Worst-Case FY2020 Earnings Scenario

In our worst-case scenario, ING would generate net income of PLN 731m in 2020, falling to PLN 664m in 2021, followed by a boost to PLN 1,369m in 2022. This scenario also assumes another rate cut which would reduce expected total income by 5% relative to the base case scenario. Further, the indicated risk reserves are PLN 1,857m in 2020, a 25% higher amount than in the base case, and in 2021 they decrease to PLN 1,555m (+32% to base case). ING's per-share value in the worst-case scenario would be slashed to PLN 97.73.

(PLN m)	2018	2019	2020E	2021E	2022E
Net interest income	3,759.3	4,293.9	4,431.8	4,498.6	4,759.9
Noninterest income	1,473.4	1,495.9	1,502.4	1,478.9	1,541.6
Total costs	2,326.8	2,497.4	2,546.3	2,641.8	2,719.5
Operating income*	2,905.9	3,292.4	3,387.9	3,335.8	3,582.0
Net income	1,523.8	1,658.7	1,023.3	1,209.9	1,627.9
Costs/Income (%)	44.5	43.1	42.9	44.2	43.2
ROE (%)	12.1	11.6	6.6	7.5	9.5
P/E (x)	13.1	12.1	19.6	16.5	12.3
P/B (x)	1.5	1.3	1.3	1.2	1.1
DPS	3.20	3.50	0.00	3.93	4.65
Dividend yield (%)	2.1	2.3	0.0	2.6	3.0

*before provisioning

Current Price	PLN 153.80
Target Price	PLN 126.36
MCap	PLN 20.0bn
Free Float	PLN 5.0bn
ADTV (3M)	PLN 5.0m

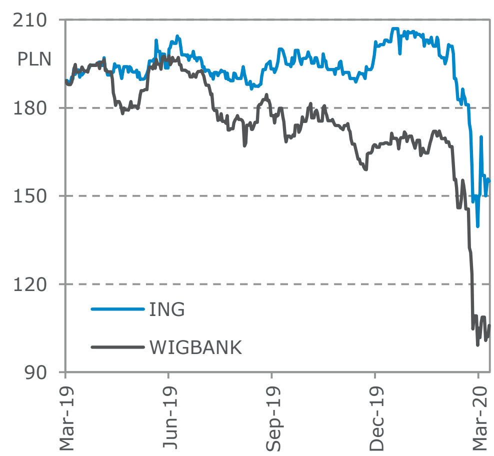
Ownership

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. 90%. 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	Target Price		Rating	
	new	old	new	old
ING BSK	126.36	170.00	sell	sell

Name	Current Price	Target Price	Downside
ING BSK	153.80	126.36	-17.8%

Forecast Update	2020E	2021E	2022E
Total income	-5.9%	-12.6%	-
Pre-tax income	-33.9%	-31.4%	-
Net income	-42.0%	-36.9%	-

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Millennium: buy (upgraded)

MIL PW; MILP.WA | Banks, Poland

Priced-In Crisis and FX Loan Risk

We upgrade Millennium from hold to buy after lowering the target price to PLN 4.06 per share. Millennium faces the same coronavirus-induced economic recession as all other banks, reflected in FY2020-2021 forecast reductions of 65%-18% after factoring in hiked costs of risk (154bp in 2020E vs 91pb w 2019), declines in corporate lending (-2.5%), and interest rate cuts. Also incorporated into our updated models are expected PLN 100m costs related to refunds of unused fees on remaining terms of prepaid loans. Our initial assessment of Millennium's interest rate sensitivity at 13% of NIM was undermined by the November 2019 acquisition of Eurobank, together with its lower-risk loan book where commercial loans, including leases and factoring, account for 26.8% of the total, of which lower-risk leases represent one-third. As a result, we can say that the Eurobank takeover has diluted Millennium's recession-fueled exposure to SME loan risk. MIL stock is currently trading at 0.6x P/B on our updated estimates, implying a buy recommendation.

Slashing Forecasts

Our revised earnings outlook for Millennium, with the 2020 net income estimate slashed by 65% and the 2021 forecast reduced by 18%, is not a result of interest rate cuts like in the case of most other banks – rather, it stems from heightened cost of risk (154bp w 2020, 91bp in 2021), and expectations of reduced credit demand from businesses, plus PLN 100m expected provisions for potential prepaid loan fee refunds. Furthermore, after rolling the potential risks related to lawsuits from CHF mortgage holders over to 2021, we currently expect Millennium to generate ROE of 2.3% in 2020 and 2.6% in 2021.

FX Loan Provisioning Pushed Back to 2021

Neither the regulator, nor financial auditors, are going to exert pressure on banks to keep raising provisions for potential lawsuits from Swiss franc borrowers this year under the current circumstances. Not least because the current lockdown creates disruptions in the operation of Polish courts and legal firms. To reflect this, we have shifted the additional CHF loan risk provisioning anticipated of Millennium back from 2020 to 2021.

A Worst-Case Earnings Scenario for FY2020

Our worst-case scenario would likely result in an annual loss of PLN 81.5m in 2020, rising to PLN 131m in 2021 amid economic contraction underpinned by FX loan charge-offs. This scenario also assumes another rate cut, which would reduce expected total banking income by just under 8% a year in the two-year period relative to the base-case scenario. Relative to the base case, the FY2020 worst-case provisioning ex. CHF lawsuits come out 33% higher at PLN 1,457m, and the estimated difference in FY2021 is 55% at PLN 1,028m. With high sensitivity to extended periods of low interest rates weighing, the worst-case DCF valuation of MIL could be expected to approximate PLN 1.72.

(PLN m)	2018	2019	2020E	2021E	2022E
Net interest income	1,817.5	2,436.9	2,741.7	2,760.7	2,892.3
Noninterest income	940.3	1,115.2	1,128.2	1,104.2	1,144.0
Total costs	1,332.2	1,841.7	2,165.8	2,013.6	2,010.6
Operating income*	1,425.6	1,710.4	1,704.0	1,851.3	2,025.7
Net income	760.7	560.7	199.8	387.3	394.2
Costs/Income (%)	48.3	51.8	56.0	52.1	49.8
ROE (%)	9.4	6.5	2.3	4.4	4.4
P/E (x)	5.2	7.1	20.0	10.3	10.1
P/B (x)	0.5	0.4	0.5	0.4	0.4
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 3.30
Target Price	PLN 4.06
MCap	PLN 4.0bn
Free Float	PLN 2.0bn
ADTV (3M)	PLN 9.7m

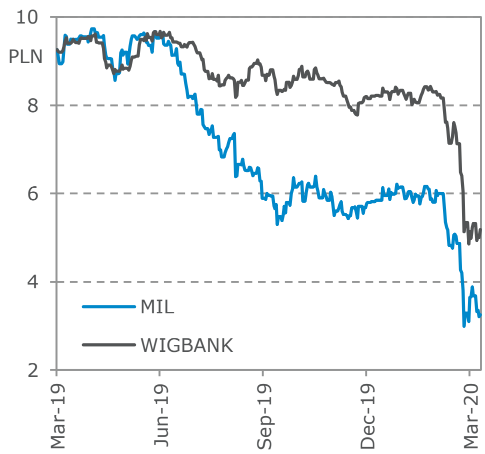
Ownership

Millennium BCP	50.10%
NN OFE	8.24%
Aviva OFE	6.33%
PZU OFE	5.57%
Others	29.76%

Business Profile

Millennium is the seventh-largest bank in Poland with a market share of ca. 4%. Its assets are mostly consumer loans and deposits. 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 in the next two years.

MIL vs. WIG Banks



Name	9MTP new	9MTP old	Rating new	Rating old
MIL	4.06	5.47	buy	hold

Name	Current Price	Target Price	Upside
Millennium	3.30	4.06	+23.4%

Forecast Update	2020E	2021E	2022E
Total income	-3.0%	-8.3%	-
Pre-tax income	-43.2%	-11.7%	-
Net income	-65.2%	-18.0%	-

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Monday, March 30, 2020 | update

Handlowy: hold (downgraded)

BHW PW; BHW.WA | Banks, Poland

Stressed SMEs Boost Risk Exposure

We downgrade Handlowy to hold, and we lower the target price to PLN 45.66 per share. The Bank faces increased credit risk amid a global recession on a scale which prompts us to lower our FY2020-2022 earnings forecasts by 19-32%, respectively. Handlowy's commercial loan portfolio includes only 9% of SME exposures, but, based on the Bank's own estimate that as many as 70% of its business customers are exporters, mainly to the EU, we predict a sharp rise in the risk costs related to the commercial segment in the second and third quarter of 2020. The consumer portfolio should be a mitigating factor, however, with any appreciation in its risk cost most likely driven by model variable changes rather than an actual rise in delinquencies. All told, we currently anticipate an increase in CoR to 202bp in 2020 from 114bp a year earlier, followed by a drop to 90bp in 2021 and a further decline to 55bp in 2022. At the same time, we expect Handlowy to be able to grow its commercial loan book by a projected 3.5% this year as one of few lenders, while losing about 2.8% of market share in consumer loans. The recent volatility in Treasury yields directly benefits Handlowy by providing opportunities to take profits on its substantial trading book, expected to boost FY2020 trading profit by 34% in total, with most of the transactions likely to take place in Q1 and Q2. As for dividends, we currently expect Handlowy to make the distribution from retained 2018 earnings, originally scheduled for 2020, a year later, offering DPS of PLN 3.49 in 2021.

Slashing Forecasts

We expect Handlowy to use the same strategy of profit taking on its trading book to mitigate negative recession impacts as the Bank had enrolled back in 2012. Yields on US Treasuries have dropped 54% since the beginning of the year, and at the same time Polish 10Y government bonds had their yields cut by 33%. A volatile market can offer windfall profits on trade in 2020, which we currently put at as much as PLN 657m after hiking our original estimate by 30%.

A Worst-Case Earnings Scenario for FY2020

In our worst-case scenario, Handlowy would generate net income of PLN 314m in 2020, falling to PLN 242m in 2021, only to rebound to PLN 407m in 2022. This scenario also assumes another rate cut which would reduce expected total income by just under 7% a year in the two-year period relative to the base case scenario. Further, the indicated risk reserves are PLN 530 m in 2020, a 23% higher amount than in the base case, and in 2021 they decrease to 300m (+50% to base case). BHW's per-share value in the worst-case scenario amounts to PLN 34.65.

(PLN m)	2018	2019	2020P	2021P	2022P
Net interest income	1,107.6	1,153.7	1,051.6	1,013.8	1,054.7
Noninterest income	1,081.0	1,102.1	1,243.2	1,122.1	1,157.9
Total costs	1,209.0	1,254.2	1,225.0	1,233.5	1,265.0
Operating income*	979.6	1,001.6	1,069.9	902.4	947.7
Net income	638.9	486.5	389.4	433.4	525.1
Costs/Income (%)	55.2	55.6	53.4	57.7	57.2
ROE (%)	9.1	6.9	5.4	5.8	7.0
P/E (x)	9.0	11.8	14.8	13.3	10.9
P/B (x)	0.8	0.8	0.8	0.8	0.8
DPS	4.11	3.74	0.00	3.49	2.49
Dividend yield (%)	9.3	8.5	0.0	7.9	5.7

*before provisioning

Current Price	PLN 44.00
Target Price	PLN 45.66
MCap	PLN 5.7bn
Free Float	PLN 1.4bn
ADTV (3M)	PLN 5.2m

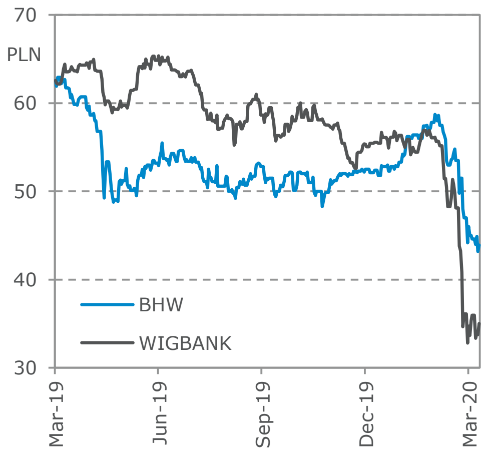
Ownership

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 a conservative balance sheet and a low L/D ratio of ca. 60%.

BHW vs. WIG-Banks



Name	Target Price		Rating	
	new	old	new	old
Handlowy	45.66	63.46	hold	accumulate

Name	Current Price	Target Price	Upside
Handlowy	44.00	45.66	+3.7%

Forecast Update	2020E	2021E	2022E
Total income	-1.2%	-11.4%	-11.3%
Pre-tax income	-33.5%	-30.5%	-22.6%
Net income	-40.1%	-36.5%	-27.4%

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Monday, March 30, 2020 | update

Alior Bank: buy (reiterated)

ALR PW; ALR.WA | Banks, Poland

Sitting on a PLN 3 Billion Liquidity Surplus

Alior Bank ("Alior") stands to be hit worse by the upcoming crisis than any other bank in our coverage universe. The Bank's current loan book is 66% made up of SME and consumer exposures – a mixture which points to a huge surge in risk costs, projected to reach a staggering 300bp in FY2020 compared to 240bp posted in 2019 (180bp ex one-time charge-offs). However note that is a conservative forecast which assumes that, on stable consumer CoR of ca. 200bp, cost of risk associated with commercial loans would skyrocket to 900bp in Q2 2020, and then gradually decrease to 480bp in Q3 and drop to 220bp in Q4. When it comes to NIM, we measure the impact of the 50bp March interest rate cut at 9bp, expected to be registered in Q2, with full-year NIM additionally undercut to the tune of 41bp by provisioning for prepaid loan fee refund cases. Alior's earnings and value are inevitably going to suffer once the crisis sets in, however we see its stock as grossly underpriced at 0.2x, a ratio next only to the Greek banking sector, considering the Bank's substantial and sustainable capital surplus in excess of PLN 3bn indicated by our base-case scenario. We maintain a buy rating for ALR, with the new target price set at PLN 24.72 per share, and a fair P/B of 0.4x, but we nevertheless point out that, at PLN 9.28, our worst-case valuation of the Bank indicates downside risk.

Slashing Forecasts

We expect Alior to generate low net income of PLN 21.5m in FY2020 after two in-the-red quarters in Q2 and Q3 – a consequence of an assumed risk cost increase, peaking at 491bp in Q2. The initial NIM impact of the March rate cut will quickly dissipate in our view, but amid to high financing costs and declining loan volumes Alior will probably have to overhaul its pricing policy for savings and deposits. Summing up, we expect that, after taking a rapid and brutal beating in the initial aftermath of the coronavirus crisis, Alior's recovery toward profitability will be equally swift but more durable.

Sitting on a PLN 3bn Liquidity Surplus

On the face of it, Alior's current market valuation implies that the Bank might be teetering on the brink of bankruptcy. In actuality, however, after accounting for Poland's March annulment of the systemic risk buffer requirement, Alior seems to have accumulated a capital surplus of over 3 billion zlotys. In order for this surplus to be erased, the Bank's cost of risk would have to shoot up to 980bp, of which 2,100bp in the commercial segment – a highly unlikely scenario in our view. Relative to the minimum CRR requirement, the solvency cushion is more than PLN 4.6bn.

A Worst-Case Earnings Scenario for FY2020

In our worst-case scenario, Alior would generate a net loss of PLN 165.9m in 2020, rising to PLN 244 in 2021, followed by a rebound to the positive territory in 2022 with net income of PLN 93m. This scenario also assumes another rate cut which would reduce expected total income by just under 16% a year in the two-year period relative to the base case scenario. Further, the indicated risk reserves are PLN 2,011m in 2020, a 13% higher amount than in the base case, and in 2021 they decrease to PLN 1,555m (+17% to base case). ALR's per-share value in the worst-case scenario would be slashed to PLN 9.28.

(PLN m)	2018	2019	2020P	2021P	2022P
Net interest income	3,084.5	3,181.4	2,883.2	2,915.6	3,084.8
Noninterest income	1,012.8	958.6	844.3	851.7	892.4
Total costs	1,846.8	1,975.7	1,656.2	1,659.5	1,666.8
Operating income*	2,250.5	2,164.4	2,071.3	2,107.9	2,310.4
Net income	713.4	252.8	21.5	402.9	576.3
Costs/Income (%)	45.1	47.7	44.4	44.0	41.9
ROE (%)	10.8	3.8	0.3	5.8	7.6
P/E (x)	2.4	6.6	78.1	4.2	2.9
P/B (x)	0.3	0.2	0.2	0.2	0.2
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 13.00
Target Price	PLN 24.72
MCap	PLN 1.7bn
Free Float	PLN 1.2bn
ADTV (3M)	PLN 24.1m

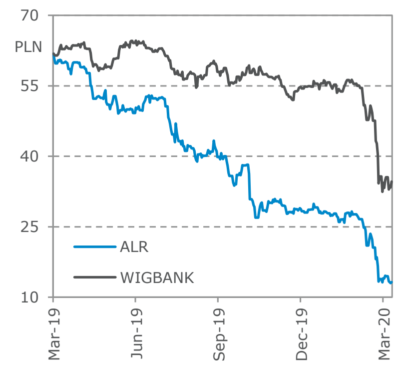
Ownership

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	24.72	30.50	buy	buy

Name	Current Price	Target Price	Upside
Alior Bank	13.00	24.72	+90.1%

Forecast Update	2020E	2021E	2022E
Total income	-10.10%	-13.05%	-
Pre-tax income	-66.23%	-16.51%	-
Net income	-95.18%	-14.51%	-

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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%
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The production of this recommendation was completed on March 30, 2020, 8:35 AM.
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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.
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mBank issued the following recommendations for PKO BP in the 12 months prior to this publication:

PKO BP

Rating	**buy**	**accumulate**	**accumulate**	**buy**	**accumulate**	**accumulate**
Rating date	2020-03-04	2020-02-05	2019-12-05	2019-08-02	2019-06-26	2019-05-09
Target price (PLN)	39.69	39.69	39.50	47.17	47.17	40.92
Price on rating day	33.10	36.00	34.99	39.34	42.20	37.78

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

Pekao

Rating	**buy**	**buy**	**accumulate**	**buy**
Rating date	2019-12-05	2019-08-02	2019-07-03	2019-05-30
Target price (PLN)	115.20	119.75	121.00	121.00
Price on rating day	96.34	99.88	112.95	103.75

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

Santander Bank Polska

Rating	**hold**	**hold**	**reduce**	**hold**	**hold**	**reduce**	**hold**
Rating date	2020-02-05	2019-12-05	2019-11-06	2019-10-07	2019-08-02	2019-07-12	2019-06-03
Target price (PLN)	287.90	265.50	276.55	276.55	337.00	337.00	377.27
Price on rating day	304.00	279.00	317.40	286.00	319.60	357.20	365.20

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

ING BSK

Rating	**sell**	**hold**	**hold**	**accumulate**	**hold**	**reduce**
Rating date	2020-02-04	2019-12-05	2019-10-07	2019-09-05	2019-08-02	2019-07-03
Target price (PLN)	170.00	187.77	197.53	197.53	191.80	191.80
Price on rating day	202.00	190.80	194.80	187.40	189.80	203.50

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

Millennium

Rating	**hold**	**reduce**	**hold**	**sell**	**reduce**	**buy**
Rating date	2020-03-04	2020-02-05	2019-12-05	2019-11-06	2019-10-07	2019-08-02
Target price (PLN)	5.47	5.47	5.47	5.18	5.18	10.00
Price on rating day	5.06	5.91	5.49	6.40	5.48	7.51

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

Handlowy

Rating	**accumulate**	**accumulate**	**accumulate**	**accumulate**	**buy**	**buy**	**hold**
Rating date	2020-02-27	2019-12-05	2019-07-03	2019-06-03	2019-05-21	2019-05-09	2019-03-05
Target price (PLN)	63.46	57.44	59.45	61.00	61.00	65.50	65.50
Price on rating day	55.90	51.70	53.60	53.70	52.40	52.80	65.90

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

Alior Bank

Rating	**buy**	**hold**	**buy**	**buy**
Rating date	2020-02-21	2019-11-06	2019-07-03	2019-06-03
Target price (PLN)	30.50	31.00	72.30	77.00
Price on rating day	26.62	29.34	51.10	52.80

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