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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.

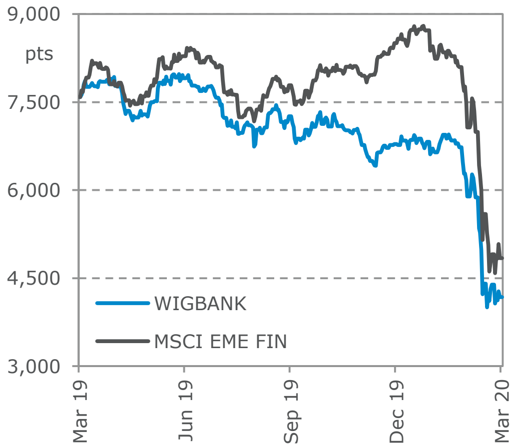
The Worst-Case Scenario

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			P/BV			ROE (%)		
	20E	21E	22E	20E	21E	22E	20E	21E	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		Recommendation	
	new	old	new	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%

Analysts:

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl

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Investment Case

In anticipation of recession caused by the COVID-19 pandemic we revise our 2020-2021 forecasts concerning the net profit of the Polish banking sector down by 44%-32%. Our base-case scenario assumes that the quarantine will last for approximately three months through May. Every extension by one month will require further adjustments to our forecasts.

The coexistence of a supply and demand shock in the face of a pandemic is unprecedented, which puts an additional obstacle to estimating the amount of losses that banks are likely to sustain. The change in forecasts is attributable mainly to a 100% increase in risk cost to 155 bps (+PLN 6.5bn y/y). Although pessimists consider this level to be set too low, our narrative is supported by a range of regulatory measures taken by the European Banking Authority (EBA), the Polish Financial Supervision Authority (KNF), the Polish Bank Association (ZBP), and the National Bank of Poland (NBP). New regulatory guidelines give banks more flexibility in creating provisions and encourage them to keep providing liquidity to companies hit by the crisis. Nevertheless, we believe that, for example, loan repayment holidays are a one-off solution, after which banks will be forced to create provisions on a mass scale. This is why it is important to estimate the duration of the quarantine period as precisely as possible.

We also took the 50 bps rate cut, which reduces the forecasts by another PLN 1 billion, into account. It is worth noting that the capital position of the sector during the current crisis is incomparably better (with TCR at 19%) than e.g. in 2008 (TCR at 11%).

We also apply a negative scenario assuming an additional rate cut by 50 bps in 2021 and 50 bps higher risk cost in 2020/2021 to our forecasts. As a result, net profit in 2020 and 2021 would be 33% and 52% lower compared with the base-case forecast.

Considering our current operational assumptions, we believe that the sector's present upside potential is 17%. Bank Pekao is currently our top pick. Its stocks are traded at a historically low P/BV'21 ratio of 0.5x and, at the same time, it is one of the most crisis resilient banks. On the other hand, we maintain a sell recommendation on ING BSK whose market value dropped by 19% y/y vs. the anticipated forecast cut by approx. 40%.

Summary of Polish bank valuations and returns on equity

	Recommendation	Target price	Current price	P/E (x)			P/BV (x)			ROE (%)		
				2020E	2021E	2022E	2020E	2021E	2022E	2020E	2021E	2022E
PKO BP	buy	26.90	22.75	12.0	9.3	7.9	0.6	0.6	0.6	5.5	6.9	8.1
Bank Pekao	buy	83.51	55.32	8.2	7.6	6.0	0.6	0.6	0.5	7.3	7.5	9.0
Santander BPL	buy	229.52	173.90	12.8	9.9	8.0	0.7	0.6	0.6	5.3	6.5	7.5
ING BSK	sell	126.36	153.80	19.6	16.5	12.3	1.3	1.2	1.1	6.6	7.5	9.5
Bank Millennium	buy	4.06	3.30	20.0	10.3	10.1	0.5	0.5	0.4	2.3	4.4	4.4
Bank Handlowy	hold	45.66	44.00	14.8	13.3	10.9	0.8	0.8	0.8	5.4	5.8	7.0
Alior Bank	buy	24.72	13.00	78.1	4.2	2.9	0.2	0.2	0.2	0.3	5.8	7.6
Average				**14.9**	**10.9**	**8.8**	**0.8**	**0.7**	**0.7**			

Source: mBank

Exploring Best- and Worst Case Scenarios

Extreme economic uncertainty prompted us to analyze a best- and worst-case scenario to try and capture the possible outcomes of the coronavirus epidemic.

In the **worst-case scenario**, price pressures would abate permanently, triggering **another 50bp rate cut** at the beginning of 2021. Further, **costs of risk** for banks would **increase by another 50bp** each this year and next as a reflection of deteriorating business momentum, but they would stop rising in 2022. The worst-case scenario uses the same assumptions as to loan growth as the base-case scenario.

In the **best-case scenario** (note that the input values to the best- and worst-case scenarios are not symmetrical), we model a **25bp rate hike in 2021** facilitated by an economic recovery from the second half of 2020. In this scenario **cost of risk would decrease by 25bp per year** in 2020 and 2021 for both consumer exposures and corporate loans. The best-case scenario uses the same assumptions as to loan growth as the base-case scenario.

Scenario Analysis

Due to the high degree of uncertainty regarding the current economic slowdown, we have decided to present two scenarios differing from our base-case assumptions. In the **worst-case scenario,** we assume that the price pressure will slow permanently, leading to another rate cut of **50 bps** in early 2021. Moreover, this scenario assumes that banks' risk costs will go up by another **50 bps** in both 2020 and 2021, reflecting a general deterioration in economic activity. In this case, the risk cost forecast for 2022 remains unchanged. This scenario **does not provide for a change** in credit volumes compared with our base-case assumptions.

We also present a **best-case scenario.** It is not symmetrical to the worst-case scenario. In this scenario, we assume that following an economic revival in the second half of 2020, the Monetary Policy Council will raise interest rates by **25 bps** in 2021. We also assume **25 bps** lower risk cost in both the retail and corporate portfolio in 2020-2021 and no changes in 2022. Similarly to the worst-case scenario, we do not assume any changes in credit volumes.

Alior Bank ('buy,' reiterated, 90.1% upside)

We expect that the high share of SME loans in the portfolio (66%) will contribute to high risk costs. Our forecast for 2020 is 300 bps. However, despite very weak profit prospects, Alior's capital position is good. The bank has approx. PLN 3 billion in surplus capital in every year covered by the forecast. In addition, Alior's 2021 forecast cut is the lowest in the sector, which makes a good starting point for when the recession is over. This is why we believe that Alior's current share price is too low.

Scenarios: Alior Bank

(PLN million)	2020	2021	2022
Worst-case scenario			
Net banking income	3,727.6	3,174.6	3,365.6
Net provisioning	2,010.8	1,555.1	1,298.1
Net profit	-165.9	-244.4	93.2
valuation (PLN)	**9.28**		
Base-case scenario			
Net banking income	3,727.6	3,767.3	3,977.2
Net provisioning	1,773.6	1,328.3	1,298.1
Net profit	21.5	402.9	576.3
valuation (PLN)	**24.72**		
Best-case scenario			
Net banking income	3,727.6	4,063.7	4,283.0
Net provisioning	1,655.0	1,214.9	1,237.2
Net profit	115.2	726.6	866.0
valuation (PLN)	**42.86**		

Source: mBank

Bank Handlowy ('hold,' downgraded, 3.7% upside)

Although SME loans account for a minor part of Bank Handlowy's portfolio, we believe that the corporate portfolio may witness high write-offs due to a substantial share of exporters (70%). This is why our 2020 CoR forecast is 202 bps, which should be partially offset by solid net trading income. However, we expect that in this case risk costs will go down to the average level faster than in other banks, as a result of which we will witness much lower net provisioning in 2021 and, in particular, in 2022. We believe that the current valuation adequately reflects the difficulties and risks to be faced by the bank and the lack of dividend this year. This is why, our recommendation is "hold."

Scenarios: Bank Handlowy

(PLN million)	2020	2021	2022
Worst-case scenario			
Net banking income	2,294.8	1,988.5	2,060.0
Net provisioning	529.4	300.1	124.4
Net profit	314.0	242.1	406.8
valuation (PLN)	**34.65**		
Base-case scenario			
Net banking income	2,294.8	2,135.9	2,212.6
Net provisioning	432.0	200.6	124.4
Net profit	389.4	433.4	525.1
valuation (PLN)	**45.66**		
Best-case scenario			
Net banking income	2,294.8	2,209.6	2,288.9
Net provisioning	383.3	150.9	110.1
Net profit	427.2	529.1	595.3
valuation (PLN)	**52.78**		

Source: mBank

ING BSK ('sell,' reiterated, 17.8% downside)

Similarly to other banks, we anticipate risk cost to jump to 123 bps in 2020. We expect a 9 bps margin decrease in 2020 and a 1% contraction in credit volumes, which partially undermines the growth story underlying ING's valuation. On the other hand, modest lending accompanied by relatively high profitability encourage us to revise our dividend payout ratio forecast up to 50% from 2021. All in all, we maintain the sell recommendation.

Scenarios: ING

(PLN million)	2020	2021	2022
Worst-case scenario			
Net banking income	5,934.2	5,655.6	5,967.3
Net provisioning	1,856.7	1,555.1	859.5
Net profit	731.0	664.4	1,368.5
valuation (PLN)	**97.73**		
base-case scenario			
Net banking income	5,934.2	5,977.5	6,301.5
Net provisioning	1,479.9	1,174.0	859.5
Net profit	1,023.3	1,209.9	1,627.9
valuation (PLN)	**126.36**		
best-case scenario			
Net banking income	5,934.2	6,138.5	6,468.7
Net provisioning	1,291.6	983.5	823.9
Net profit	1,169.5	1,482.7	1,785.2
valuation (PLN)	**140.79**		

Source: mBank

Bank Millennium ('buy,' upgraded, 23.4% upside)

In addition to higher risk costs (154 bps) the bank will also need to struggle with the CHF portfolio that casts a deep shadow over its valuation, wiping about PLN 1.80 per share off Millennium's share price. On the other hand, the impact of Eurobank will soften the effect on interest margin and thus Millennium will not be hit as hard as other banks. Given the current market valuation, our recommendation is to buy; however, note that once the pandemic is over, the CHF portfolio will again weigh on sentiment.

Scenarios: Millennium

(PLN million)	2020	2021	2022
Worst-case scenario			
Net banking income	3,869.9	3,567.7	3,732.5
Net provisioning	1,457.1	1,364.8	1,163.9
Net profit	-81.5	-130.7	161.0
valuation (PLN)	**1.72**		
base-case scenario			
Net banking income	3,869.9	3,864.9	4,036.3
Net provisioning	1,098.5	1,001.7	1,163.9
Net profit	199.8	387.3	394.2
valuation (PLN)	**4.06**		
best-case scenario			
Net banking income	3,869.9	4,013.4	4,188.2
Net provisioning	921.4	814.2	1,163.9
Net profit	338.8	651.0	512.8
valuation (PLN)	**5.20**		

Source: mBank

Pekao ('buy,' reiterated, 50.9% upside)

Over the last 15 years Pekao has not seen its risk cost going beyond 75 bps, which proves its long-term quality. We forecast CoR to stand at 96 bps in 2020, which is far below the market average of 155 bps. Both the corporate portfolio (with a small share of SMEs) and the retail portfolio (with an increase generated mainly in mortgages) will perform relatively well in our opinion. We forecast that, compared to other banks, Pekao will emerge relatively unscathed from the current crisis, and so we maintain our buy call on PEO.

Scenarios: Pekao

(PLN million)	2020	2021	2022
Worst-case scenario			
Net banking income	8,543.9	7,917.1	8,383.3
Net provisioning	1,825.9	1,562.5	836.1
Net profit	1,461.7	1,146.1	1,927.9
valuation (PLN)	**79.85**		
base-case scenario			
Net banking income	8,543.9	8,507.2	9,008.7
Net provisioning	1,422.9	1,160.2	836.1
Net profit	1,772.0	1,910.4	2,409.4
valuation (PLN)	**83.51**		
best-case scenario			
Net banking income	8,543.9	8,802.3	9,321.4
Net provisioning	1,221.4	959.0	798.1
Net profit	1,927.2	2,292.5	2,679.4
valuation (PLN)	**86.70**		

Source: mBank

PKO BP ('buy,' reiterated, 18.2% upside)

High sensitivity to interest rate cuts (40%) and risk cost forecast by us at 161 bps will weigh heavily on the bank's performance in 2020. Moreover, the KNF's recommendations on dividend payment dispelled all doubts about profit sharing this year. On the other hand, strong capital position bodes well for dividend payments in the future. What is more, we think that the current price to book value (0.7x) is too low and hence we maintain our buy recommendation to investors.

Scenarios: PKO BP

(PLN million)	2020	2021	2022
Worst-case scenario			
Net banking income	14,820.4	14,146.7	14,956.7
Net provisioning	4,976.8	4,002.3	2,784.7
Net profit	1,536.0	1,614.5	2,958.6
valuation (PLN)	**21.02**		
base-case scenario			
Net banking income	14,820.4	14,943.1	15,773.9
Net provisioning	3,914.7	2,957.8	2,784.7
Net profit	2,364.3	3,050.4	3,604.2
valuation (PLN)	**26.90**		
best-case scenario			
Net banking income	14,820.4	15,341.3	16,182.4
Net provisioning	3,406.4	2,435.5	2,466.7
Net profit	2,760.9	3,768.3	4,178.1
valuation (PLN)	**32.16**		

Source: mBank

Santander ('buy,' upgraded, 32.0% upside)

Similarly to PKO BP, we expect Santander to be materially affected by interest rate cuts (sensitivity at around 40%) and face high risk costs (167 bps) which in our opinion are largely attributed to the portfolio of Santander Consumer Bank. In addition, the CHF exposure still looms large over the bank, which does not improve sentiment. On the other hand, the capital build-up and the still unlocked synergy potential from the merger with DB give a more optimistic outlook for 2020 onwards. Moreover, given its strong capital position, Santander is likely to pay handsome dividends in the future. Therefore, considering the recent price slump, we upgrade our recommendation to buy.

Scenarios: Santander

(PLN million)	2020	2021	2022
Worst-case scenario			
Net banking income	9,302.9	9,105.9	9,621.4
Net provisioning	2,953.6	2,643.1	2,119.3
Net profit	1,020.5	1,121.2	1,894.5
valuation (PLN)	**192.10**		
base-case scenario			
Net banking income	9,302.9	9,500.6	10,037.2
Net provisioning	2,487.5	2,179.1	2,119.3
Net profit	1,388.7	1,799.6	2,223.0
valuation (PLN)	**229.52**		
best-case scenario			
Net banking income	9,302.9	9,697.9	10,245.0
Net provisioning	2,092.4	1,785.0	2,048.5
Net profit	1,700.9	2,266.7	2,443.2
valuation (PLN)	**249.08**		

Source: mBank

Macroeconomic Outlook

(The following forecasts are provided by the mBank Research Team: Dr Ernest Pytlarczyk, CFA, Dr Marcin Mazurek, Piotr Bartkiewicz, CFA, and Maciej Zdrolik.)

The coexistence of a supply and demand shock in the face of a pandemic and an enforced halt of economic activity is unprecedented. It is the first time ever when the start and trough of a recession affects services. For the first time the economy has entered a sudden-stop recession. What it means is that we have entered a period where the interrelations among macroeconomic variables in Poland (but not only in Poland) must be forecast largely on an expert basis. Our base-case scenario assumes a mild recession (-0.3%). It is an optimistic variant akin to a V-shaped recession.

Right now making comparisons with and drawing conclusions from the 2008/2009 data seems utterly inadequate because the exchange rate no longer acts as it did back then in view of the coordinated and simultaneous collapse of demand observed virtually everywhere in the world. The economy, however, has entered this period without any imbalances and at a brisk pace (3-4% according to January and February estimates). Under these specific circumstances the task of keeping the economy afloat has been taken over by the government and the National Bank of Poland (NBP). Although both institutions are committed to rising to this challenge, it will all boil down to how effectively and fast they act. In our opinion, retaining jobs and protecting system liquidity will be of key importance. With unemployment soaring, a restart will prove extremely difficult and there will be neither a V- nor even a U-shaped rebound.

Without GDP growth, there will be no inflation, especially core inflation. However, inflation will not go down rapidly, and non-cyclical components of core inflation in the form of regulated prices may reside for a long time due to a very difficult and quickly deteriorating situation of local governments. Nevertheless, inflation will certainly go back to the NBP's target in 2021, with core inflation dropping to approx. 0.5% y/y.

In the short term, inflation will be stifled by oil prices, with fuel prices falling by 5-7% m/m for two consecutive months.

Oil prices will be low (USD 25-35 per barrel); however, given the current levels, each USD 10 increase generates enormous relative growth (and companies will be hungry for margins after a drought). Consequently, the second half-year may be marked by increases in fuel prices, but, on a positive note, gas prices are likely to decrease (~10%). Food prices, on the other hand, will remain high, all the more so because labor shortages are likely to affect mainly seasonal work. Food prices were presumably already extremely high in March due to the fears generated among consumers (who stocked up on supplies in the face of the pandemic). The seasonal factors, which cannot be forecast, will also play an important role. As for now, we do not expect deflation, even in 2021. Broken supply chains and specific anti-globalization, which can result from a change in the lifestyle of societies (and companies), puts into question the lasting oversupply, which gave rise to deflation processes back in 2015-2016. In the base-case scenario, the Monetary Policy Council will not cut interest rates any further.

Base-case macro scenario

(PLN million)	Q1 2020	Q2 2020	Q3 2020	Q4 2020
GDP	1.50	-2.10	-1.50	0.50
CPI	4.50	3.60	3.20	3.50
EUR/USD	1.09	1.12	1.15	1.17
USD/PLN	4.17	4.02	3.87	3.76
EUR/PLN	4.55	4.50	4.45	4.40
EUR/CHF	1.06	1.06	1.07	1.07
CHF/PLN	4.29	4.25	4.18	4.11

Source: mBank

The base-case scenario is optimistic. We also have a less best-case scenario – a deeper, U-shaped recession – which, however, is still not catastrophic (unlike an L-shaped recession). The scenario provides for lay-offs on a much larger scale, a hike in the unemployment rate, and a lowering of interest rates by the NBP.

Pessimistic macro scenario

(PLN million)	Q1 2020	Q2 2020	Q3 2020	Q4 2020
GDP	1.5	-4.0	-3.2	-1.0
CPI	4.5	3.8	3.0	3.1
EUR/PLN	4.55	4.80	4.80	4.70

Source: mBank

Financial Forecasts

We believe that market expectations of the banking sector's performance are completely outdated due to the looming crisis caused by COVID-19. Our forecasts for 2020 and 2021 have been reduced by 43.6% and 31.5%, respectively, due to higher risk cost and lower interest margin caused by the interest rate cut by 50 bps. We expect that as a result of a two- or three-month lockdown as a result of the pandemic, the risk cost in the Polish banking sector will increase from 79 bps to 155 bps, reaching a peak in Q2 2020 and Q3 2020, and the interest rate cuts will push down the net result of the analyzed banks by a total of PLN 1.1 billion. Finally, we have lowered our expectations with regard to the 2020 increase in loans by 10%. We now expect a flat y/y growth rate with a drop by more than 3% in the corporate segment. Consequently, the crisis will lead to a decrease in the sector's profitability calculated as ROE from 8% to 5%. Due to the quarantine, we postpone the effect of litigations related to FX mortgages by one year, and consequently, we do not expect any new provisions related to them in 2020. It is worth noting that the sector's capital position during the current crisis is incomparably better than e.g. in 2008 (current TCR of 19% vs. 11% in 2008). Additionally, in accordance with the KNF's recommendations, we do not assume any dividend payouts in 2020. The payout of undistributed profit will take place in 2021.

We have decreased our 2020 forecasts by the largest margin for Alior Bank (-95%) due to its low base and Millennium (-65%) due to its relatively large portfolio of SMEs and consumer loans. The forecasts that have changed the least were those of Bank Handlowy (-40%) due to a small share of SMEs and Bank Pekao (-29%), which outperformed other banks during recent crises.

Change in net profit forecasts (PLN million)

	2020E			2021E		
	Old	New	change	Old	New	change
PKO	4,316	2,364	-45%	4,563	3,050	-33%
PEO	2,482	1,772	-29%	2,655	1,910	-28%
ING	1,764	1,023	-42%	1,918	1,210	-37%
SPL	2,450	1,387	-43%	2,659	1,797	-32%
MIL	574	200	-65%	472	387	-18%
BHW	650	388	-40%	683	430	-37%
ALR	446	22	-95%	471	403	-15%
Σ	**12,683**	**7,156**	**-44%**	**13,422**	**9,188**	**-32%**

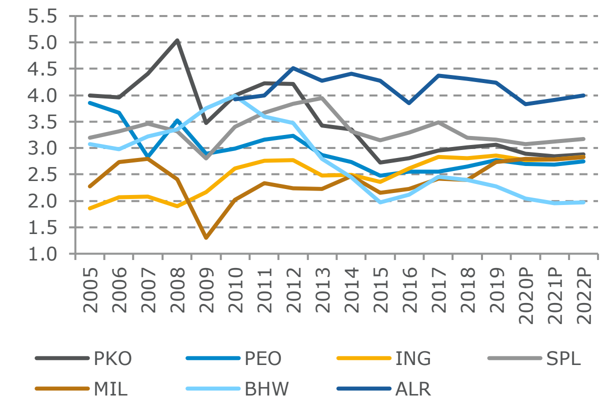
Source: mBank

Finally, please note that our forecasts are based on the assumption that the quarantine will last for 2-3 months, not 6-12, so the estimates may be subject to further modification.

Interest Rate Cut vs. Interest Margins

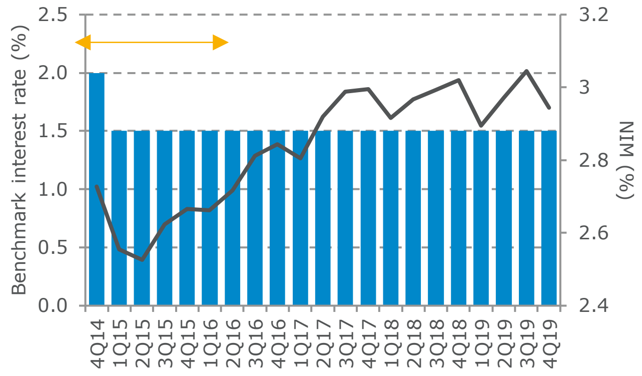
Following the 50 bps emergency rate cut announced by the MPC, we expect the banking sector's margin to go down by 13 bps to 2.89% (banks analyzed by us). Thus, net interest income will decrease by PLN 281 million y/y for the first time since 2015. At the same time, remember that a comparison between the 2019 and 2020 margin is distorted by the reimbursement of commission on consumer loans, which was fully recognized only in Q4 2019. We expect the greatest decrease in interest margin as a consequence of the interest rate cut to be reported by PKO BP and Bank Handlowy (-24 bps each) and Santander (-20 bps). However, including the so-called "small CJEU" effect, Alior Bank and Bank Handlowy will record the greatest drops in interest margin in 2020 (-41 bps and -24 bps, respectively). We expect the sector's interest margin to remain relatively flat in the subsequent two years covered by the forecast.

Interest margins of rated Polish banks (%)



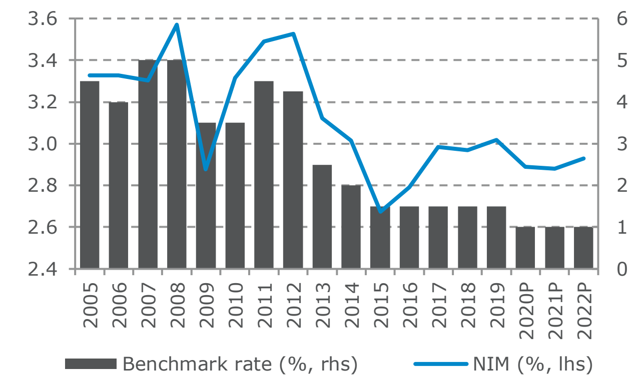
Source: mBank

Banks recovered from the last 50bp cut in six quarters



Source: mBank

NIM evolution over the last 17 years



Source: mBank

Loans and Deposits

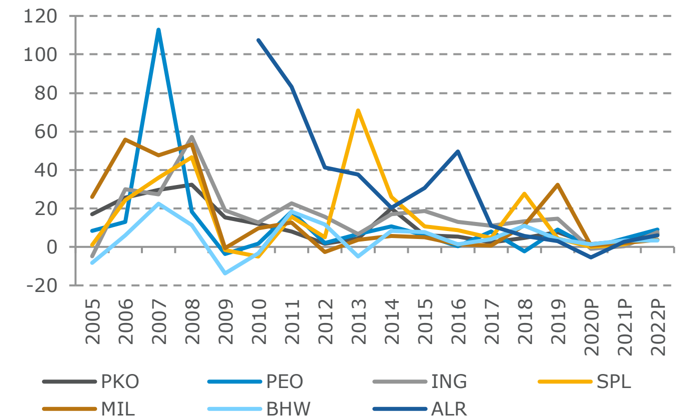
In 2020 we expect a significant decline in loan growth in all segments due to a recession predicted for 2020 caused by COVID-19, among others. Our current forecasts assume a +0.2% loan growth in 2020, which is lower than reported during the 2009 and 2012 crises (+10% and +1.7%, respectively). We expect that after such a major economic shock, a noticeable increase in loan volumes of 4% will occur not earlier than in 2022, and will remain flat in 2021. Similarly as in the previous crises, in 2020 we expect the biggest decrease to occur in corporate and consumer lending (-3% and -1%, respectively), with a simultaneous inertial growth in mortgage loans (+5%). At the same time we wish to stress that our forecast regarding corporate loans, which are the primary target of the regulatory stimulus, may be overly pessimistic. Banks agreed to extend financing for corporates affected by COVID-19 which will also receive even greater support from BGK under the *de minimis* program. Finally, in 2020 we expect the biggest decline in lending in Alior Bank (-5%) and ING (-1%). In 3-year CAGR terms (2019-2022), PKO BP and Pekao are expected to post the greatest loan growth (+4% each), followed by Bank Handlowy (+3%).

Loans and deposits growth forecast for Poland

(PLN billion)	2020	y/y	2021	y/y	2022	y/y
Loans						
Retail	788.0	2.8%	794.5	0.8%	836.2	5.2%
Mortgages	486.2	5.4%	499.0	2.6%	529.4	6.1%
Other	301.8	-1.1%	295.6	-2.1%	306.8	3.8%
Corporates	527.5	-3.4%	527.0	-0.1%	542.6	3.0%
Total	**1,315.5**	**0.2%**	**1,321.5**	**0.5%**	**1,378.8**	**4.3%**
Deposits						
Retail	968.5	6.8%	940.3	-2.9%	936.3	-0.4%
Corporates	501.4	-2.1%	538.6	7.4%	565.3	5.0%
Total	**1,469.9**	**3.6%**	**1,479.0**	**0.6%**	**1,501.6**	**1.5%**

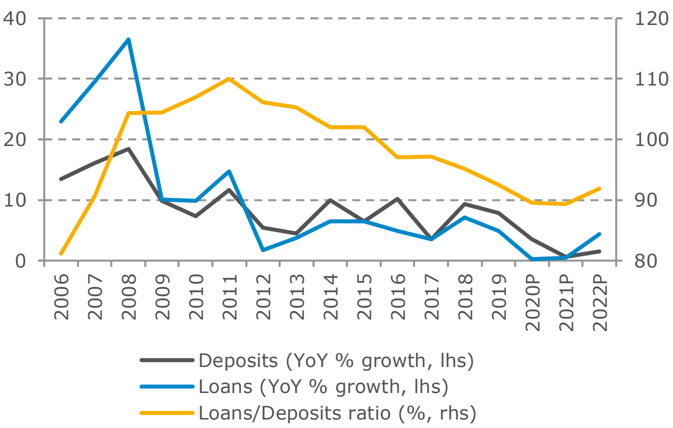
Source: mBank

Net growth of banks' loans (y/y, %)



Source: mBank

Poland: loan and deposit growth forecast

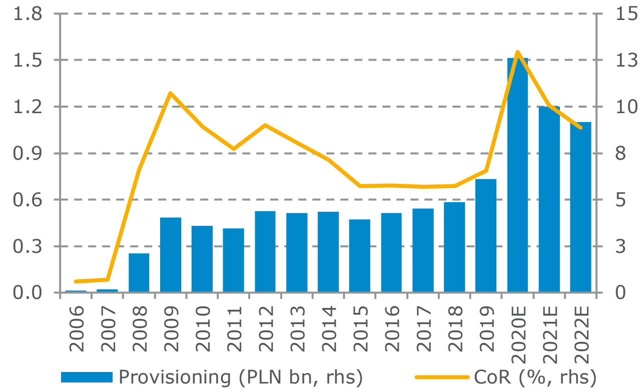


Source: mBank

Record-High Risk Costs in the Sector

We expect that, despite a wide range of support programs, partial suspension of economic activity both in Poland and in the EU will lead to fast deterioration of the credit situation and a wave of bankruptcies among companies. We believe that SMEs and micro enterprises without working capital flexibility will be particularly affected by the crisis. Although the ECB suggests that the pro-cyclical IFRS 9 rules should not be used in an excessively restrictive manner, we think that banks will continue to include such parameters as forecast GDP growth in their projections regarding expected credit losses. A decrease in forecast GDP growth should lead to an increase in risk costs in the retail segment, ceteris paribus. These two effects together should result in an abrupt increase in risk costs in the sector, at least in Q2-Q3 2020. Summing up, based on a sample of banks analyzed by us, we expect CoR to stand at 155 bps in 2020 (up by 81 bps), which will translate into net provisioning of PLN 12.6 billion vs. PLN 6.09 billion in 2019.

Risk cost and net provisioning forecast for rated banks



Source: mBank

Change in Regulator's Approach

Further authorities supervising the banking sector suggest relaxing accounting regulations so that some supporting measures do not impair the results of the sector. This is the case of the KNF which is ready to suspend the implementation of Recommendation R, which means that offering credit holidays to borrowers in need will not result in automatic creation of provisions for a given exposure. EBA, which took a similar stance, calls for flexibility and pragmatic approach to applying IFRS 9 to the offered credit moratoria. As we stated before, the ECB recommends that banks avoid pro-cyclical assumptions in risk models to avoid creating excessive provisions on relatively safe positions. We believe that the above rules will allow banks to avoid creating provisions in cases where the current situation has led to temporary liquidity or profitability problems. However, we would like to point out that the suspension of economic activity in some sectors will be more than temporary and many businesses may permanently lose the ability to repay liabilities. Therefore, we believe that high risk costs are unavoidable.

Unique Circumstances

The current situation differs significantly from slowdowns we have experienced in the last 20 years. Almost complete derailment of economic activity and revenue in some industries is unlike anything the banking sector has ever experienced before. In the recent years, the greatest increases in risk costs were reported in 2009 to 129 bps (delta of 50 bps) and in 2012 to 108 bps (delta of 15 bps). In 2009 the Polish banking sector was shaken by both the global financial crisis and our local crisis related to currency options, which additionally increased net provisions. In 2012 risk costs resulted mainly from hardships in the construction sector, due to which provisions for receivables from companies increased by 170% in the entire sector. The current slowdown is more dispersed and affects SMEs and micro enterprises the most. As regards bigger companies, we believe that exporters will face difficulties due to the global nature of the coronavirus crisis. Finally, we assume that the aggregated CoR of the analyzed banks will increase to 155 bps, and the sector will post record-high provisions of PLN 12.6 billion. In addition, we forecast that echoes of the current situation will still be noticeable in 2021, and CoR will stand at 121 bps, which corresponds to provisions of PLN 10.8 billion. Please remember that under the current circumstances our forecasts are very uncertain, and the situation changes dynamically.

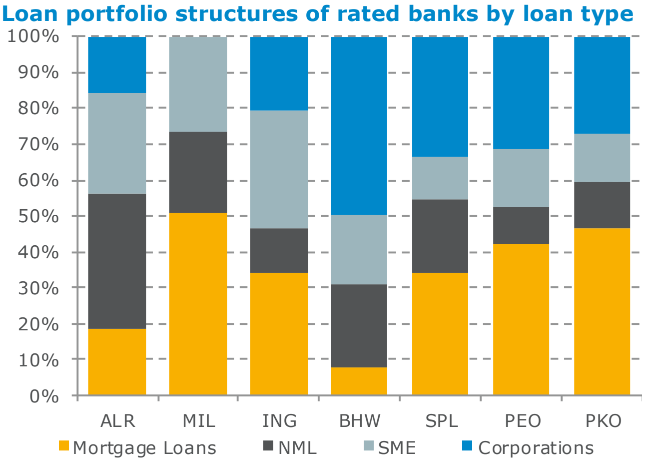
Comparison of risk costs during crisis periods

(PLN million)	2009	2012	2020
PKO BP	1.50	1.56	1.61
Pekao	0.63	0.63	0.96
ING BSK	1.05	0.77	1.23
Santander	1.34	1.24	1.67
Millennium	1.27	0.57	1.55
Bank Handlowy	3.81	0.37	2.02
Alior Bank	-	2.20	3.00
Total	**1.29**	**1.08**	**1.55**

Source: mBank

Considering the structure of portfolios of individual banks, Alior's situation is definitely the least favorable as loans for SMEs and consumer loans constitute 28% and 38% of its portfolio, respectively. Millennium is in an only slightly better situation with loans for SMEs and consumer loans constituting 27% and 22% of its portfolio, respectively. PKO BP and Pekao fare much better with the share of both categories combined not exceeding 30%.

Loan portfolio structures of rated banks by loan type

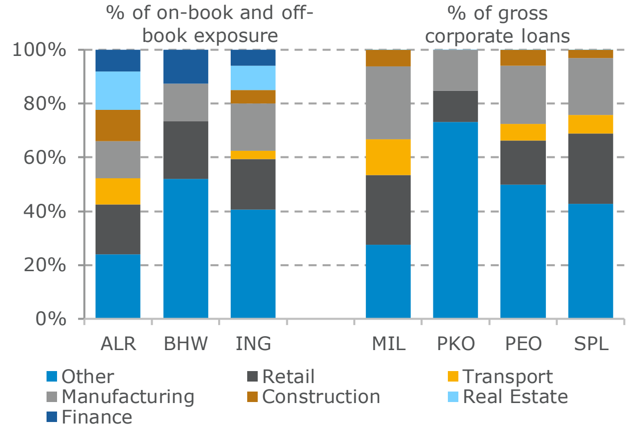


Source: Banks, mBank

Updating Credit Exposures to Industries

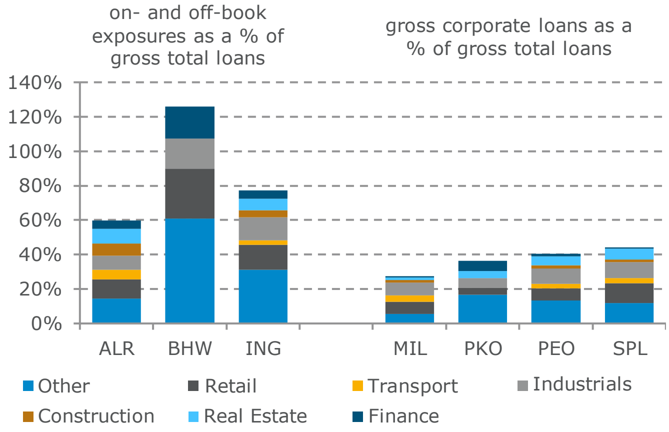
Our review of annual financial statements includes an analysis of the data on exposures of particular banks broken down by industry. Like last year some banks present their exposures by portfolios (MIL, PKO, PEO and SPL), whereas some differentiate between balance sheet and off-balance sheet exposures (ALR, BHW and ING). Banks do not stick to a uniform classification of sectors and industries; while some of them distinguish between 20 categories, others distinguish 6, and this is why we present bank exposures broken down by 7 categories: retail, transport, industry, construction, finance, real property, and others. All the banks report the highest exposure to **retail** (11.6%-26.1%), led by **Santander (26.1%) and Millennium (25.8%)**, and **manufacturing** (10.6%-27.2%), which accounts for the largest chunk of the loan books of **Millennium (27.2%) and Pekao (21.5%).** Another category which may herald portfolio problems is the service of real property, where the banks' exposure exceeds 10% on average (except for Millennium and Bank Handlowy, which does not report such a category). As far as exposures of particular banks are concerned, we wish to point out transport (including pipeline transport, and transportation and storage), which accounts for a substantial portion of Millennium's and Alior's portfolios (13.3% and 9.6%, respectively). The below chart presents corporate exposures by categories.

Breakdown of gross corporate loans/exposures by industry or sector



Source: Banks

Share of particular sectors in total assets



Source: Banks

Sector Risks

In our opinion, the risk of capital shortfall in the analyzed banks is rather small, taking into account the fact that the NBP's macro prudential supervision lowered the systemic risk buffer from 3% to 0%. Additionally, none of the analyzed banks will incur net loss given substantially limited lending, which should additionally strengthen their capital adequacy. We believe SKOKs, cooperative banks, Idea Bank or GNB may encounter financial problems.

Credit Unions

The financial standing of Poland's largest credit union, SKOK, improved substantially over the last few years and now only 11% of the branches fail to meet the KNF's requirements. At present, their total solvency ratio stands at 5.85%, whereas capital surplus equals PLN 73.5 million. In 2019 SKOK reported a net profit of PLN 42 million. We expect that the 50 bps rate cut will reduce the sector's performance to PLN 9 million, provided that other parameters remain the same as in 2019. However, assuming that SKOKs do not release their provisions but the risk cost will amount to 100 bps, and they will manage to keep the C/I ratio at 95%, net loss will stand at PLN 20 million. This means that some SKOKs may face capital shortfalls and, as a result, declare bankruptcy. In our opinion, the BFG will not try to bail SKOKs out using the restructuring fund, but it will pay out the guaranteed deposits to members, or, the KNF will encourage commercial banks to take over bankrupt entities. At the same time, it is worth noticing that the generated surplus will suffice for approx. 3 years of SKOKs' operation provided that no further rate cuts take place. The balance sheet of SKOKs amounts to PLN 8.7 billion in total.

Cooperative Banks

Net profit of cooperative banks in 2019 stood at PLN 639 million, whereas their CET1 capital adequacy ratio equaled 16.93%. The sector's capital buffer in the case of an economic slowdown amounts to PLN 7.5 billion. A 50 bps rate cut will probably reduce net profit by approx. PLN 250 million. However, assuming that the risk cost doubles to 153 bps, the banks will report zero net profit for 2019. This shows the banks' limits and the level at which they will start generating losses. Any further rate cut or an increase in risk cost will generate more problems for the sector. However, in our opinion, cooperative banks do not pose an immediate threat to the sector, especially taking into account their capital buffer.

Idea Bank and Getin Noble Bank

Due to its weak capital position and credit exposure, Idea Bank may be seriously affected by the crisis. At present, Idea Bank lacks approx. PLN 490 million to meet Tier 1 capital ratio under CRR and PLN 723 million to meet Tier 1 capital ratio imposed by the KNF. As regards TCR, Idea Banks lacks PLN 590 million and PLN 823 million, respectively. Although in Q4 2019 Idea Bank generated net profit of PLN 5 million again, any increase in net provisioning will soon bring about net loss. At the end of 2019, the total capital of Idea Bank stood at PLN 156 million, which leaves little room for maneuver.

Getin Noble Bank (GNB) seems to be doing much better, even though it does not meet the KNF's requirements either. A reduction of the systemic risk buffer from 3% to 0% decreased Tier 1 capital shortfall in GNB to PLN 389 million (data as at the end of Q3 2019) and TCR to PLN 572 million. As regards the requirements under CRR, the bank has a "safe" margin of approx. PLN 1 billion.

In our opinion, in the light of the economic crisis, Idea Bank is about to face serious problems. Substantial capital shortfall and potential losses that the bank may incur may be a signal for the BFG to act more decisively. At the end of 2019, deposits at Idea Bank amounted to PLN 16.5 billion, which suggests a resolution scenario, where PLN 0.5 billion of capital injection would be enough for the bank to meet the CRR requirements. Additional funds for the restructuring fund were collected already in 2019 and hence the BFG should not have any problems with the implementation of such a solution. However, the panic that may spread among deposit holders in GNB (the bank belongs to the same capital group as Idea Bank) if Idea Bank is taken over by the BFG may pose a serious problem (at the end of Q3 2019, deposits at GNB amounted to PLN 45.3 billion.

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Monday, March 30, 2020 | update

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

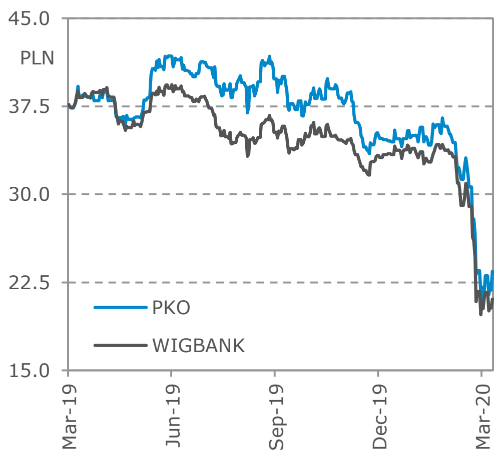
Ownership

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%	-

Analysts:

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl

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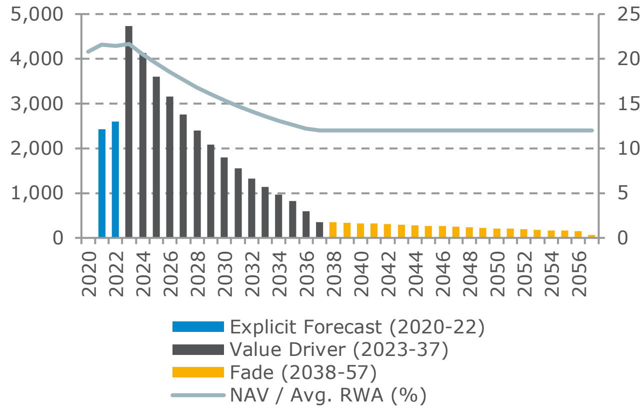
Valuation

Dividend Discount Model

	(PLN m)	%
Explicit forecast (2020-22)	5,025.2	11.5
Adjustment for time value of money	627.7	1.4
Value driver (2023-37)	31,412.4	72.2
Fade (2038-57)	4,781.5	11.0
Terminal value	1,677.0	3.9
Fair value of equity	**43,523.8**	**100.0**
Shares outstanding (millions)	1,250.0	
Fair value per share (PLN)	**34.8**	
Cost of equity (%)	8.5	
9M target price (PLN)	**37.0**	

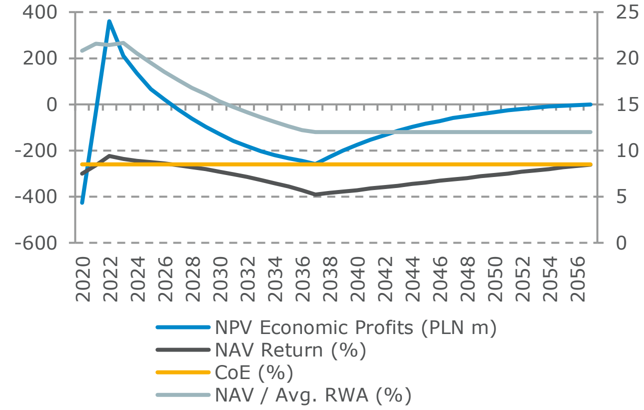
Dividend Discount Valuation (PLN m)



Economic Profit Model

	(PLN m)	(%)
Opening tangible NAV	45,901.9	99.5
Explicit forecast (2020-22)	-101.0	-0.2
Adjustment for time value of money	3,252.5	7.0
Value driver (2023-37)	-1,377.9	-3.0
Fade (2038-57)	-1,526.9	-3.3
Fair value of equity	**46,148.6**	**100.0**
Shares outstanding (millions)	1,250.0	
Fair value per share (PLN)	**36.9**	
Cost of equity (%)	8.5	
9M target price (PLN)	**39.3**	

Economic Profit Model

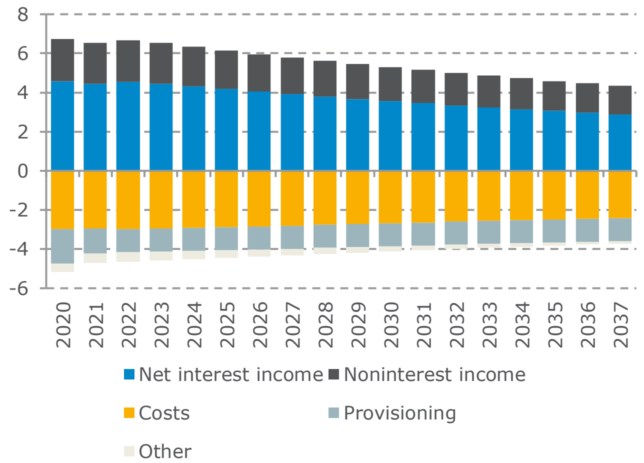


Key Ratios

(%)	2020	2021	2022	Avg.*
Net interest income / Average RWA	4.6	4.4	4.5	3.6
Net interest income / Average RWA	2.1	2.1	2.1	1.8
Costs / Average RWA	-3.0	-2.9	-3.0	-2.7
Costs / Income	44.2	45.0	44.5	50.4
Provisioning / Average RWA	-1.8	-1.3	-1.2	-1.2
Effective tax rate	-22.2	-22.1	-21.1	-19.0
Other / RWA	-0.4	-0.5	-0.5	-0.3
Net profit / Average RWA	1.6	1.8	2.0	1.2
NAV / Average RWA	20.8	21.6	21.4	15.9
Tangible return on NAV	7.5	8.4	9.4	7.5
Net profit growth	-32.4	20.9	14.8	-6.2
Average RWA (PLN bn)	220	229	236	266
Growth in average RWA	6.4	3.8	3.2	1.3

*2023-37E avg.

Costs/Income as a pct. of RWA



Valuation Summary

	(PLN)
Dividend Discount Model	34.82
Economic Profit Model	36.92
Average Fair Value	**35.87**
Bank tax	-10.59
9M target price	**26.90**

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Income Statement (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Net interest income	**7,754.8**	**8,606.0**	**9,353.0**	**10,279.0**	**10,118.2**	**10,136.4**	**10,740.3**
Fee income	2,693.4	2,969.0	3,013.0	3,047.0	2,903.3	2,979.3	3,173.1
Trading income	1,024.0	518.0	664.0	807.0	848.7	829.6	802.9
Other income	648.5	733.0	630.0	905.0	950.3	997.8	1,057.6
Non-interest income	**4,365.9**	**4,220.0**	**4,307.0**	**4,759.0**	**4,702.3**	**4,806.7**	**5,033.6**
Total income	**12,120.7**	**12,826.0**	**13,660.0**	**15,038.0**	**14,820.4**	**14,943.1**	**15,773.9**
Costs	**5,920.4**	**6,050.0**	**6,218.0**	**6,967.0**	**6,557.5**	**6,725.0**	**7,024.6**
Operating income before provisioning	**6,200.3**	**6,776.0**	**7,442.0**	**8,071.0**	**8,262.9**	**8,218.0**	**8,749.3**
Provisioning	1,622.7	1,617.0	1,451.0	1,261.0	3,914.7	2,957.8	2,784.7
Equity in profits/losses of associates	34.5	22.0	37.0	31.0	32.6	34.2	36.2
Pre-tax income	**4,612.1**	**5,181.0**	**6,028.0**	**6,841.0**	**4,380.7**	**5,294.5**	**6,000.8**
Tax	-907.1	-1,140.0	-1,336.0	-1,787.0	-963.8	-1,164.8	-1,260.2
Non-controlling interest	-2.1	-5.0	-1.0	-1.0	-1.0	-1.1	-1.1
Net income before bank tax	**3,702.9**	**4,036.0**	**4,691.0**	**5,053.0**	**3,415.9**	**4,128.6**	**4,739.6**
Bank tax	828.9	932.0	950.0	1,022.0	1,051.6	1,078.2	1,135.4
Net income	**2,874.0**	**3,104.0**	**3,741.0**	**4,031.0**	**2,364.3**	**3,050.4**	**3,604.2**

Balance Sheet (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Cash and central bank balances	13,325	17,810	22,925	14,677	16,014	16,807	17,809
Loans and advances to banks	5,345	5,233	7,661	4,092	5,932	5,932	6,110
Loans and borrowings	**200,607**	**205,628**	**214,911**	**231,434**	**234,787**	**241,648**	**258,154**
Debt securities	51,790	54,468	64,458	80,949	77,711	81,597	83,229
Fixed assets and intangible assets	6,768	6,343	6,229	7,761	7,270	6,747	6,088
Other assets	7,738	7,430	8,071	9,131	9,588	10,067	10,570
Total assets	**285,573**	**296,912**	**324,255**	**348,044**	**351,302**	**362,798**	**381,961**
Deposits from banks	19,213	4,564	2,008	2,885	310	1,420	4,515
Deposits	**205,066**	**220,917**	**242,816**	**258,199**	**264,211**	**270,718**	**284,128**
Securities issued	14,493	23,932	28,627	31,148	28,033	31,117	32,050
Subordinated loans	2,539	1,720	2,731	2,730	2,845	2,960	3,075
Other liabilities	11,693	9,523	8,972	11,504	11,961	12,440	12,943
Equity	**32,585**	**36,267**	**39,111**	**41,587**	**43,951**	**44,153**	**45,258**
Non-controlling interest	-16	-11	-10	-9	-9	-10	-10
Total equity and liabilities	**285,573**	**296,912**	**324,255**	**348,044**	**351,302**	**362,798**	**381,961**

Key Ratios

%	2016	2017	2018	2019	2020P	2021P	2022P
YoY Growth							
Loans	5.4	2.5	4.5	7.7	1.4	2.9	6.8
Deposits	4.8	7.7	9.9	6.3	2.3	2.5	5.0
Equity	7.6	11.3	7.8	6.3	5.7	0.5	2.5
Assets	7.0	4.0	9.2	7.3	0.9	3.3	5.3
Net income	10.1	8.0	20.5	7.8	-41.3	29.0	18.2
Net interest income	10.3	11.0	8.7	9.9	-1.6	0.2	6.0
Balance-Sheet Ratios							
Loans / Deposits	97.8	93.1	88.5	89.6	88.9	89.3	90.9
Deposits / Assets	71.8	74.4	74.9	74.2	75.2	74.6	74.4
Loans / Assets	70.2	69.3	66.3	66.5	66.8	66.6	67.6
Equity / Assets (incl. minority inter.)	11.4	12.2	12.1	11.9	12.5	12.2	11.8
Capital Adequacy Ratio	15.8	17.4	18.9	18.4	19.2	18.7	18.1
Tier 1 Ratio	14.5	16.5	17.5	17.2	18.0	17.5	17.0
Asset Quality Metrics							
NPL / Loans	5.9	5.5	4.9	4.1	7.0	7.0	6.5
Provisioning / Loans	3.8	3.7	3.7	3.0	5.0	5.0	4.8
Provisioning / NPL	65.0	66.6	75.0	73.8	71.4	71.4	73.8
Net Provisioning / Average Loans	0.8	0.8	0.7	0.5	1.6	1.2	1.1
Profitability Metrics							
Net Interest Margin*	3.0	3.1	3.2	3.2	3.0	3.0	3.0
Interest income / Average assets	2.8	3.0	3.0	3.1	2.9	2.8	2.9
Non-Interest Income / Average Assets	1.6	1.4	1.4	1.4	1.3	1.3	1.4
Costs / Average Assets	2.1	2.1	2.0	2.1	1.9	1.9	1.9
Costs / Income	48.8	47.2	45.5	46.3	44.2	45.0	44.5
Net provisioning / Average assets	0.6	0.6	0.5	0.4	1.1	0.8	0.7
Pre-tax profit / Average assets	1.7	1.8	1.9	2.0	1.3	1.5	1.6
Effective tax rate	19.7	22.0	22.2	26.1	22.0	22.0	21.0
ROA	1.0	1.1	1.2	1.2	0.7	0.9	1.0
ROE	9.1	9.0	9.9	10.0	5.5	6.9	8.1
Valuation Multiples							
Shares outstanding (eop, millions)	1,250.0	1,250.0	1,250.0	1,250.0	1,250.0	1,250.0	1,250.0
Shares outstanding (avg., millions)	1,250.0	1,250.0	1,250.0	1,250.0	1,250.0	1,250.0	1,250.0
EPS (PLN)	2.3	2.5	3.0	3.2	1.9	2.4	2.9
BVPS (PLN)	26.1	29.0	31.3	33.3	35.2	35.3	36.2
P/E (x)	9.9	9.2	7.6	7.1	12.0	9.3	7.9
P/B (x)	0.9	0.8	0.7	0.7	0.6	0.6	0.6
DPS (PLN)	0.00	0.00	0.55	1.33	0.00	2.28	2.66
Dividend Yield (%)	0.0	0.0	2.4	5.8	0.0	10.0	11.7

*Interest income / Average interest-earning assets

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Monday, March 30, 2020 | update

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

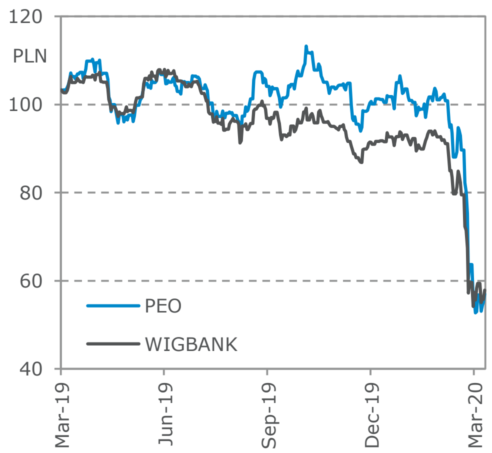
Ownership

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 new	9MTP old	Rating new	Rating 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%	-

Analysts:

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl

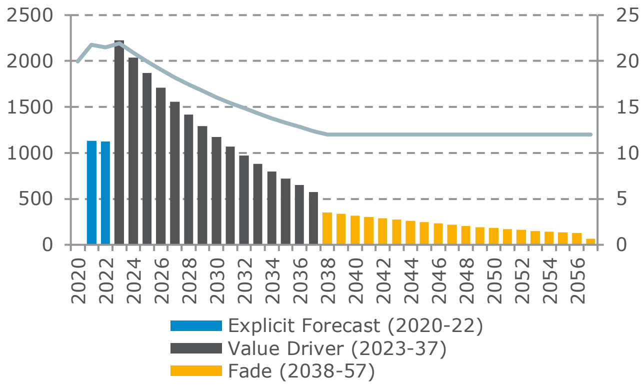
mBank Biuro maklerskie

Valuation

Dividend Discount Model

	(PLN m)	(%)
Explicit forecast (2020-22)	2,250.7	7.8
Adjustment for time value of money	1,607.2	5.6
Value driver (2023-37)	18,949.3	65.8
Fade (2038-57)	4,348.9	15.1
Terminal value	1,634.7	5.7
Fair value of equity	**28,790.8**	**100.0**
Shares outstanding (millions)	262.3	
Fair value per share (PLN)	**109.7**	
Cost of equity (%)	8.5	
9M target price (PLN)	**116.7**	

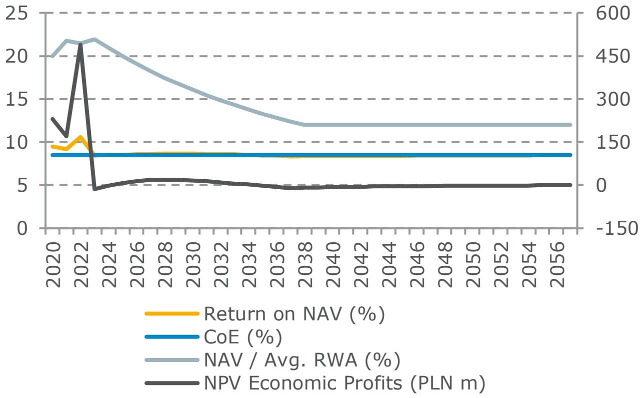
Dividend Discount Valuation (PLN m)



Economic Profit Model

	(PLN m)	(%)
Opening tangible NAV	26,264.1	94.8
Explicit forecast (2020-22)	889.4	3.2
Adjustment for time value of money	509.0	1.8
Value driver (2023-37)	93.3	0.3
Fade (2038-57)	-63.2	-0.2
Fair value of equity	**27,692.6**	**100.0**
Shares outstanding (millions)	262.5	
Fair value per share (PLN)	**105.5**	
Cost of equity (%)	8.5	
9M target price (PLN)	**112.2**	

Economic Profit Model

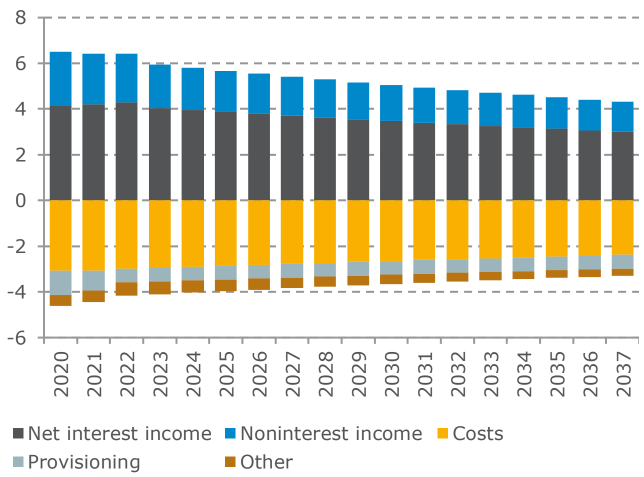


Key Ratios

(%)	2020	2021	2022	Śr.*
Net interest income / Average RWA	4.2	4.2	4.3	3.5
Net interest income / Average RWA	2.3	2.2	2.1	1.6
Costs / Average RWA	-3.1	-3.1	-3.0	-2.7
Costs / Income	47.2	47.8	46.5	52.4
Provisioning / Average RWA	-1.1	-0.9	-0.6	-0.6
Effective tax rate	-23.0	-23.0	-23.0	-23.0
Other / RWA	-0.5	-0.5	-0.6	-0.4
Net profit / Average RWA	1.9	2.0	2.3	1.4
NAV / Average RWA	20.0	21.7	21.5	16.5
Tangible return on NAV	9.5	9.2	10.6	8.5
Net profit growth	-13.8	6.4	21.3	-2.1
Average RWA (PLN bn)	131.5	132.2	140.1	180.3
Growth in average RWA	1.9	0.6	5.9	2.9

*2023-37E avg.

Costs/Income as a pct. of RWA



Valuation Summary

	(PLN)
Dividend Discount Model	109.75
Economic Profit Model	105.51
Average Fair Value	**107.63**
Bank tax	-29.13
9M target price	**83.51**

Income Statement (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Net interest income	**4,382.0**	**4,593.5**	**4,994.0**	**5,468.0**	**5,473.9**	**5,579.9**	**6,020.5**
Fee income	2,390.0	2,353.0	2,462.6	2,533.7	2,408.1	2,458.4	2,526.8
Trading income	508.4	254.5	237.0	236.5	484.0	292.7	276.4
Other income	21.4	77.0	136.7	43.5	71.1	67.2	73.8
Non-interest income	**2,919.8**	**2,684.6**	**2,836.2**	**2,813.7**	**2,963.1**	**2,818.3**	**2,877.0**
Total income	**7,301.8**	**7,278.1**	**7,830.2**	**8,281.7**	**8,437.0**	**8,398.2**	**8,897.5**
Costs	**3,493.7**	**3,534.9**	**3,709.8**	**3,991.8**	**3,926.9**	**3,953.2**	**4,077.2**
Operating income before provisioning	**3,808.1**	**3,743.2**	**4,120.4**	**4,289.9**	**4,510.1**	**4,445.0**	**4,820.3**
Provisioning	500.6	521.4	511.0	696.0	1,422.9	1,160.2	836.1
Equity in profits/losses of associates	38.6	453.4	0.0	0.0	0.0	0.0	0.0
Pre-tax income	**3,346.1**	**3,675.3**	**3,609.3**	**3,593.9**	**3,087.2**	**3,284.9**	**3,984.2**
Tax	616.8	677.3	759.5	835.9	710.1	755.5	916.4
Non-controlling interest	-0.5	-0.6	-0.7	-1.6	-1.7	-1.8	-2.0
Net income before bank tax	**2,728.8**	**2,997.4**	**2,849.2**	**2,756.5**	**2,375.5**	**2,527.5**	**3,065.8**
Bank tax	449.5	522.3	562.0	591.4	603.4	617.1	656.4
Net income	**2,279.3**	**2,475.1**	**2,287.2**	**2,165.0**	**1,772.0**	**1,910.4**	**2,409.4**

Balance Sheet (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Cash and central bank balances	5,873	5,236	13,027	5,163	6,830	6,988	7,158
Loans and advances to banks	3,258	2,627	2,268	1,791	1,828	1,890	1,962
Loans and borrowings	**122,664**	**132,301**	**129,297**	**140,913**	**140,618**	**146,705**	**160,016**
Debt securities	35,853	38,636	39,350	47,175	45,288	47,552	49,930
Fixed assets and intangible assets	2,019	2,951	2,947	3,538	3,391	3,231	3,057
Other assets	4,548	3,714	4,202	4,743	4,980	5,229	5,490
Total assets	**174,215**	**185,466**	**191,090**	**203,323**	**202,935**	**211,596**	**227,614**
Deposits from banks	4,830	4,987	5,621	6,544	1	2,626	5,867
Deposits	**137,816**	**146,186**	**149,491**	**157,990**	**162,843**	**167,743**	**178,501**
Securities issued	2,196	3,241	5,333	6,493	5,843	6,194	6,566
Subordinated loans	0	1,257	2,012	2,764	2,626	2,495	2,370
Other liabilities	6,461	6,526	5,824	6,134	6,371	6,620	6,882
Equity	**22,897**	**23,268**	**22,797**	**23,386**	**25,237**	**25,903**	**27,411**
Non-controlling interest	15	0	11	12	13	15	17
Total equity and liabilities	**174,215**	**185,466**	**191,090**	**203,323**	**202,935**	**211,596**	**227,614**

Key Ratios

(%)	2016	2017	2018	2019	2020P	2021P	2022P
YoY Growth							
Loans	0.5	7.9	-2.3	9.0	-0.2	4.3	9.1
Deposits	6.9	6.1	2.3	5.7	3.1	3.0	6.4
Equity	-2.2	1.6	-2.0	2.6	7.9	2.6	5.8
Assets	3.2	6.5	3.0	6.4	-0.2	4.3	7.6
Net income	-0.6	8.6	-7.6	-5.3	-18.2	7.8	26.1
Net interest income	5.2	4.8	8.7	9.5	0.1	1.9	7.9
Balance-Sheet Ratios							
Loans / Deposits	89.0	90.5	86.5	89.2	86.4	87.5	89.6
Deposits / Assets	79.1	78.8	78.2	77.7	80.2	79.3	78.4
Loans / Assets	70.4	71.3	67.7	69.3	69.3	69.3	70.3
Equity / Assets (incl. minority inter.)	13.2	12.5	11.9	11.5	12.4	12.2	12.1
Capital Adequacy Ratio	17.6	16.1	15.8	15.4	17.8	18.0	17.7
Tier 1 Ratio	17.6	17.1	17.4	16.9	19.4	19.4	19.1
Asset Quality Metrics							
NPL / Loans	6.0	5.4	5.4	5.2	8.0	8.0	7.0
Provisioning / Loans	4.5	4.0	4.3	4.1	6.0	6.0	5.0
Provisioning / NPL	74.5	74.7	79.0	79.3	75.0	75.0	71.4
Net Provisioning / Average Loans	0.4	0.4	0.4	0.5	1.0	0.8	0.5
Profitability Metrics							
Net Interest Margin*	2.7	2.7	2.8	2.89	2.81	2.81	2.85
Interest income / Average assets	2.6	2.6	2.7	2.8	2.7	2.7	2.7
Non-Interest Income / Average Assets	1.8	1.6	1.6	1.5	1.5	1.4	1.4
Costs / Average Assets	2.1	2.1	2.0	2.1	2.0	2.0	1.9
Costs / Income	48.4	49.8	48.3	48.8	47.2	47.8	46.5
Net provisioning / Average assets	0.3	0.3	0.3	0.4	0.7	0.6	0.4
Pre-tax profit / Average assets	2.0	2.0	1.9	1.8	1.5	1.6	1.8
Effective tax rate	18.4	18.4	21.0	23.3	23.0	23.0	23.0
ROA	1.3	1.4	1.2	1.1	0.9	0.9	1.1
ROE	9.8	10.7	9.9	9.4	7.3	7.5	9.0
Valuation Multiples							
Shares outstanding (eop, millions)	262.5	262.5	262.5	262.5	262.5	262.5	262.5
Shares outstanding (avg., millions)	262.5	262.5	262.5	262.5	262.5	262.5	262.5
EPS (PLN)	8.7	9.4	8.7	8.2	6.8	7.3	9.2
BVPS (PLN)	87.2	88.6	86.9	89.1	96.2	98.7	104.4
P/E (x)	6.4	5.9	6.3	6.7	8.2	7.6	6.0
P/B (x)	0.6	0.6	0.6	0.6	0.6	0.6	0.5
DPS (PLN)	8.7	8.7	7.9	6.6	0.0	5.1	5.5
Dividend Yield (%)	15.7	15.7	14.3	11.9	0.0	9.2	9.9

*Interest income / Average interest-earning assets

Monday, March 30, 2020 | update

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

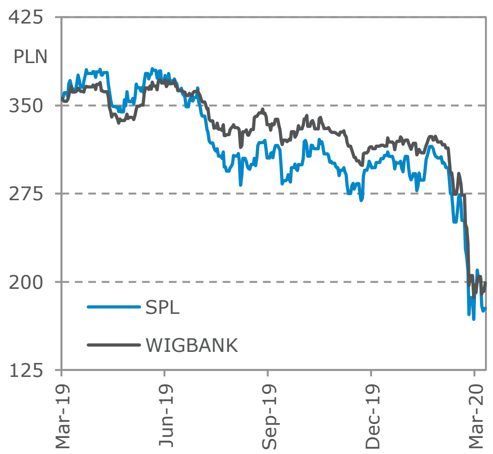
Ownership

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%

Analysts:

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

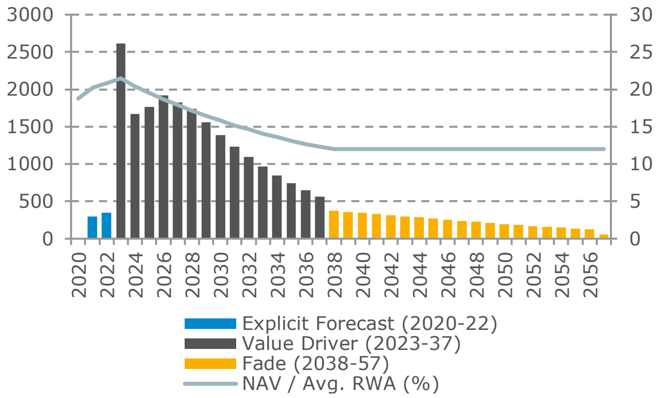
Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl

Valuation

Dividend Discount Model

	(PLN m)	(%)
Explicit forecast (2020-22)	647.1	2.2
Adjustment for time value of money	1,768.8	6.1
Value driver (2023-37)	20,557.8	71.0
Fade (2038-57)	4,678.9	16.2
Terminal value	1,304.7	4.5
Fair value of equity	**28,957.4**	**100.0**
Shares outstanding (millions)	99.2	
Fair value per share (PLN)	**291.8**	
Cost of equity (%)	8.5	
9M target price (PLN)	**310.4**	

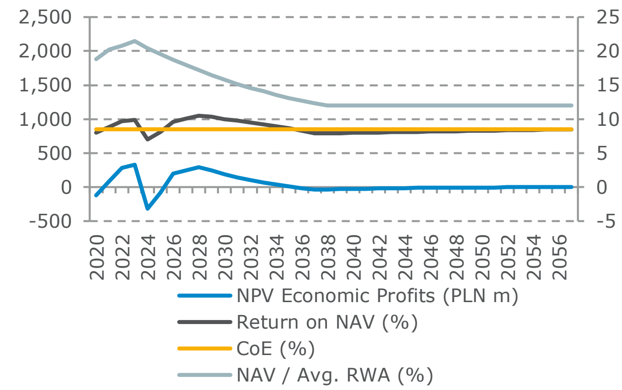
Dividend Discount Valuation (PLN m)



Economic Profit Model

	(PLN m)	(%)
Opening tangible NAV	25,791.4	93.1
Explicit forecast (2020-22)	234.5	0.8
Adjustment for time value of money	502.9	1.8
Value driver (2023-37)	1,395.9	5.0
Fade (2038-57)	-233.2	-0.8
Fair value of equity	**27,691.5**	**100.0**
Shares outstanding (millions)	99.2	
Fair value per share (PLN)	**279.1**	
Cost of equity (%)	8.5	
9M target price (PLN)	**296.8**	

Economic Profit Model

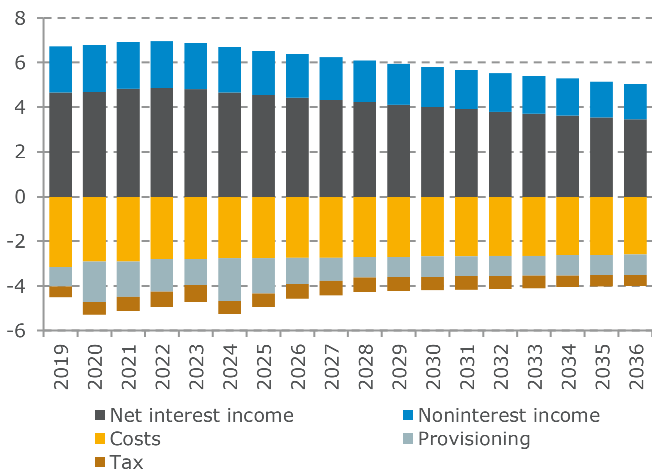


Key Ratios

(%)	2020	2021	2022	Avg.*
Net interest income / Average RWA	4.7	4.8	4.9	4.0
Net interest income / Average RWA	2.1	2.1	2.1	1.8
Costs / Average RWA	-2.9	-2.9	-2.8	-2.7
Costs / Income	42.9	42.0	40.1	46.4
Provisioning / Average RWA	-1.8	-1.6	-1.5	-1.1
Effective tax rate	-21.5	-21.4	-21.4	-21.0
Other / RWA	-0.6	-0.6	-0.7	-0.6
Net profit / Average RWA	1.5	1.8	2.0	1.5
NAV / Average RWA	18.8	20.3	20.8	16.2
Tangible return on NAV	8.0	8.8	9.7	9.2
Net profit growth	-27.8	20.6	18.4	-1.2
Average RWA (PLN bn)	137	137	144	188
Growth in average RWA	-2.9	0.1	4.9	2.9

*2023-37E avg.

Costs/Income as a pct. of RWA



Valuation Summary

	(PLN)
Dividend Discount Model	291.81
Economic Profit Model	279.05
Average Fair Value	**285.43**
Bank tax	-69.67
9M target price	**229.52**

Income Statement (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Net interest income	**4,770.4**	**5,276.9**	**5,742.4**	**6,580.2**	**6,434.3**	**6,630.3**	**7,007.2**
Fee income	1,914.7	2,013.1	2,057.8	2,128.2	1,992.4	2,103.1	2,246.5
Trading income	780.3	323.0	282.1	500.2	600.3	480.2	485.0
Other income	140.8	150.6	213.8	275.9	275.9	287.0	298.4
Non-interest income	**2,835.8**	**2,486.8**	**2,553.7**	**2,904.3**	**2,868.6**	**2,870.3**	**3,030.0**
Total income	**7,606.1**	**7,763.7**	**8,296.1**	**9,484.5**	**9,302.9**	**9,500.6**	**10,037.2**
Costs	**3,367.7**	**3,372.4**	**3,769.0**	**4,488.7**	**3,995.4**	**3,986.3**	**4,027.8**
Operating income before provisioning	**4,238.4**	**4,391.2**	**4,527.2**	**4,995.8**	**5,307.5**	**5,514.3**	**6,009.4**
Provisioning	784.6	690.5	1,085.1	1,219.4	2,487.5	2,179.1	2,119.3
Equity in profits/losses of associates	55.4	58.3	62.7	67.2	67.2	67.2	67.2
One-time gains	0.0	0.0	419.3	0.0	0.0	0.0	0.0
Pre-tax income	**3,509.3**	**3,759.0**	**3,924.0**	**3,843.6**	**2,887.3**	**3,402.4**	**3,957.2**
Tax	738.0	816.7	727.1	800.5	606.3	714.5	831.0
Non-controlling interest	-217.2	-305.5	-333.8	-305.8	-305.1	-304.5	-303.9
Net income before bank tax	**2,554.1**	**2,636.9**	**2,863.1**	**2,737.4**	**1,975.8**	**2,383.3**	**2,822.3**
Bank tax	-387.2	-423.8	-499.8	-599.0	-587.1	-583.8	-599.3
Net income	**2,166.8**	**2,213.1**	**2,363.4**	**2,138.3**	**1,388.7**	**1,799.6**	**2,223.0**

Balance Sheet (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Cash and central bank balances	4,776	4,146	8,908	7,973	10,283	10,440	10,601
Loans and advances to banks	3,513	2,136	2,936	3,717	3,791	3,867	3,944
Loans and borrowings	**103,069**	**107,840**	**137,460**	**143,403**	**143,660**	**145,563**	**154,124**
Debt securities	32,489	31,832	49,930	46,327	44,011	48,412	50,349
Fixed assets and intangible assets	3,054	3,133	3,518	4,197	3,768	3,370	2,967
Other assets	3,200	3,587	3,904	3,860	3,975	4,095	4,217
Total assets	**150,100**	**152,674**	**206,656**	**209,476**	**209,488**	**215,746**	**226,202**
Deposits from banks	2,561	2,783	2,833	5,032	1,086	1,720	3,527
Deposits	**112,522**	**111,481**	**149,617**	**156,480**	**158,834**	**164,035**	**170,243**
Securities issued	7,338	7,134	10,850	12,486	12,861	11,575	11,922
Subordinated loans	440	1,489	2,644	2,630	2,367	2,131	1,917
Other liabilities	6,219	6,444	14,118	5,868	5,984	6,103	6,226
Equity	**19,781**	**21,907**	**25,031**	**25,432**	**26,821**	**28,660**	**30,857**
Non-controlling interest	1,238	1,436	1,564	1,548	1,535	1,522	1,510
Total equity and liabilities	**150,100**	**152,674**	**206,656**	**209,476**	**209,488**	**215,746**	**226,202**

mBank Biuro maklerskie

Key Ratios

(%)	2016	2017	2018	2019	2020P	2021P	2022P
YoY Growth							
Loans	8.6	4.6	27.5	4.3	0.2	1.3	5.9
Deposits	11.1	-0.9	34.2	4.6	1.5	3.3	3.8
Equity	2.0	10.7	14.3	1.6	5.5	6.9	7.7
Assets	7.4	1.7	35.4	1.4	0.0	3.0	4.8
Net income	-6.9	2.1	6.8	-9.5	-35.1	29.6	23.5
Net interest income	10.7	10.6	8.8	14.6	-2.2	3.0	5.7
Balance-Sheet Ratios							
Loans / Deposits	91.6	96.7	91.9	91.6	90.4	88.7	90.5
Deposits / Assets	75.0	73.0	72.4	74.7	75.8	76.0	75.3
Loans / Assets	68.7	70.6	66.5	68.5	68.6	67.5	68.1
Equity / Assets (incl. minority inter.)	14.0	15.3	12.9	12.9	13.5	14.0	14.3
Capital Adequacy Ratio	15.0	16.7	16.0	16.8	19.0	19.3	19.4
Tier 1 Ratio	14.6	15.3	14.1	14.9	17.0	17.4	17.6
Asset Quality Metrics							
NPL / Loans	6.6	5.8	4.5	5.2	4.4	4.6	4.6
Provisioning / Loans	4.5	4.3	3.1	3.5	3.2	3.5	3.5
Provisioning / NPL	68.5	74.1	68.2	67.8	72.7	76.1	76.1
Net Provisioning / Average Loans	0.8	0.6	0.9	0.8	1.7	1.5	1.4
Profitability Metrics							
Net Interest Margin*	3.4	3.6	3.3	3.28	3.19	3.23	3.28
Interest income / Average assets	3.3	3.5	3.2	3.2	3.1	3.1	3.2
Non-Interest Income / Average Assets	2.0	1.6	1.4	1.4	1.4	1.3	1.4
Costs / Average Assets	2.3	2.2	2.1	2.2	1.9	1.9	1.8
Costs / Income	44.3	43.4	45.4	47.3	42.9	42.0	40.1
Net provisioning / Average assets	0.5	0.5	0.6	0.6	1.2	1.0	1.0
Pre-tax profit / Average assets	2.4	2.5	2.2	1.8	1.4	1.6	1.8
Effective tax rate	21.0	21.7	18.5	20.8	21.0	21.0	21.0
ROA	1.5	1.5	1.3	1.0	0.7	0.8	1.0
ROE	11.1	10.6	10.1	8.5	5.3	6.5	7.5
Valuation Multiples							
Shares outstanding (eop, millions)	99,235	99,235	102,088	102,088	102,088	102,088	102,088
Shares outstanding (avg., millions)	99,235	99,235	100,661	102,088	102,088	102,088	102,088
EPS (PLN)	21.8	22.3	23.5	20.9	13.6	17.6	21.8
BVPS (PLN)	199.3	220.8	245.2	249.1	262.7	280.7	302.3
P/E (x)	8.0	7.8	7.4	8.3	12.8	9.9	8.0
P/B (x)	0.9	0.8	0.7	0.7	0.7	0.6	0.6
DPS (PLN)	21.33	5.40	3.10	19.72	0.00	3.40	4.41
Dividend Yield (%)	12.3	3.1	1.8	11.3	0.0	2.0	2.5

*Interest income / Average interest-earning assets

Monday, March 30, 2020 | update

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

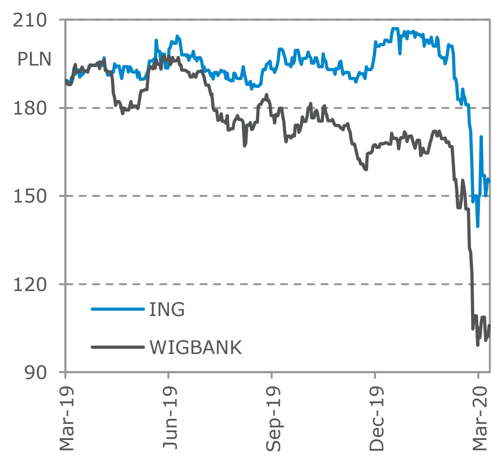
Current Price	PLN 153.80
Target Price	PLN 126.36
MCap	PLN 20.0bn
Free Float	PLN 5.0bn
ADTV (3M)	PLN 5.0m

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%	-

Analysts:

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

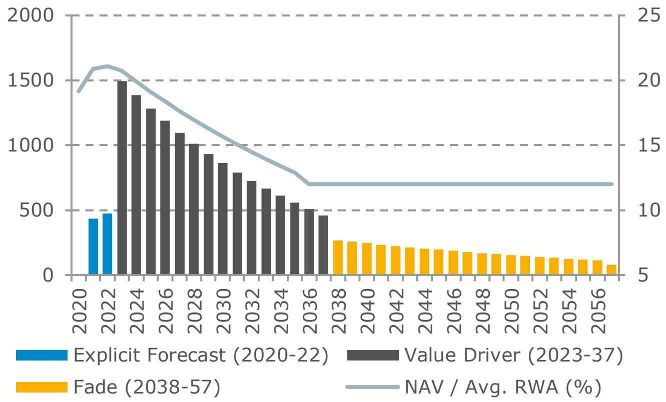
Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl

Valuation

Dividend Discount Model

	(PLN m)	(%)
Explicit forecast (2020-22)	908.3	4.2
Adjustment for time value of money	1,454.0	6.8
Value driver (2023-37)	13,564.9	63.0
Fade (2038-57)	3,534.4	16.4
Terminal value	2,058.0	9.6
Fair value of equity	**21,519.5**	**100.0**
Shares outstanding (millions)	130.1	
Fair value per share (PLN)	**165.4**	
Cost of equity (%)	8.5	
9M target price (PLN)	**176.0**	

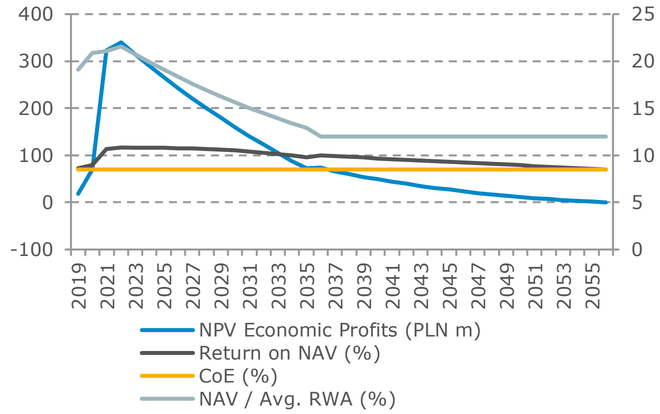
Dividend Discount Valuation (PLN m)



Economic Profit Model

	(PLN m)	(%)
Opening tangible NAV	16,305.5	79.8
Explicit forecast (2020-22)	411.1	2.0
Adjustment for time value of money	370.9	1.8
Value driver (2023-37)	2,819.2	13.8
Fade (2038-57)	518.9	2.5
Fair value of equity	**20,425.8**	**100.0**
Shares outstanding (millions)	130.1	
Fair value per share (PLN)	**157.0**	
Cost of equity (%)	8.5	
9M target price (PLN)	**167.0**	

Economic Profit Model

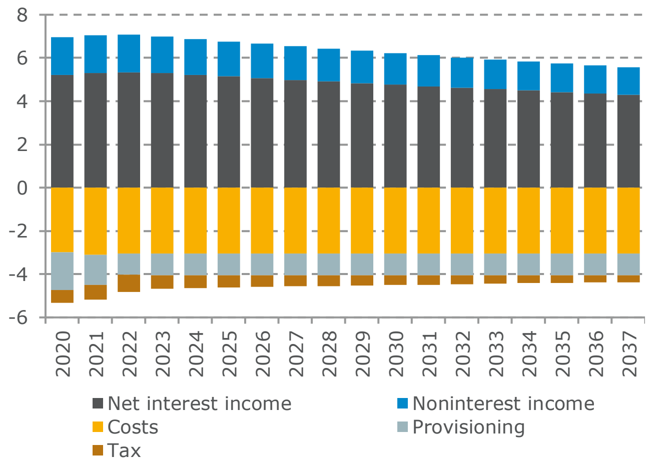


Key Ratios

(%)	2020	2021	2022	Avg.*
Net interest income / Average RWA	5.2	5.3	5.3	4.8
Net interest income / Average RWA	1.8	1.7	1.7	1.5
Costs / Average RWA	-3.0	-3.1	-3.1	-3.1
Costs / Income	42.9	44.2	43.2	49.1
Provisioning / Average RWA	-1.7	-1.4	-1.0	-1.0
Effective tax rate	-22.5	-22.5	-22.5	-21.0
Other / RWA	-0.6	-0.7	-0.8	-0.5
Net profit / Average RWA	1.6	1.9	2.3	1.7
NAV / Average RWA	19.1	20.9	21.1	16.5
Tangible return on NAV	8.6	9.0	10.7	10.5
Net profit growth	-29.1	13.3	25.9	0.0
Average RWA (PLN bn)	85	85	89	132
Growth in average RWA	6.4	11.1	14.9	4.6

*2023-37E avg.

Costs/Income as a pct. of RWA



Valuation Summary

	(PLN)
Dividend Discount Model	165.41
Economic Profit Model	157.00
Average Fair Value	**161.20**
Bank tax	-42.42
9M target price	**126.36**

Income Statement (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Net interest income	**2,953.4**	**3,452.8**	**3,759.3**	**4,293.9**	**4,431.8**	**4,498.6**	**4,759.9**
Fee income	1,064.8	1,182.8	1,304.9	1,371.7	1,312.5	1,332.7	1,388.5
Trading income	286.9	117.3	154.1	130.3	175.9	131.9	138.5
Other income	19.4	3.0	14.4	-6.1	14.0	14.3	14.6
Non-interest income	**1,371.1**	**1,303.1**	**1,473.4**	**1,495.9**	**1,502.4**	**1,478.9**	**1,541.6**
Total income	**4,324.5**	**4,755.9**	**5,232.7**	**5,789.8**	**5,934.2**	**5,977.5**	**6,301.5**
Costs	**2,099.2**	**2,122.6**	**2,326.8**	**2,497.4**	**2,546.3**	**2,641.8**	**2,719.5**
Operating income before provisioning	**2,225.3**	**2,633.3**	**2,905.9**	**3,292.4**	**3,387.9**	**3,335.8**	**3,582.0**
Provisioning	300.6	421.2	500.9	605.5	1,479.9	1,174.0	859.5
Equity in profits/losses of associates	0.0	0.0	-0.3	6.6	6.6	6.6	6.5
Pre-tax income	**1,924.7**	**2,212.1**	**2,404.7**	**2,693.5**	**1,914.6**	**2,168.4**	**2,729.0**
Tax	391.4	478.9	507.1	599.1	428.9	485.7	611.3
Non-controlling interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income before bank tax	**1,533.3**	**1,733.2**	**1,897.6**	**2,094.4**	**1,485.7**	**1,682.6**	**2,117.7**
Bank tax	280.2	330.1	373.8	435.7	462.4	472.7	489.8
Net income	**1,253.1**	**1,403.1**	**1,523.8**	**1,658.7**	**1,023.3**	**1,209.9**	**1,627.9**

Balance Sheet (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Cash and central bank balances	1,825	2,815	1,237	1,403	4,758	5,128	5,528
Loans and advances to banks	1,113	2,235	777	799	2,426	2,465	2,512
Loans and borrowings	81,980	91,088	103,126	118,288	117,303	117,851	127,039
Debt securities	29,665	27,242	33,873	35,230	33,241	34,844	35,469
Fixed assets and intangible assets	1,004	980	995	1,386	1,261	1,122	966
Other assets	1,890	1,654	1,805	1,506	1,558	1,613	1,669
Total assets	**117,478**	**126,014**	**141,813**	**158,611**	**160,548**	**163,022**	**173,183**
Deposits from banks	5,043	4,109	5,196	6,256	921	558	836
Deposits	95,825	104,503	117,683	130,474	135,965	137,077	144,643
Securities issued	1,341	1,035	1,410	648	662	676	692
Subordinated loans	665	627	1,077	2,131	3,185	4,240	5,294
Other liabilities	4,126	3,945	3,126	3,879	3,932	3,986	4,043
Equity	**10,475**	**11,795**	**13,322**	**15,223**	**15,883**	**16,484**	**17,676**
Non-controlling interest	2	0	0	0	0	0	0
Total equity and liabilities	**117,478**	**126,014**	**141,813**	**158,611**	**160,548**	**163,022**	**173,183**

Key Ratios

(%)	2016	2017	2018	2019	2020P	2021P	2022P
YoY Growth							
Loans	13.0	11.1	13.2	14.7	-0.8	0.5	7.8
Deposits	9.1	9.1	12.6	10.9	4.2	0.8	5.5
Equity	-1.9	12.6	12.9	14.3	4.3	3.8	7.2
Assets	7.9	7.3	12.5	11.8	1.2	1.5	6.2
Net income	36.1	13.0	9.5	10.4	-29.1	13.3	25.9
Net interest income	19.7	16.9	8.9	14.2	3.2	1.5	5.8
Balance-Sheet Ratios							
Loans / Deposits	85.6	87.2	87.6	90.7	86.3	86.0	87.8
Deposits / Assets	81.6	82.9	83.0	82.3	84.7	84.1	83.5
Loans / Assets	69.8	72.3	72.7	74.6	73.1	72.3	73.4
Equity / Assets (incl. minority inter.)	8.9	9.4	9.4	9.6	9.9	10.1	10.2
Capital Adequacy Ratio	14.7	16.7	15.6	16.9	20.4	21.0	20.6
Tier 1 Ratio	13.7	15.8	14.7	14.5	17.9	18.5	18.2
Asset Quality Metrics							
NPL / Loans	2.6	2.8	2.8	3.0	3.2	3.6	3.6
Provisioning / Loans	1.8	1.8	2.0	1.9	2.4	2.6	2.6
Provisioning / NPL	67.3	64.1	70.0	64.5	75.0	72.2	72.2
Net Provisioning / Average Loans	0.4	0.5	0.5	0.5	1.2	1.0	0.7
Profitability Metrics							
Net Interest Margin*	2.7	2.9	2.9	2.9	2.8	2.8	2.9
Interest income / Average assets	2.6	2.8	2.8	2.9	2.8	2.8	2.8
Non-Interest Income / Average Assets	1.2	1.1	1.1	1.0	0.9	0.9	0.9
Costs / Average Assets	1.9	1.7	1.7	1.7	1.6	1.6	1.6
Costs / Income	48.5	44.6	44.5	43.1	42.9	44.2	43.2
Net provisioning / Average assets	0.3	0.3	0.4	0.4	0.9	0.7	0.5
Pre-tax profit / Average assets	1.7	1.8	1.8	1.8	1.2	1.3	1.6
Effective tax rate	20.3	21.6	21.1	22.2	22.4	22.4	22.4
ROA	1.1	1.2	1.1	1.1	0.6	0.7	1.0
ROE	11.8	12.6	12.1	11.6	6.6	7.5	9.5
Valuation Multiples							
Shares outstanding (eop, millions)	130.1	130.1	130.1	130.1	130.1	130.1	130.1
Shares outstanding (avg., millions)	130.1	130.1	130.1	130.1	130.1	130.1	130.1
EPS (PLN)	9.6	10.8	11.7	12.7	7.9	9.3	12.5
BVPS (PLN)	80.5	90.7	102.4	117.0	122.1	126.7	135.9
P/E (x)	16.0	14.3	13.1	12.1	19.6	16.5	12.3
P/B (x)	1.9	1.7	1.5	1.3	1.3	1.2	1.1
DPS (PLN)	4.30	0.00	3.20	3.50	0.00	3.93	4.65
Dividend Yield (%)	2.8	0.0	2.1	2.3	0.0	2.6	3.0

*Interest income / Average interest-earning assets

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Monday, March 30, 2020 | update

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

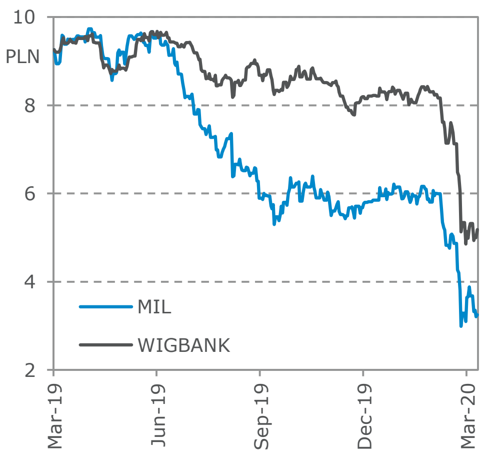
Ownership

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%	-

Analysts:

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

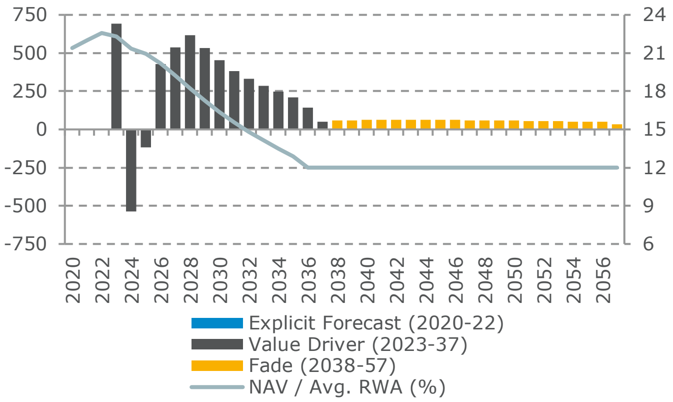
Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl

Valuation

Dividend Discount Model

	(PLN m)	%
Explicit forecast (2020-22)	0.0	0.0
Adjustment for time value of money	438.6	6.5
Value driver (2023-37)	4,248.1	63.4
Fade (2038-57)	1,141.8	17.0
Terminal value	869.5	13.0
Fair value of equity	**6,698.0**	**100.0**
Shares outstanding (millions)	1,213.1	
Fair value per share (PLN)	**5.5**	
Cost of equity (%)	8.5	
9M target price (PLN)	**5.9**	

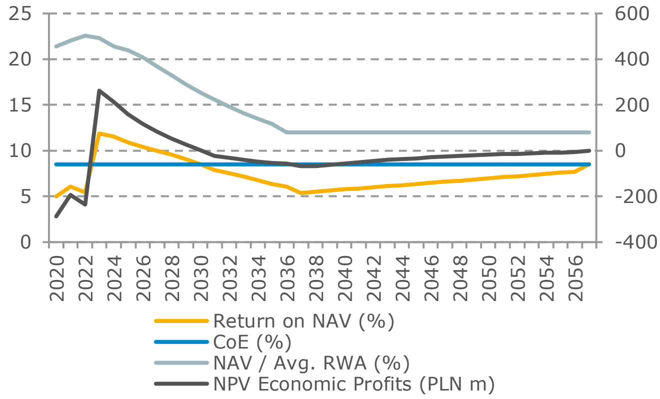
Dividend Discount Valuation (PLN m)



Economic Profit Model

	(PLN m)	(%)
Opening tangible NAV	9,657.0	105.9
Explicit forecast (2020-22)	-717.2	-7.9
Adjustment for time value of money	159.7	1.8
Value driver (2023-37)	593.3	6.5
Fade (2038-57)	-569.9	-6.2
Fair value of equity	**9,122.9**	**100.0**
Shares outstanding (millions)	1213.1	
Fair value per share (PLN)	**7.5**	
Cost of equity (%)	8.5	
9M target price (PLN)	**8.0**	

Economic Profit Model

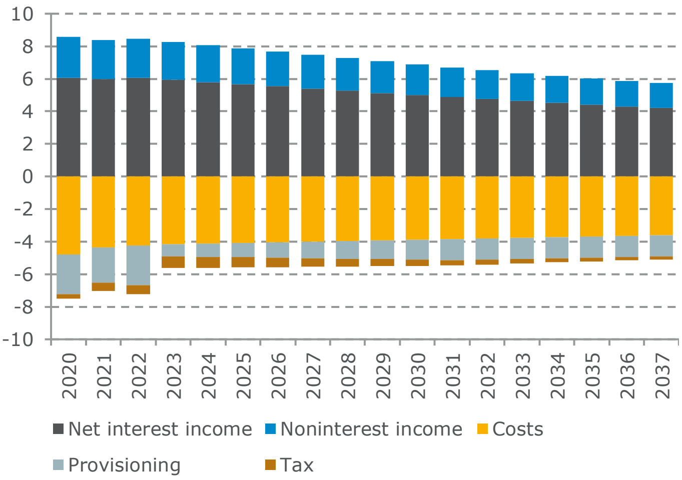


Key Ratios

(%)	2020	2021	2022	Avg.*
Net interest income / Average RWA	6.1	6.0	6.1	5.1
Net interest income / Average RWA	2.5	2.4	2.4	1.9
Costs / Average RWA	-4.8	-4.4	-4.2	-3.9
Costs / Income	56.0	52.1	49.8	56.2
Provisioning / Average RWA	-2.4	-2.2	-2.4	-1.1
Effective tax rate	-21.5	-21.5	-21.5	-21.5
Other / RWA	-0.3	-0.5	-0.6	-0.4
Net profit / Average RWA	1.1	1.3	1.2	1.6
NAV / Average RWA	21.4	22.0	22.6	17.1
Tangible return on NAV	5.0	6.1	5.4	8.8
Net profit growth	-41.3	40.3	1.5	-52.7
Average RWA (PLN bn)	45,170	46,112	47,644	61,276
Growth in average RWA	13.0	2.1	3.3	3.4

*2023-37E avg.

Costs/Income as a pct. of RWA



Valuation Summary

	(PLN)
Dividend Discount Model	5.52
Economic Profit Model	7.52
Average Fair Value	**6.52**
Bank tax	-2.70
9M target price	**4.06**

Income Statement (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Net interest income	**1,505.8**	**1,696.5**	**1,817.5**	**2,436.9**	**2,741.7**	**2,760.7**	**2,892.3**
Fee income	581.0	663.6	661.1	699.2	700.5	722.8	750.1
Trading income	490.6	219.6	228.5	318.5	328.1	278.9	287.3
Other income	50.6	69.9	50.7	97.6	99.5	102.5	106.6
Non-interest income	**1,122.2**	**953.1**	**940.3**	**1,115.2**	**1,128.2**	**1,104.2**	**1,144.0**
Total income	**2,628.0**	**2,649.6**	**2,757.7**	**3,552.1**	**3,869.9**	**3,864.9**	**4,036.3**
Costs	**1,268.1**	**1,280.6**	**1,332.2**	**1,841.7**	**2,165.8**	**2,013.6**	**2,010.6**
Operating income before provisioning	**1,359.9**	**1,368.9**	**1,425.6**	**1,710.4**	**1,704.0**	**1,851.3**	**2,025.7**
Provisioning	231.2	255.4	202.5	627.1	1,098.5	1,001.7	1,163.9
Equity in profits/losses of associates	-1.4	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax income	**1,127.3**	**1,113.5**	**1,223.1**	**1,083.3**	**605.5**	**849.6**	**861.8**
Tax	252.0	244.0	264.0	274.6	130.4	183.0	185.3
Non-controlling interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income before bank tax	**875.3**	**869.6**	**959.1**	**808.7**	**475.1**	**666.6**	**676.5**
Bank tax	174.1	188.3	198.5	248.0	275.3	279.2	282.3
Net income	**701.3**	**681.2**	**760.7**	**560.7**	**199.8**	**387.3**	**394.2**

Balance Sheet (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Cash and central bank balances	1,779	2,080	2,450	2,203	2,340	2,454	2,598
Loans and advances to banks	1,268	254	731	784	841	877	929
Loans and borrowings	47,020	47,411	52,712	69,755	70,307	71,826	74,386
Debt securities	17,790	19,598	23,038	23,075	22,498	23,285	24,333
Fixed assets and intangible assets	226	266	307	1,009	885	759	634
Other assets	709	1,532	1,220	1,230	1,242	1,254	1,279
Total assets	**68,793**	**71,141**	**80,459**	**98,056**	**98,112**	**100,456**	**104,159**
Deposits from banks	1,271	2,353	1,789	1,579	1,277	1,294	1,560
Deposits	55,876	57,273	66,244	81,455	81,845	83,921	87,365
Securities issued	1,653	1,347	1,041	1,536	1,459	1,386	1,331
Subordinated loans	664	702	702	1,546	1,563	1,581	1,598
Other liabilities	2,388	1,694	2,299	2,998	3,423	3,391	3,087
Equity	**6,941**	**7,773**	**8,384**	**8,942**	**8,545**	**8,884**	**9,219**
Non-controlling interest	0	0	0	0	0	0	0
Total equity and liabilities	**68,793**	**71,141**	**80,459**	**98,056**	**98,112**	**100,456**	**104,159**

Key Ratios

%	2016	2017	2018	2019	2020P	2021P	2022P
YoY Growth							
Loans	1.4	0.8	11.2	32.3	0.8	2.2	3.6
Deposits	5.8	2.5	15.7	23.0	0.5	2.5	4.1
Equity	7.7	12.0	7.9	6.6	-4.4	4.0	3.8
Assets	3.9	3.4	13.1	21.9	0.1	2.4	3.7
Net income	60.2	-0.7	10.3	-15.7	-41.3	40.3	1.5
Net interest income	10.3	12.7	7.1	34.1	12.5	0.7	4.8
Balance-Sheet Ratios							
Loans / Deposits	84.2	82.8	79.6	85.6	85.9	85.6	85.1
Deposits / Assets	81.2	80.5	82.3	83.1	83.4	83.5	83.9
Loans / Assets	68.4	66.6	65.5	71.1	71.7	71.5	71.4
Equity / Assets (incl. minority inter.)	10.1	10.9	10.4	9.1	8.7	8.8	8.9
Capital Adequacy Ratio	17.4	22.0	22.6	19.3	18.6	18.6	18.5
Tier 1 Ratio	17.3	20.0	20.8	17.8	17.2	17.2	17.2
Asset Quality Metrics							
NPL / Loans	4.5	4.6	4.4	4.5	4.3	4.3	4.3
Provisioning / Loans	2.8	3.1	3.2	2.7	3.2	3.2	3.2
Provisioning / NPL	62.6	67.1	73.2	61.3	74.4	74.4	74.4
Net Provisioning / Average Loans	0.5	0.5	0.5	0.7	1.4	0.9	0.6
Profitability Metrics							
Net Interest Margin*	2.3	2.5	2.5	2.8	2.9	2.8	2.9
Interest income / Average assets	2.2	2.4	2.4	2.7	2.8	2.8	2.8
Non-Interest Income / Average Assets	1.7	1.4	1.2	1.2	1.2	1.1	1.1
Costs / Average Assets	1.9	1.8	1.8	2.1	2.2	2.0	2.0
Costs / Income	48.3	48.3	48.3	51.8	56.0	52.1	49.8
Net provisioning / Average assets	0.3	0.4	0.3	0.7	1.1	1.0	1.1
Pre-tax profit / Average assets	1.7	1.6	1.6	1.2	0.6	0.9	0.8
Effective tax rate	22.4	21.9	21.6	25.3	21.5	21.5	21.5
ROA	1.0	1.0	1.0	0.6	0.2	0.4	0.4
ROE	10.5	9.3	9.4	6.5	2.3	4.4	4.4
Valuation Multiples							
Shares outstanding (eop, millions)	1,213.1	1,213.1	1,213.1	1,213.1	1,213.1	1,213.1	1,213.1
Shares outstanding (avg., millions)	1,213.1	1,213.1	1,213.1	1,213.1	1,213.1	1,213.1	1,213.1
EPS (PLN)	0.6	0.6	0.6	0.5	0.2	0.3	0.3
BVPS (PLN)	5.7	6.4	6.9	7.4	7.0	7.3	7.6
P/E (x)	5.7	5.9	5.2	7.1	20.0	10.3	10.1
P/B (x)	0.6	0.5	0.5	0.4	0.5	0.4	0.4
DPS (PLN)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

*Interest income / Average interest-earning assets

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

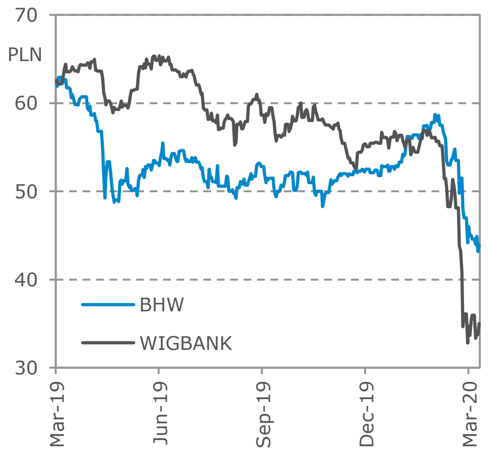
Ownership

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%

Analysts:

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

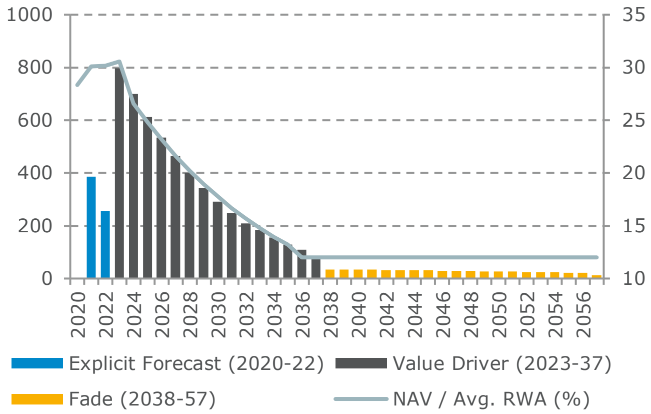
Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl

Valuation

Dividend Discount Model

	(PLN m)	(%)
Explicit forecast (2020-22)	641.3	9.0
Adjustment for time value of money	396.2	5.5
Value driver (2023-37)	5,262.5	73.6
Fade (2038-57)	555.5	7.8
Terminal value	296.3	4.1
Fair value of equity	**7,151.8**	**100.0**
Shares outstanding (millions)	130.7	
Fair value per share (PLN)	**54.7**	
Cost of equity (%)	8.5	
9M target price (PLN)	**58.2**	

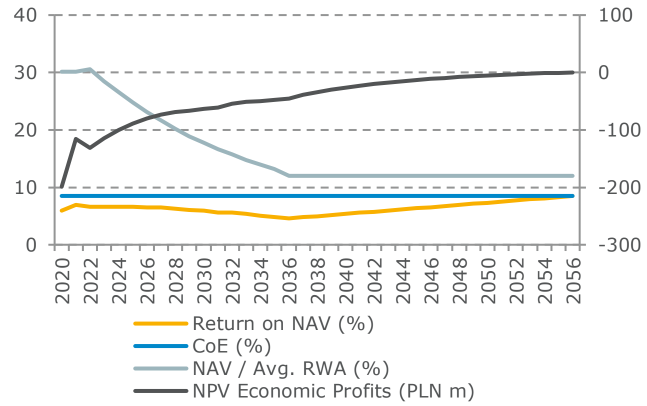
Dividend Discount Valuation (PLN m)



Economic Profit Model

	(PLN m)	(%)
Opening tangible NAV	8,659.1	126.6
Explicit forecast (2020-22)	-537.2	-7.9
Adjustment for time value of money	82.1	1.2
Value driver (2023-37)	-1,095.9	-16.0
Fade (2038-57)	-268.1	-3.9
Fair value of equity	**6,840.0**	**100.0**
Shares outstanding (millions)	130.7	
Fair value per share (PLN)	**52.3**	
Cost of equity (%)	8.5	
9M target price (PLN)	**55.7**	

Economic Profit Model

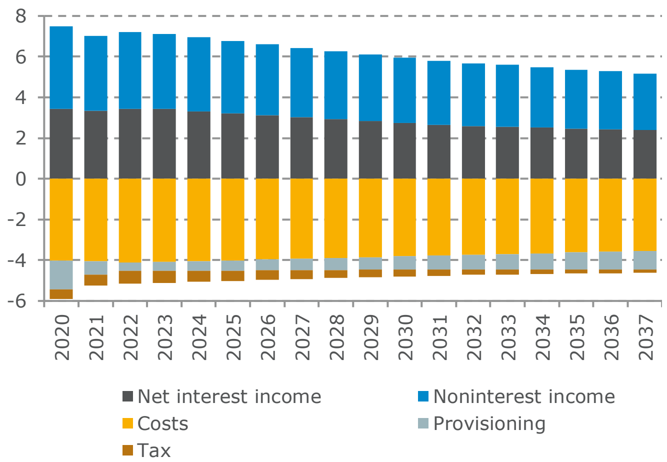


Key Ratios

(%)	2020	2021	2022	Śr.*
Net interest income / Average RWA	3.4	3.3	3.4	2.8
Net interest income / Average RWA	4.1	3.7	3.8	3.3
Costs / Average RWA	-4.0	-4.1	-4.1	-3.8
Costs / Income	53.4	57.7	57.2	62.7
Provisioning / Average RWA	-1.4	-0.7	-0.4	-0.6
Effective tax rate	-22.5	-22.5	-22.5	-22.5
Other / RWA	-0.5	-0.5	-0.6	-0.4
Net profit / Average RWA	1.6	1.8	2.1	1.3
NAV / Average RWA	28.3	30.1	30.1	21.1
Tangible return on NAV	5.7	5.9	6.9	6.1
Net profit growth	-15.4	10.0	17.3	-4.8
Average RWA (PLN bn)	30.6	30.4	30.7	35.5
Growth in average RWA	1.3	-0.5	0.8	1.7

*2023-37E avg.

Costs/Income as a pct. of RWA



Valuation Summary

	(PLN)
Dividend Discount Model	54.74
Economic Profit Model	52.35
Average Fair Value	**53.54**
Bank tax	-10.62
9M target price	**45.66**

Income Statement (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Net interest income	**1,003.6**	**1,082.1**	**1,107.6**	**1,153.7**	**1,051.6**	**1,013.8**	**1,054.7**
Fee income	561.2	580.7	549.9	564.9	539.5	553.7	569.8
Trading income	497.4	395.7	487.0	491.4	657.3	520.3	538.3
Other income	48.3	52.5	44.0	45.8	46.4	48.1	49.8
Non-interest income	**1,106.9**	**1,028.8**	**1,081.0**	**1,102.1**	**1,243.2**	**1,122.1**	**1,157.9**
Total income	**2,110.5**	**2,110.9**	**2,188.5**	**2,255.8**	**2,294.8**	**2,135.9**	**2,212.6**
Costs	**1,231.2**	**1,223.3**	**1,209.0**	**1,254.2**	**1,225.0**	**1,233.5**	**1,265.0**
Operating income before provisioning	**879.4**	**887.7**	**979.6**	**1,001.6**	**1,069.9**	**902.4**	**947.7**
Provisioning	45.8	103.2	63.5	237.8	432.0	200.6	124.4
Equity in profits/losses of associates	0.1	0.2	0.0	0.0	0.0	0.0	0.0
Pre-tax income	**833.6**	**784.7**	**916.0**	**763.8**	**637.9**	**701.8**	**823.2**
Tax	162.7	171.5	189.8	179.6	143.5	157.9	185.2
Non-controlling interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net income before bank tax	**670.9**	**613.2**	**726.2**	**584.3**	**494.4**	**543.9**	**638.0**
Bank tax	69.3	77.6	87.4	97.7	104.9	110.5	112.9
Net income	**601.6**	**535.6**	**638.9**	**486.5**	**389.4**	**433.4**	**525.1**

Balance Sheet (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Cash and central bank balances	666	462	7,272	3,737	3,961	4,080	4,202
Loans and advances to banks	2,277	2,832	3,481	4,316	4,532	4,532	4,532
Loans and borrowings	17,170	17,854	19,802	20,589	20,840	21,566	22,252
Debt securities	22,887	19,657	16,538	20,994	19,337	20,301	21,111
Fixed assets and intangible assets	1,694	1,729	1,783	1,943	1,759	1,744	1,727
Other assets	516	504	429	408	504	537	573
Total assets	**45,210**	**43,038**	**49,305**	**51,986**	**50,933**	**52,761**	**54,398**
Deposits from banks	6,997	6,422	8,442	6,682	5,430	5,944	5,848
Deposits	**29,251**	**27,284**	**31,294**	**35,231**	**35,039**	**36,233**	**37,616**
Securities issued	1,306	1,353	1,609	1,897	1,802	1,910	2,025
Subordinated loans	0	0	0	0	0	0	0
Other liabilities	867	1,040	902	1,095	1,191	1,224	1,260
Equity	**6,790**	**6,939**	**7,057**	**7,081**	**7,471**	**7,449**	**7,649**
Non-controlling interest	0	0	0	0	0	0	0
Total equity and liabilities	**45,210**	**43,038**	**49,305**	**51,986**	**50,933**	**52,761**	**54,398**

Key Ratios

(%)	2016	2017	2018	2019	2020P	2021P	2022P
YoY Growth							
Loans	1.3	4.0	10.9	4.0	1.2	3.5	3.2
Deposits	3.7	-6.7	14.7	12.6	-0.5	3.4	3.8
Equity	-0.9	2.2	1.7	0.3	5.5	-0.3	2.7
Assets	-8.7	-4.8	14.6	5.4	-2.0	3.6	3.1
Net income	-4.0	-11.0	19.3	-23.8	-20.0	11.3	21.1
Net interest income	2.8	7.8	2.3	4.2	-8.8	-3.6	4.0
Balance-Sheet Ratios							
Loans / Deposits	58.7	65.4	63.3	58.4	59.5	59.5	59.2
Deposits / Assets	64.7	63.4	63.5	67.8	68.8	68.7	69.1
Loans / Assets	38.0	41.5	40.2	39.6	40.9	40.9	40.9
Equity / Assets (incl. minority inter.)	15.0	16.1	14.3	13.6	14.7	14.1	14.1
Capital Adequacy Ratio	17.4	17.9	16.8	16.7	18.5	18.2	18.3
Tier 1 Ratio	17.4	17.9	16.8	16.7	18.5	18.2	18.3
Asset Quality Metrics							
NPL / Loans	3.6	3.5	3.2	3.4	3.5	3.5	3.5
Provisioning / Loans	2.9	2.9	2.9	2.8	3.2	3.2	3.2
Provisioning / NPL	80.3	81.3	91.8	81.1	91.4	91.4	91.4
Net Provisioning / Average Loans	0.3	0.6	0.3	1.1	2.0	0.9	0.5
Profitability Metrics							
Net Interest Margin*	2.2	2.6	2.5	2.4	2.1	2.0	2.1
Interest income / Average assets	2.1	2.5	2.4	2.3	2.0	2.0	2.0
Non-Interest Income / Average Assets	2.3	2.3	2.3	2.2	2.4	2.2	2.2
Costs / Average Assets	2.6	2.8	2.6	2.5	2.4	2.4	2.4
Costs / Income	58.3	57.9	55.2	55.6	53.4	57.7	57.2
Net provisioning / Average assets	0.1	0.2	0.1	0.5	0.8	0.4	0.2
Pre-tax profit / Average assets	1.8	1.8	2.0	1.5	1.2	1.4	1.5
Effective tax rate	19.5	21.9	20.7	23.5	22.5	22.5	22.5
ROA	1.3	1.2	1.4	1.0	0.8	0.8	1.0
ROE	8.8	7.8	9.1	6.9	5.4	5.8	7.0
Valuation Multiples							
Shares outstanding (eop, millions)	130.7	130.7	130.7	130.7	130.7	130.7	130.7
Shares outstanding (avg., millions)	130.7	130.7	130.7	130.7	130.7	130.7	130.7
EPS (PLN)	4.6	4.1	4.9	3.7	3.0	3.3	4.0
BVPS (PLN)	52.0	53.1	54.0	54.2	57.2	57.0	58.5
P/E (x)	9.6	10.7	9.0	11.8	14.8	13.3	10.9
P/B (x)	0.8	0.8	0.8	0.8	0.8	0.8	0.8
DPS (PLN)	4.68	4.53	4.11	3.74	0.00	3.49	2.49
Dividend Yield (%)	10.6	10.3	9.3	8.5	0.0	7.9	5.7

*Interest income / Average interest-earning assets

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

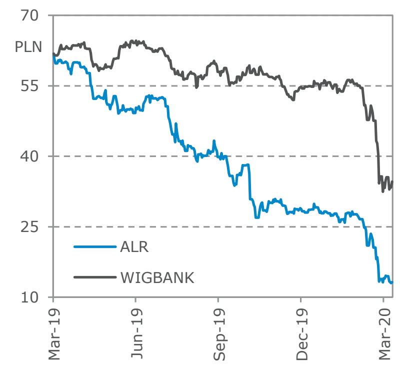
Ownership

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%	-

Analitycy:

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl

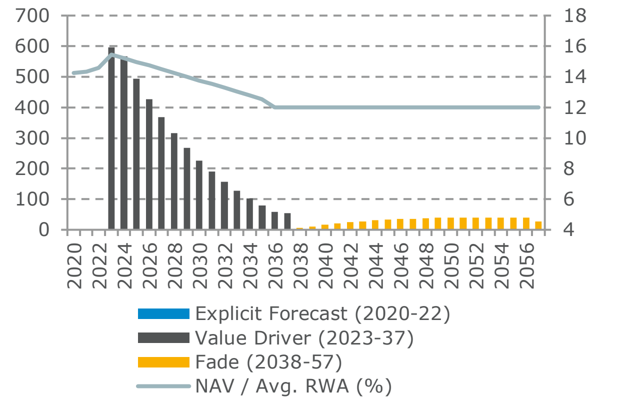
Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl

Valuation

Dividend Discount Model

	(PLN m)	(%)
Explicit forecast (2020-22)	0.0	0.0
Adjustment for time value of money	325.0	5.8
Value driver (2023-37)	4,026.3	71.5
Fade (2038-57)	624.2	11.1
Terminal value	654.3	11.6
Fair value of equity	**5,629.8**	**100.0**
Shares outstanding (millions)	129.3	
Fair value per share (PLN)	**43.6**	
Cost of equity (%)	8.5	
9M target price (PLN)	**46.3**	

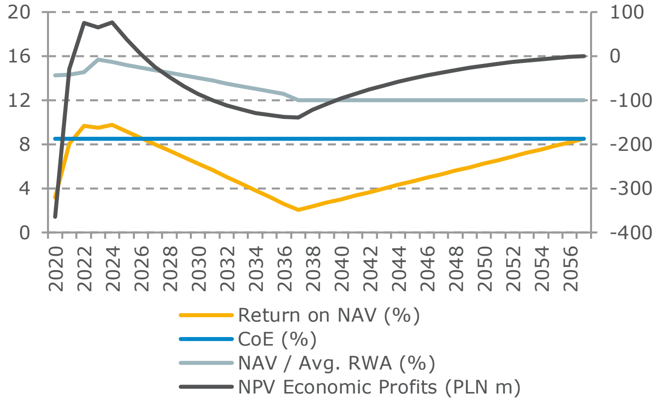
Dividend Discount Valuation (PLN m)



Economic Profit Model

	(PLN m)	(%)
Opening tangible NAV	7,419.3	137.3
Explicit forecast (2020-22)	-318.2	-5.9
Adjustment for time value of money	98.1	1.8
Value driver (2023-37)	-918.3	-17.0
Fade (2038-57)	-876.8	-16.2
Fair value of equity	**5,404.2**	**100.0**
Shares outstanding (millions)	129.3	
Fair value per share (PLN)	**41.8**	
Cost of equity (%)	8.5	
9M target price (PLN)	**44.5**	

Economic Profit Model

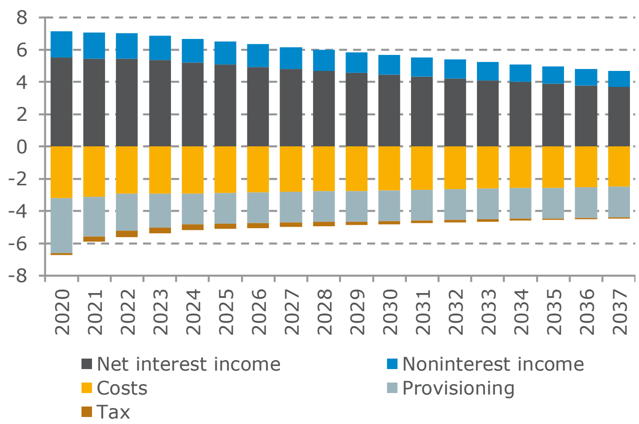


Key Ratios

(%)	2020	2021	2022	Śr.*
Net interest income / Average RWA	5.5	5.5	5.4	4.5
Net interest income / Average RWA	1.6	1.6	1.6	1.2
Costs / Average RWA	-3.2	-3.1	-2.9	-2.7
Costs / Income	44.4	44.0	41.9	47.8
Provisioning / Average RWA	-3.4	-2.5	-2.3	-1.9
Effective tax rate	-21.0	-21.0	-21.0	-19.0
Other / RWA	-0.1	-0.3	-0.4	-0.2
Net profit / Average RWA	0.5	1.2	1.4	0.9
NAV / Average RWA	14.2	14.3	14.6	14.0
Tangible return on NAV	3.2	8.0	9.7	6.2
Net profit growth	-50.9	161.8	29.9	-8.9
Average RWA (PLN bn)	52.1	53.4	56.7	66.6
Growth in average RWA	0.5	2.6	6.2	2.0

*2023-37E avg.

Costs/Income as a pct. of RWA



Valuation Summary

	(PLN)
Dividend Discount Model	43.55
Economic Profit Model	41.81
Average Fair Value	**42.68**
Bank tax	-19.44
9M target price	**24.72**

Income Statement (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Net interest income	**1,946.0**	**2,856.1**	**3,084.5**	**3,181.4**	**2,883.2**	**2,915.6**	**3,084.8**
Fee income	331.1	430.8	710.0	666.6	611.2	610.1	641.9
Trading income	342.5	344.8	175.8	148.6	104.0	106.1	108.2
Other income	578.1	112.4	127.0	143.5	129.1	135.6	142.4
Non-interest income	1,251.7	887.9	1,012.8	958.6	844.3	851.7	892.4
Total income	**3,197.8**	**3,744.1**	**4,097.4**	**4,140.1**	**3,727.6**	**3,767.3**	**3,977.2**
Costs	**1,618.6**	**1,939.5**	**1,846.8**	**1,975.7**	**1,656.2**	**1,659.5**	**1,666.8**
Operating income before provisioning	**1,579.1**	**1,804.6**	**2,250.5**	**2,164.4**	**2,071.3**	**2,107.9**	**2,310.4**
Provisioning	799.9	914.9	1,054.1	1,443.1	1,773.6	1,328.3	1,298.1
Pre-tax income	**779.3**	**889.6**	**1,196.5**	**721.3**	**297.8**	**779.5**	**1,012.3**
Tax	73.3	217.6	274.9	242.5	62.5	163.7	212.6
Non-controlling interest	-0.2	0.4	0.0	0.0	0.0	0.0	0.0
Net income before bank tax	**706.1**	**671.7**	**921.6**	**478.8**	**235.2**	**615.8**	**799.7**
Bank tax	130.9	200.5	208.2	226.0	213.7	212.9	223.4
Net income	**575.2**	**471.2**	**713.4**	**252.8**	**21.5**	**402.9**	**576.3**

Balance Sheet (IFRS consolidated figures)

(PLN m)	2016	2017	2018	2019	2020P	2021P	2022P
Loans and advances to banks	2,449.3	1,867.0	2,251.5	1,592.0	2,069.6	2,214.5	2,369.5
Loans and borrowings	**46,247.2**	**51,266.6**	**54,246.0**	**55,871.3**	**52,817.8**	**54,229.8**	**57,505.4**
Debt securities	10,163.1	14,051.7	14,060.8	16,134.2	15,811.5	15,890.5	16,049.4
Fixed assets and intangible assets	1,002.2	1,024.3	1,033.0	1,343.9	1,288.2	1,244.3	1,209.7
Other assets	1,298.6	1,306.4	1,828.7	1,794.4	1,812.4	1,830.5	1,848.8
Total assets	**61,160.5**	**69,516.0**	**73,419.9**	**76,735.8**	**73,799.4**	**75,409.6**	**78,982.8**
Deposits from banks	428.6	891.6	593.3	822.5	571.0	1,274.2	1,371.3
Deposits	**51,368.7**	**57,657.0**	**62,435.6**	**64,999.3**	**62,006.9**	**62,435.6**	**65,124.4**
Securities issued	298.3	435.9	416.4	436.9	480.5	528.6	581.5
Subordinated loans	1,164.8	1,915.0	1,918.1	1,794.0	1,803.0	1,812.0	1,821.0
Other liabilities	1,740.2	1,925.5	1,570.6	1,924.1	2,157.5	2,175.6	2,193.9
Equity	**6,158.9**	**6,689.7**	**6,485.9**	**6,759.1**	**6,780.6**	**7,183.5**	**7,890.7**
Non-controlling interest	1.0	1.3	0.0	0.0	0.0	0.0	0.0
Total equity and liabilities	**61,160.5**	**69,516.0**	**73,419.9**	**76,735.8**	**73,799.4**	**75,409.6**	**78,982.8**

Key Ratios

(%)	2016	2017	2018	2019	2020P	2021P	2022P
YoY Growth							
Loans	49.6	10.9	5.8	3.0	-5.5	2.7	6.0
Deposits	52.6	12.2	8.3	4.1	-4.6	0.7	4.3
Equity	52.9	13.7	5.6	4.5	-3.8	2.2	4.7
Assets	52.9	13.7	5.6	4.5	-3.8	2.2	4.7
Net income	85.8	-18.1	51.4	-64.6	-91.5	1773.3	43.0
Net interest income	29.6	46.8	8.0	3.1	-9.4	1.1	5.8
Balance-Sheet Ratios							
Loans / Deposits	90.0	88.9	86.9	86.0	85.2	86.9	88.3
Deposits / Assets	84.0	82.9	85.0	84.7	84.0	82.8	82.5
Loans / Assets	75.6	73.7	73.9	72.8	71.6	71.9	72.8
Equity / Assets (incl. minority inter.)	10.1	9.6	8.8	8.8	9.2	9.5	10.0
Capital Adequacy Ratio	13.6	15.2	15.8	17.0	17.6	16.7	16.5
Tier 1 Ratio	11.3	12.1	12.8	14.0	14.6	13.8	13.9
Asset Quality Metrics							
NPL / Loans	9.8	10.8	10.6	10.3	9.9	9.8	9.8
Provisioning / Loans	6.2	6.2	7.9	8.9	7.4	7.4	7.4
Provisioning / NPL	63.0	57.5	74.8	86.3	75.0	75.0	75.0
Net Provisioning / Average Loans	1.9	1.8	1.9	2.4	3.0	2.3	2.2
Profitability Metrics							
Net Interest Margin*	4.1	4.6	4.6	4.5	4.1	4.1	4.2
Interest income / Average assets	3.8	4.4	4.3	4.2	3.8	3.9	4.0
Non-Interest Income / Average Assets	2.5	1.4	1.4	1.3	1.1	1.1	1.2
Costs / Average Assets	3.2	3.0	2.6	2.6	2.2	2.2	2.2
Costs / Income	50.6	51.8	45.1	47.7	44.4	44.0	41.9
Net provisioning / Average assets	1.6	1.4	1.5	1.9	2.4	1.8	1.7
Pre-tax profit / Average assets	1.5	1.4	1.7	1.0	0.4	1.0	1.3
Effective tax rate	9.4	24.5	23.0	33.6	21.0	21.0	21.0
ROA	1.1	0.7	1.0	0.3	0.0	0.5	0.7
ROE	11.9	7.3	10.8	3.8	0.3	5.8	7.6
Valuation Multiples							
Shares outstanding (eop, millions)	129.3	129.3	129.3	129.3	129.3	129.3	129.3
Shares outstanding (avg., millions)	101.0	129.3	129.3	129.3	129.3	129.3	129.3
EPS (PLN)	5.7	3.6	5.5	2.0	0.2	3.1	4.5
BVPS (PLN)	47.6	51.8	50.2	52.3	52.5	55.6	61.0
P/E (x)	2.3	3.6	2.4	6.6	78.1	4.2	2.9
P/B (x)	0.3	0.3	0.3	0.2	0.2	0.2	0.2
DPS (PLN)	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0	0.0	0.0

*Interest income / Average interest-earning assets

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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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

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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

mBank S.A.
Senatorska 18
00-950 Warszawa
http://www.mbank.pl/

Research Department

Kamil Kliszcz
director
+48 22 438 24 02
kamil.kliszcz@mbank.pl
energy, power generation

Michał Marczak
+48 22 438 24 01
michal.marczak@mbank.pl
strategy

Michał Konarski
+48 22 438 24 05
michal.konarski@mbank.pl
banks, financials

Jakub Szkopek
+48 22 438 24 03
jakub.szkopek@mbank.pl
industrials, chemicals, metals

Paweł Szpigiel
+48 22 438 24 06
pawel.szpigiel@mbank.pl
media, IT, telco

Piotr Bogusz
+48 22 438 24 08
piotr.bogusz@mbank.pl
retail, gaming

Aleksandra Szklarczyk
+48 22 438 24 04
aleksandra.szklarczyk@mbank.pl
construction, real-estate development

Piotr Poniatowski
+48 22 438 24 09
piotr.poniatowski@mbank.pl
industrials

Mikołaj Lemańczyk
+48 22 438 24 07
mikolaj.lemanczyk@mbank.pl
banks, financials

Sales and Trading

Traders

Piotr Gawron
director
+48 22 697 48 95
piotr.gawron@mbank.pl

Krzysztof Bodek
+48 22 697 48 89
krzysztof.bodek@mbank.pl

Tomasz Jakubiec
+48 22 697 47 31
tomasz.jakubiec@mbank.pl

Adam Prokop
+48 22 697 47 90
adam.prokop@mbank.pl

Magdalena Bernacik
+48 22 697 47 35
magdalena.bernacik@mbank.pl

Andrzej Sychowski
+48 22 697 48 46
andrzej.sychowski@mbank.pl

Sales, Foreign Markets

Bartosz Orzechowski
+48 22 697 48 47
bartosz.orzechowski@mbank.pl

Jędrzej Łukomski
+48 22 697 49 85
jedrzej.lukomski@mbank.pl

Private Client Sales

Kamil Szymański
director
+48 22 697 47 06
kamil.szymanski@mbank.pl

Jarosław Banasiak
deputy director
+48 22 697 48 70
jaroslaw.banasiak@mbank.pl