

Friday, 10 November 2023 | update

Bank Pekao: buy (reiterated)

PEO PW; PEO.WA | Banks, Poland

The Complete Package

We maintain a buy call on Bank Pekao with a higher target price of PLN 160.71 per share.

Following 3Q'23 results, we have updated our 2023-2025 financial forecasts for Bank Pekao, with the biggest revisions applied to net interest income (NII). The reported 3Q'23 NII, which exceeded our expectations by close to PLN 250m, has set the pace for future quarters. Further, we have shifted the projected costs of extended credit holidays (PLN 644m gross) from 2023 to 2024, although whether the extension bill passes remains uncertain. The NII expected in 2025 received an additional boost from the KNF's decision to delay the switch from WIBOR to WIRON from 2025 to 2027. All of this was enough to more than offset Pekao's updated NIM sensitivity assessment of ca. 30 b.p. per 1 p.p. rate cut, allowing us to increase our 2023 and 2025 NII forecasts by 9%-10%.

We expect Bank Pekao to report ROE of 24%-15% in the 2023-2025 period, unquestionably one of the highest returns in the region. With improving capital adequacy ratios, a recovering Polish economy, and strong profitability, we expect the Bank to maximize its dividend payout ratio to 75%, which would translate to DY between 14%-12% in the next two years.

Finally, we do not find Bank Pekao's valuation to be overly demanding. Trading at a 2024 P/BV of 1.1x, and P/E at 6.4x, PEO shows respective discount of 14% and 27% to its Polish peers. Compared to the CEE averages, Bank Pekao is trading on a par on P/BV but shows a 16% discount to the P/E ratio despite much higher dividends and profitability.

We see Bank Pekao as the complete package with superior profitability, high dividend potential, and attractive valuation, and thus we reiterate it as our top pick among Tier 1 CEE banks.

Post Election Reality

The ongoing endeavors to form a government in Poland work in favor of Bank Pekao's shareholders as the chances that an extension of credit holidays will be passed still this year diminishes, and the Bank's 2024 dividend potential increases. Without attempting to speculate about the future of the current Management Board, we can assume with confidence that any changes, or lack of them, in the ranks, are not likely to have a major impact either on the Bank's earnings, or on dividends. At the 3Q'23 earnings call, the CFO indicated that current market conditions favored a dividend payout ratio at the higher end of the 50%-75% range. At the same time, the economics spokesperson for the Civic Coalition has hinted that the new government may want to maximize dividends from state-owned companies. A 100% dividend payout ratio is still an option for Bank Pekao, albeit a far-fetched one as the Bank braces for increased demand for corporate loans in coming years that will require capital.

No Re-Rating, Just Fundamentals

On our target price, Bank Pekao is trading at 2025 P/BV of 1.3x and P/E of 8.7x – multiples that do not seem demanding to us given strong profitability and high dividends. On 12M forward P/E, PEO is currently trading at a 43% discount to the 10Y average along with an 11% discount on P/BV despite the fact that its ROE and DY are 60% and 40%, respectively, higher than average. Note that the discount is about to get even bigger with expected upward revisions to the net profit consensus of 21% for 2023, 14% for 2024, and 18% for 2025.

(PLN m)	2021	2022	2023E	2024E	2025E
net interest income	5,660.8	8,243.8	11,627.3	10,413.2	10,078.2
noninterest income	2,901.1	2,564.9	3,388.9	3,331.1	3,438.2
costs	4,028.3	5,001.7	4,887.4	5,217.6	5,463.1
operating income	4,533.6	5,807.1	10,128.8	8,526.7	8,053.3
net profit	2,174.9	1,717.6	6,394.8	5,330.8	4,872.6
C/I (%)	47.6	49.1	33.2	38.7	41.1
ROE (%)	8.8	7.4	24.3	17.5	15.4
P/E (x)	15.8	20.0	5.4	6.4	7.0
P/B (x)	1.4	1.5	1.1	1.1	1.1
DPS (PLN)	3.21	4.30	5.42	18.27	15.23
dividend yield (%)	2.5	3.3	4.1	14.0	11.6

current price	PLN 130.85
target price	PLN 160.71
mCap	PLN 34.34bn
free float	PLN 23.08bn
ADTV (3M)	PLN 159.00m

*Price as of November 09, 2023, 5:00 PM

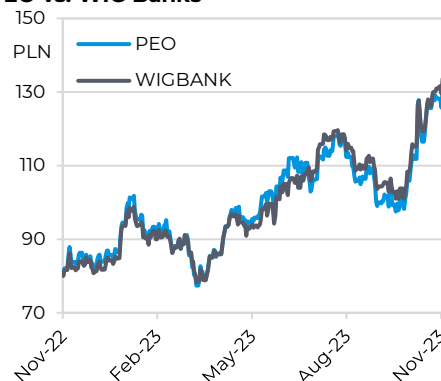
Shareholders

PZU	20.00%
Polish Development Fund	12.80%
Aviva OFE	5.06%
NN OFE	5.03%
Others	57.11%

About

Pekao is the second largest bank in Poland with strong corporate business. Bank has been always perceived as a dividend player thanks to strong profitability, low risk and above average capital adequacy ratios. Bank Pekao, along with Alior Bank, belongs to PZU group which has a controlling stake in the bank. Pekao plans to use its capital surplus toward organic growth and acquisitions.

PEO vs. WIG Banks



name	target price		recommendation	
	new	old	new	old
Bank Pekao	160.71	141.97	buy	buy

name	current price	target price	upside
	Bank Pekao	130.85	160.71

forecast update	2023E	2024E	2025E
	total income	+7.0%	-4.5%
pre-tax profit	+12.3%	-7.5%	+10.6%
net profit	+17.0%	-6.3%	+15.8%

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List of abbreviations and ratios used by mBank:

EV (Enterprise Value) – Equity Value + Net Debt; **EBIT** – Earnings Before Interest and Taxes; **EBITDA** – EBIT + Depreciation & Amortisation; **Net Debt** – Borrowings + Debt Securities + Interest-Bearing Loans - Cash and Cash Equivalents; **P/E** (Price/Earnings) – Price Per Share Divided by Earnings Per Share; **P/CE** (Price to Cash Earnings) – Price Per Share Divided by Earnings + Depreciation & Amortisation; **P/B** (Price to Book Value) – Price Per Share Divided by Book Value Per Share; **P/CF** (Price to Cash Flow) – Price Divided by Cash Flow from Operations; **ROE** (Return on Equity) – Earnings Divided by Shareholders' Equity; **ROCE** (Return on Capital Employed) – EBIT x (Average Assets - Current Liabilities); **ROIC** (Return on Invested Capital) – EBIT x (1-Tax Rate) / (Average Equity + Minority Interest + Net Debt); **FCFF** (Free Cash Flow to Firm) – Cash Flow from Operations - CAPEX - Lease Payments; **FCFE** (Free Cash Flow to Equity) – Free Cash Flow to Firm - Net Interest Expense (incl. Debt + Leases)
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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NAV – valuation based on equity value, one of the most frequently used method in case of developing companies; the weak point of the method is that it does not factor in future changes in revenue/profits of a company.

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

Bank Pekao (Michał Konarski, Mikołaj Lemańczyk)

Rating	buy	buy	buy	buy
Rating date	2023-09-28	2023-06-26	2023-03-27	2022-12-01
Target price (PLN)	141.97	130.47	126.00	100.00
Price on rating day	97.82	108.30	78.90	83.90



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