HAITONG

Warsaw, August 12, 2020

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Haitong Bank in a report from August 11 (08:00) keeps mBank at SELL (FV PLN 161.5).

Valuation Methodology

Valuation: We use a Dividend Discount Model (DDM) with a 50% weighting and a Polish banks' peer multiples' analysis with a 50% weighting to value mBank. Our FV is based on the weighted average of these two methodologies.

Sensitivity: We provide two sensitivity analyses for our fair value estimates wherein we examine two sets of variables: (i) ROEs and perpetuity growth rates; and (ii) equity risk premium and the risk-free rate.

CHF risk adjustment: We estimate a total PLN 30bn (almost 5x higher compared to previous PLN 6bn) cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into account the Polish Bank Association's (ZBP's) expected PLN 60bn loss on the portfolio of CHF mortgages to individuals, based on the assumption that the loan will be switch to PLN at the historical exchange rate and repaid at the CHF LIBOR rates, assuming 60% of clients will go to the court and 80% will win the court case. We are aware that given the large number of assumptions this calculation has a very high margin of error. Subsequently we apply a market share weighted portion of this loss per share to individual banks. Notably we have applied a 50% probability ratio that the CHF portfolio risk will be taken over by Commerzbank.

Main assumption changes: We apply a cost of equity of 8.5%. We assume a terminal ROE at 6.5% (vs 8.5% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

Forecast revisions: Our 2020E-21E NI forecasts drop by 17%/14% to PLN 0.45bn (-52% YoY) and PLN 0.64bn (+43% YoY), respectively, on the back of: 1) lower interest rate assumptions, both in the short term with the last NBP reference rate cut by 40bps to 0.1% and a mid-term cut to 0.5% from 1.25%; 2) higher deposit volumes but lower deposit costs 3) higher fees, 4) higher net provisioning for CHF mortgage portfolio (2.5% of the CHF book, up from 2% previously).

Our earnings expectations differ from consensus by +7%/-1%/-12% for '20-22E. This is, in our opinion, mainly due to the highly unpredictable effect of the COVID-19 pandemic especially in terms of volumes and risk costs, as well as different interest rate assumptions in the mid-term and assumptions for CHF mortgage related provisions.

Risks to Fair Value

Macro related: Risks of a different macroeconomic scenario, especially in light of the highly unpredictable outcome of the COVID-19 outbreak, both in terms of magnitude and length, including: i) interest rates; ii) asset quality/cost of risk; iii) volume growth in Poland.

Interest rate related: Material difference in size and timing of Central Bank interest rate changes versus our base assumption of flat interest rates at 0.1% through 2022 and increase to 0.5% in 2023.

NIM expansion: Faster NIM expansion due to potentially higher assets spreads could lead to higher earnings;

Funding costs: Competitive rise in deposit rates could lead to NIM narrowing;

Better/worse assets quality: could lead to a lower/higher cost of risk, which would have a positive/negative impact on earnings;

FX rate: Relatively high exposure to FX risk of its CHF mortgage portfolio (some 13% of loan book).

Cost of risk: Sensitivity of NI to changes in the cost of risk is stronger than average. Exposure to segments where the risk is naturally higher, i.e. consumer finance (21% of portfolio) and SME segment (16%) is above the market average.

Dividend: Higher-than-expected near-term dividend - upside risk. Lower-than-expected near-term dividend - downside risk.

Regulatory risk:

- CHF mortgages: The restructuring of foreign currency housing loans in a different way to our base scenario and/or additional costs, i.e. spread bill. Different approach to the CHF portfolio provisioning given the large and rising number of court cases.
- Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.
- Increase in LGD ratios for banks using IRB methodology, raising min. requirements (in line with the Financial Stability Committee Recommendation of 13 January 2017).
- Regulatory risk: Potential liquidity squeeze in the banking sector (commercial / cooperative segment) and financial institutions (SKOK segment) may lead to a larger contribution to the BFG fund.
- MREL requirement may be set high: mBank reported an estimated 27.94% of the MREL requirement (as a % of TRAE), vs the 22.8% consolidated requirement reported by PKO BP. Meanwhile MBK's TCR ratio stood at 19.5% in 4Q19. In our opinion this would imply that MBK requires more than PLN 6.0bn additional MREL compliant funds by the end of 2022. This risk has been mitigated by recent changes to the capital requirements.

Strategy related: mBank has presented a new 2020-23 strategy – risk of not delivering on its targets.

M&A/Shareholders related: Risk that the major shareholder Commerzbank (69.3%) will come back to the plan to put mBank up for sale as a part of its restructuring strategy (announced in September'19/dropped May'20). This would pose a risk of deal execution, valuation, continuation of existing strategy.

Volume growth significantly below/above our expectations.

Valuation:

- Higher Risk Free Rate (lowers valuation).
- Change in market sentiment to 'risk on', with dividend stocks preferred.

IMPORTANT DISCLOSURES

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