

Monday, 27 March 2023 | update

## Banks

Banks, Poland

### Banks Just Cannot Catch a Break

Polish banks just cannot catch a break. After several years of setbacks, from the banking tax to dividend caps, Covid-19-related provisioning, the 2020 interest rate cuts, and the additional systemic burdens of 2022 (loan holidays, borrower relief fees), in February 2023 an opinion by the CJEU Advocate General backed the sector into yet another corner. According to our estimates, a final CJEU ruling in line with the AG's opinion (i.e., a ruling stating that a bank cannot claim remuneration for lending money under a loan contract that has been canceled due to unfair clauses) represents an extra cost to Polish lenders of approx. PLN 35bn over 2023-24.

PKO BP and Santander, which represent a substantial part of the market, are able to take the hit in one financial year but are not likely to do so given upcoming MREL issuances. On the other hand, Millennium, and probably also BNP Paribas, will be forced to provision for the CHF risk over at least two years if they want to avoid violating capital requirements. Others, like Pekao, Alior, ING BSK, and Handlowy, have dealt with the CHF problem and are poised to deliver extraordinary earnings in the next three years.

Barring unlikely solvency struggles, we expect a gradual re-rating of the banking sector with the CHF saga nearing a close amid favorable market conditions marked by high interest rates and an economic soft landing.

As regards the recent wide-spread banking sell-off, we view it as is a compelling entry point for investors with minimal spill-over risk from the CS and SVB situation. Our top picks are the CHF-safe Pekao and Alior, with valuations ex. capital surplus well below the book values. We also see upside in PKO and Santander although we realize that any CHF-related bugs like large one-off charges or dividend caps can hurt sentiment.

As a final note, the entire banking sector faces political risk ahead of the 2023 general election, though any impacts will most likely be a one-off.

#### Record-high ROE for some banks

We expect our banking universe to generate ROE of 16% in 2023, followed by a normalization to 13% in 2024. The headline 2023 ROE already looks attractive but case-by-case banks like Pekao, ING, and Handlowy are expected to advance well beyond the average with ROE above 20%. We have raised our earnings outlook for rated banks to reflect strong net interest income growth in 4Q'22 and expectations for lower risk costs and a slower rise in operating costs in 2023 (+8% Y/Y). If Poland's base interest rate remains unchanged in 2023 as predicted, this might boost NIM by a hefty 60 bps Y/Y. Overall our 2023 net profit expectations are 4% above the analysts' consensus.

#### More CHF provisions needed although there is no systemic risk

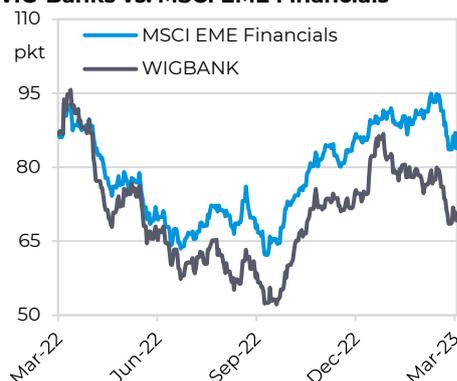
We believe the Polish banking sector as a whole is well prepared for an unfavorable CJEU ruling regarding remuneration for canceled CHF loans. We estimate the total cost to the sector at PLN 35bn of extra loan loss reserves (PLN 19bn for our coverage). We would expect that cost to be spread over at least two years, but even a one-off write-off would not take any of our rated banks close to violating basic capital requirements.

ING BSK and Pekao have already raised the required level of CHF reserves while at PKO BP and Santander surplus capital should be enough to cover all of the losses in one go. Millennium and BNP Bank Paribas should be able to address the problem over the next two years with retained earnings supported by high interest rates.

company	P/E			P/B			ROE%		
	23E	24E	25E	23E	24E	25E	23E	24E	25E
PKO	7.2	9.4	6.5	0.9	0.8	0.7	12.6	8.9	11.7
PEO	4.1	4.1	5.5	0.8	0.8	0.8	21.0	19.1	13.8
SPL	7.7	8.4	6.3	0.9	0.9	0.8	12.2	10.5	13.1
ING	6.4	7.7	9.4	1.5	1.2	1.1	27.6	17.6	12.3
BNP	6.8	6.4	4.9	0.6	0.5	0.5	8.9	8.6	10.1
MIL	12.5	144.2	3.6	0.8	0.8	0.6	6.5	0.5	18.9
BHW	4.6	5.3	9.5	1.1	1.1	1.2	26.5	21.4	12.4
ALR	3.4	3.1	4.6	0.6	0.5	0.4	18.8	16.9	9.7
BOŚ	3.8	3.3	7.0	0.4	0.3	0.3	10.4	10.5	4.5

WIG-Banks	5,817.08
MSCI EME Financials	83.82
2023E P/E	6.5x
2023E P/B	1.0x

#### WIG-Banks vs. MSCI EME Financials



name	target price		recommendation	
	new	old	new	old
PKO	35.20	35.02	buy	buy
PEO	126.00	100.00	buy	buy
SPL	338.51	328.96	buy	buy
ING	177.85	168.76	accumulate	hold
BNP	58.50	60.80	buy	accumulate
MIL	4.84	5.03	buy	hold
BHW	80.00	72.85	hold	hold
ALR	50.00	36.06	buy	hold
BOŚ	11.60	10.50	buy	buy

name	current* price	target price	upside
PKO	26.72	35.20	31.74%
PEO	78.90	126.00	59.70%
SPL	271.20	338.51	24.82%
ING	158.20	177.85	12.42%
BNP	48.30	58.50	21.12%
MIL	3.84	4.84	26.04%
BHW	79.60	80.00	0.50%
ALR	34.11	50.00	46.58%
BOŚ	8.82	11.60	31.52%

\*Prices as of March 24, 2023, 5:00 PM

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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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**ACCUMULATE** – we expect that the rate of return from an investment will range from 5% to 15%  
**HOLD** – we expect that the rate of return from an investment will range from -5% to +5%  
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**Relative** – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.

**Economic profits** – discounting of future economic profits; the weak point is high sensitivity to changes in the assumptions made in the valuation model.

**Discounted Dividends (DDM)** – discounting of future dividends; the weak point is high sensitivity to changes in the assumptions as to future dividends made in the valuation model.

**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 the companies analyzed herein in the 12 months prior to this publication:

**Alior Bank (Michał Konarski, Mikołaj Lemańczyk)**

Rating	buy	hold	buy	buy
Rating date	2023-03-27	2022-12-01	2022-09-27	2022-07-06
Target price	50.00	36.06	33.00	37.98
Price on rating	34.11	36.06	24.69	24.49

**BNP Paribas Polska (Michał Konarski, Mikołaj Lemańczyk)**

Rating	buy	accumulate	buy	buy	buy
Rating date	2023-03-27	2022-12-01	2022-09-27	2022-07-06	2022-03-03
Target price	58.50	60.80	65.00	89.24	105.00
Price on rating	48.30	56.40	48.00	55.00	75.20

**BOS Bank (Michał Konarski, Mikołaj Lemańczyk)**

Rating	buy	buy
Rating date	2023-03-27	2022-11-29
Target price	11.60	10.50
Price on rating	8.82	8.03

**Handlowy (Michał Konarski, Mikołaj Lemańczyk)**

Rating	hold	hold	buy	buy
Rating date	2023-03-27	2022-12-01	2022-09-27	2022-07-06
Target price	80.00	72.85	73.00	65.70
Price on rating	79.60	73.80	56.80	50.50

**ING BSK (Michał Konarski, Mikołaj Lemańczyk)**

Rating	accumulate	hold	buy	buy	hold	buy
Rating date	2023-03-27	2022-12-01	2022-09-27	2022-09-02	2022-07-06	2022-03-03
Target price	177.85	168.76	165.00	182.39	182.39	305.00
Price on rating	158.20	164.40	139.80	137.40	168.00	239.00

**Millennium (Michał Konarski, Mikołaj Lemańczyk)**

Rating	buy	hold	buy	buy	buy
Rating date	2023-03-27	2022-12-01	2022-09-27	2022-07-06	2022-03-03
Target price	4.84	5.03	4.60	5.30	8.40
Price on rating	3.84	4.64	3.52	3.66	6.15

**Pekao (Michał Konarski, Mikołaj Lemańczyk)**

Rating	buy	buy	buy	buy
Rating date	2023-03-27	2022-12-01	2022-09-27	2022-07-06
Target price	126.00	100.00	85.05	99.40
Price on rating	78.90	83.90	64.00	76.96

**PKO BP (Michał Konarski, Mikołaj Lemańczyk)**

Rating	buy	buy	buy	buy
Rating date	2023-03-27	2022-12-01	2022-09-27	2022-07-06
Target price	35.20	35.02	30.06	33.92
Price on rating	26.72	28.35	22.45	26.17

**Santander Bank Polska (Michał Konarski, Mikołaj Lemańczyk)**

Rating	buy	buy	buy	buy	buy
Rating date	2023-03-27	2022-12-01	2022-09-27	2022-07-06	2022-03-03
Target price	338.51	328.96	300.00	337.84	399.35
Price on rating	271.20	273.60	206.20	220.20	306.10

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