

December 18, 2018, Warsaw

Marta Czajkowska-Bałdyga, Analyst, Haitong Bank

Haitong Bank in a report from 17th December (08:00) upgrades stock recommendations for the banks:

- Bank Pekao (Buy, FV down 1% to PLN 137.3)
- Alior Bank (Buy, FV down 9% to PLN 78.9)
- Santander Bank Polska (Buy, FV up 2% to PLN 398.2)
- PKO BP (Buy, FV up 5% to PLN 44.5)
- Bank Handlowy (Downgrade to Neutral from Buy, FV down 14% to FV PLN 67.7)
- ING (Neutral, FV down 5% to PLN 184.6)
- mBank (Downgrade to Sell from Neutral, FV down 8% to PLN 366.4)
- Bank Millennium (Downgrade to Sell from Neutral, FV down 7% to PLN 8.1)

Valuation Methodology

PKO BP:

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 Polish banks. 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 bill adjustment: We estimate a total PLN 6.53bn (flat) cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into account a portfolio of CHF mortgages to individuals at PLN 107bn (December 2017), assuming: 1) a charge to the fund at a max level of 2% per annum, 2) a reduction rate of 20%, 3) natural repayments at 5% p.a, 4) a 5 year horizon (until 2022), which would imply lowering the portfolio to roughly 50% of the existing value (some 4% of total loans vs 10% now), 5) a stable FX rate at CHF/PLN 3.56; we estimate a total cumulative loss for the system at PLN 6.53bn. 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.

Main assumption changes: we apply a cost of equity of 8.5% (unchanged). We assume a terminal ROE for PKO at 11.7% (vs 11.1% before). We use a risk-free rate of 3.5% (based on the 10Y Polish Government Bond Yield).

Forecast revision: On the back of higher volumes, non-core revenues and lower net provisioning we have increased our 2018 NI forecast by 4% to PLN 3.68bn (+19% YoY). At the same time, we have lowered our forecast for sector fee income, which has left our 2019E/20E net income flat/down 2% to PLN 3.89bn (+6% YoY) and PLN 4.51bn (+16% YoY), respectively.

Bank Pekao:

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 Polish banks. 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 bill adjustment: We estimate a total PLN 6.53bn (flat) cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into account a portfolio of CHF mortgages to individuals at PLN 107bn (December 2017), assuming: 1) a charge to the fund at a max level of 2% per annum; 2) a reduction rate of 20%; 3) natural repayments at 5% p.a; 4) a 5 year horizon (until 2022), which would imply lowering the portfolio to roughly 50% of its existing value (some 4% of total loans vs 10% now); 5) a stable FX rate at CHF/PLN 3.56; we estimate a total cumulative loss for the system at PLN 6.53bn. Thus we are aware that given the number of assumptions this calculation has a very high margin of error. Subsequently we apply to an individual bank a market share weighted portion of this loss per share.

Main assumption changes: we apply a cost of equity of 8.5% (unchanged). We rolled the model out to 2022E and thus we assume a terminal ROE for PEO at 12.9% (vs 13.7% before). We use a risk-free rate of 3.5% (based on the 10Y Polish Government Bond Yield).

Forecast revisions: On the back of slower market share gains, which lead to lower provisioning, as well as slower cost cutting initiatives, but also incorporating the NPL portfolio sale in 4Q18 (some PLN 50m pre-tax impact) we increase 2018E NI by 3%, but lower 2019-20E NI by -5%/-3%. We forecast net earnings of PLN 2.18bn (-12% YoY/+2% YoY adjusted) in 2018E, PLN 2.37bn (+9% YoY) in 2019E and PLN 2.84bn (+19% YoY) in 2020E.

Santander Bank Polska:

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 Polish banks. 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 bill adjustment: We estimate a total PLN 6.53bn (flat) cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into account a portfolio of CHF mortgages for individuals at PLN 107bn (December 2017), assuming: 1) a charge to the fund at a max level of 2% per annum; 2) a reduction rate of 20%; 3) natural repayments at 5% pa; 4) a 5 year horizon (until 2022), which would imply lowering the portfolio to roughly 50% of its existing value (some 4% of total loans vs 10% now); 5) a stable FX rate at CHF/PLN 3.56; we estimate a total cumulative loss for the system at PLN 6.53bn. 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 the individual banks.

Main assumption changes: We apply a cost of equity of 8.5% (unchanged). We rolled the model over to 2022E and thus we assume a terminal ROE at 12.8% (vs 13.0% before). We use a risk-free rate of 3.5% (based on the 10Y Polish Government Bond Yield).

Forecast revisions: We lowered our 2018E net profit by 3% to PLN 2.53bn (+14% YoY, this includes an expected PLN 525m gain on the purchase of DB assets). Our 2019E-20E forecasts are down by -2% to PLN 2.71bn (+7% y/y, +24% adj.) and -2% to PLN 3.12bn (+15% y/y), respectively, on the back of forecast lower NII, higher operating expenses and a somewhat higher cost of risk.

mBank:

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 Polish banks. 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 bill adjustment: We estimate a total PLN 6.53bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into account a portfolio of CHF mortgages for individuals at PLN 107bn (December 2017), assuming: 1) a charge to the fund at a max level of 2% per annum; 2) a reduction rate of 20%; 3) natural repayments at 5% pa; 4) a 5 year horizon (until 2022), which would imply lowering the portfolio to roughly 50% of its existing value (some 4% of total loans vs 10% now); 5) a stable FX rate at CHF/PLN 3.56; we estimate a total cumulative loss for the system at PLN 6.53bn. 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.

Main assumption changes: we apply a cost of equity of 9.0% (unchanged). We assume a terminal ROE at 9.9% (vs 10.3% before). We use a risk-free rate of 3.5% (based on the 10Y Polish Government Bond Yield).

Forecast revisions: Following a better-than-expected NIM but at the same time higher risk costs and pressure on fee income following the sale of mFinance assets, we have revised downwards our 2018E reported net profit by 5% (-4% adjusted) to PLN 1.33bn (+21% YoY, +3% YoY adjusted). Our 2019E-20E NI forecasts drop by -8% to PLN 1.27bn (-4% YoY, +13% adjusted) and -7% to PLN 1.53bn (+20% YoY), respectively, on the back of a higher cost of risk which has offset stronger volumes and higher expected NII.

ING:

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 Polish banks. 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 bill adjustment: We estimate a total PLN 6.53bn (flat) cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into account a portfolio of CHF mortgages to individuals at PLN 107bn (December 2017), assuming: 1) a charge to the fund at a max level of 2% per annum; 2) a reduction rate of 20%; 3) natural repayments at 5% p.a; 4) a 5 year horizon (until 2022), which would imply lowering the portfolio to roughly 50% of existing value (some 4% of total loans vs 10% now); 5) stable FX rate at CHF/PLN 3.56; we estimate a total cumulative loss for the system at PLN 6.53bn. Thus we are aware that given the number of assumptions this calculation has a very high margin of error. Subsequently we apply to each individual bank a market share weighted portion of this loss per share.

Main assumption changes: we apply a cost of equity of 8.5% (unchanged). We assume a terminal ROE for ING of 13.2% (vs 14.1% before). We use a risk-free rate of 3.5% (based on the 10Y Polish Government Bond Yield).

Forecast revision: Our 2018E-20E forecasts are down -3%/-9%/-6% to PLN 1.47bn (+5% YoY) / PLN 1.59bn (+8% YoY) / PLN 1.86bn (+17% YoY), respectively, on the back of higher operating expenses and net provisioning.

Bank Millennium:

Valuation: We use a Dividend Discount Model (DDM) with a 30% weighting and a Polish banks' peer multiples' analysis with a 70% weighting to value Polish banks (changed from 50%-50%). 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 bill adjustment:** We estimate a total PLN 6.53bn (flat) cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into

account a portfolio of CHF mortgages to individuals at PLN 107bn (December 2017), assuming: 1) a charge to the fund at a max level of 2% per annum; 2) a reduction rate of 20%; 3) natural repayments at 5% p.a; 4) a 5 year horizon (until 2022), which would imply lowering the portfolio to roughly 50% of its existing value (some 4% of total loans vs 10% now); 5) stable FX rate at CHF/PLN 3.56; we estimate a total cumulative loss for the system at PLN 6.53bn. Thus we are aware that given the 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 each individual bank.

Main assumption changes: we apply a cost of equity of 9.5% (unchanged). We assume a terminal ROE for MIL at 12.0% (vs 10.4% before). We use a risk-free rate of 3.5% (based on the 10Y Polish Government Bond Yield).

Forecast revisions: Following 3Q18 results, which were broadly in line with expectations, our 2018E NI is unchanged at PLN 745m (+9% YoY). Incorporating Eurobank means our 2019E forecast drops by 22% to PLN 655m (-12% YoY) and in 2020E rises by 9% YoY to PLN 1.05bn (+60% YoY) (Eurobank consolidation since 4Q19).

Alior Bank:

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 Alior. Our FV is based on the weighted average of these two methodologies.

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

CHF bill adjustment: We estimate a total PLN 6.53bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into account a portfolio of CHF mortgages to individuals at PLN 107bn (December 2017), assuming: 1) a charge to the fund at a max level of 2% per annum; 2) a reduction rate of 20%; 3) natural repayments at 5% p.a; 4) a 5 year horizon (until 2022), which would imply lowering the portfolio to roughly 50% of its existing value (some 4% of total loans vs 10% now); 5) a stable FX rate at CHF/PLN 3.56; we estimate a total cumulative loss for the system at PLN 6.53bn. Thus we are aware that given the number of assumptions this calculation has a very high margin of error. Subsequently we apply to each individual bank a market share weighted portion of this loss per share i.e. PLN 0.1 per share at Alior Bank.

Main assumption changes: we apply a cost of equity of 9.0% (unchanged). We assume a terminal ROE at 12.0% (vs 12.5% before). We use a risk-free rate of 3.5% (based on the 10Y Polish Government Bond Yield).

Forecast revisions: We have revised our 2018E-20E NI forecasts by -6%/-14%/- 14%, respectively. The main swing factor is higher net provisioning (+8%/+6%/+4%), which we decided to treat as a recurring factor given its exposure to the SME segment, contrary to management assumptions. We have also lowered non-interest income due to worse volumes and the poor outlook for capital market-related fees. Costs savings from the merger with BPH seems to be on track. We have cut our expectations concerning mortgage loan expansion, which have performed worse than expected in 9M18.

Bank Handlowy:

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 Polish banks. 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 bill adjustment: We estimate a total PLN 6.53bn (flat) cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. Taking into account a portfolio of CHF mortgages for individuals at PLN 107bn (December 2017), assuming: 1) a charge to the fund at a max level of 2% per annum, 2) a reduction rate of 20%; 3) natural repayments at 5% p.a; 4) a 5 year horizon (until 2022), which would imply lowering the portfolio to roughly 50% of its existing value (some 4% of total loans vs 10% now); and 5) a stable FX rate at CHF/PLN 3.56; we estimate a total cumulative loss for the system at PLN 6.53bn. 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 for individual banks.

Main assumption changes: we apply a cost of equity of 8.5% (unchanged). We assume a terminal ROE for BHW of 11.0% (vs 12.5% before). We use a risk-free rate of 3.5% (based on the 10Y Polish Government Bond Yield).

Forecast revisions: Following worse-than-expected trading and fee income in 3Q18, we have lowered our 2018E net profit by 1% to PLN 652m (+22% YoY). Our 2019E-20E NI forecasts fall by -5% to PLN 642m (-2% y/y) and -4% to PLN 735m (+15% y/y), respectively, on the back of lower core revenues partly offset by higher trading income and somewhat higher net provisioning.

Risks to Fair Value

PKO BP:

- Macro related: Risks of a different macroeconomic scenario 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, i.e. 50bp interest rate rise in 2019. (PKO has the second highest sensitivity among Polish banks).
- Funding costs – Competitive rise in deposit rates and/or relatively high share of wholesale funding whose pricing is vulnerable to global market sentiment and may provide downside risk.

- FX rate: Relatively high exposure to FX risk of its CHF mortgage portfolio (PKO BP has a 19% market share in the CHF mortgage market with a loan book of PLN 23.5bn accounting for 11% of its loan book and 61% of equity).
- Dividend: Scenario of a 50% dividend pay-out might not materialize or PFSA may soften/temper the dividend pay-out criteria.
- Regulatory risk –
 - CHF mortgages: The restructuring of foreign currency housing loans may not materialize, may be done in a different way to our base scenario or/and additional costs, i.e. spread bill.
 - Any new regulatory requirements concerning minimum adequacy ratios and/or dividends
 - 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
- Volume growth significantly below/above our expectations
- Ownership related: PKO is state controlled (29.43%), thus we see a risk of non market-oriented decisions.
 - Lately, the press has reported (source: Parkiet Daily) that the bank could potentially become involved in the resolution of the sector's liquidity problems caused by the ongoing bribery scandal (including being the lender of last resort).
- Valuation:
 - Higher Risk Free Rate (lowers valuation)
 - Change in market sentiment to 'risk on', with a preference for dividend stocks (downside)

Bank Pekao:

- Macro related: Risk of different macroeconomic scenario including: i) interest rates ii) assets quality/cost of risk, iii) volume growth in Poland.
- Dividends: Any further cuts to the PEO's dividend policy, in the event of potential acquisition or changes to the regulations.
- Volume growth significantly below/above our expectations
- Strategic targets related: We assume PEO delivers on its 2020 strategic targets (ROE, C/I), giving the relatively new management
- the benefit of the doubt.
- Lower assets quality: As it comes with faster growth of volumes, PEO might compromise on the risk taken. Moreover PEO targets higher yield consumer loans and SMEs, i.e. segments where the risk is naturally higher.
- Acquisition related: PEO finished talks with ALR with no merger concluded. However PEO's capital buffer makes it potentially
- attractive to other companies seeking to do M&A. Therefore risks of overpaying for assets and/or not delivering upon potential synergy targets persist.
- Regulatory risk – Any new regulatory requirements concerning minimum adequacy ratios/and/or dividends.
- Lately, the press has reported (source: Parkiet Daily) that the bank could potentially become involved in the resolution of
- the sector's liquidity problems caused by the ongoing bribery scandal (including being the lender of last resort).
- Ownership related: PEO is indirectly state controlled (via PZU and PFR controlling), thus we see a risk of non-market oriented decisions.
- Potential share overhang: Although recently denied by PFR, lowering of the dividend payout below 100% could trigger a decision by PFR to withdraw from its investment (12.8% stake). According to recent statement from PZU's CFO, the company is committed to Bank Pekao as a strategic investment and therefore it would pick up any potential stake supply from co-owner PFR.
- Valuation:
 - Higher Risk Free Rate (lowers valuation)
 - Change in the market-wise sentiment towards dividend stocks

Santander Bank Polska:

- Macro related: Risks of a different macroeconomic scenario including: i) interest rates; ii) assets quality/cost of risk; iii) volume growth in Poland.
- Funding costs – Competitive rise in deposit rates. With the acquisition of DB assets, its liquidity position may be squeezed. Thus it may potentially need to raise funds, possibly both in deposits and wholesale.
- FX rate: Exposure to FX risk of its CHF mortgage portfolio (some 10% of the loan book). Appreciation of CHF may lead to further pressure on its liquidity position.
- Merger related: Given the acquisition of DB assets (0.6x P/B), we see a risk of delivery of strategy costs and synergies.
- Capital market related: The relatively higher revenue exposure to
- capital market related fees could be at risk with changing market conditions.
- Dividend: Scenario of 50% dividend pay-out might not materialize.
- Cost of risk: SCB consumer finance loan book provides above average risk to the retail non-mortgage book cost of risk assumptions.

- 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. We estimate the maximum cost of a CHF bill that BZW could bear for the bank to still be able to report a CET1 above the minimum required by the KNF of 12.0% (not taking into consideration a change in the risk weights from 150% on FX mortgages to below 100% on PLN mortgages) is PLN 4.5bn, which implies a 42% haircut of its CHF portfolio.
 - Based on a CHF mortgage book of PLN 10.9bn reported in 1H18, taking into account the presidential proposal (under the assumption of a contribution at a max. rate of 2% FX book p.a.), the first year contribution of PLN 0.18bn, i.e. 7% of 2019E NI, is not included in our forecast.
 - Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.
 - 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.
- Volume growth significantly below/above our expectations.
- Valuation:
 - Higher Risk Free Rate (lowers valuation).

mBank:

- Macro related: Risks of a different macroeconomic scenario including: i) interest rates; ii) asset quality/cost of risk; iii) volume growth in Poland.
- Funding costs: Competitive rise in deposit rates.
- FX rate: Relatively high exposure to FX risk of its CHF mortgage portfolio (22% of loan book).
- Cost of risk: Sensitivity of NI to changes in the cost of risk is stronger than average.
- Dividend: Higher-than-expected near-term dividend could materialise.
- 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. We estimate the maximum cost of a CHF bill that MBK could bear and still be able to report CET1 above the minimum required by the KNF of 12.0% at PLN 3.22bn, which implies an 18% haircut in its CHF portfolio.
 - 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.
- 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.

ING:

- Macro related: Risk of different macroeconomic scenario including: i) interest rates ii) assets quality/cost of risk, iii) volume growth in Poland.
- Competition: Intensified competition for loans/deposits resulting in lower spreads on assets/liabilities
- Volume growth significantly below/above our expectations
- Cost of risk: With above average growth of market share, the risk of deteriorating assets quality and/or rising cost of risk persist.
- Dividends: The risk that ING might need to further limit dividend payouts given its B/S growth. Upside risk that the company will increase its payout ratio given lower lending volume growth
- Regulatory risk – Any new regulatory requirements concerning minimum adequacy ratios and/or dividends
 - 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
- Valuation:
 - Higher Risk Free Rate (lowers valuation)
 - Change in the market-wise sentiment towards stocks with high dividend yield
 - Low liquidity

Bank Millennium:

- Macro related: Risk of different macroeconomic scenarios including: i) interest rates; ii) assets quality/cost of risk; iii) volume growth in Poland.
- 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 assets quality – could lead to a lower cost of risk, which would have a positive impact on earnings;
- Regulatory risk –

- CHF mortgages: The restructuring of foreign currency housing loans a different way to our base scenario or/and additional costs, i.e. spread bill. We estimate the maximum cost of a CHF bill that MIL could bear for it to still be able to report a CET1 above the minimum required by the KNF of 10.875% to be PLN 2.9bn, which implies a 21% cut in its CHF portfolio;
- Any new regulatory requirements concerning minimum adequacy ratios and/or dividends;
- Increase in LGD ratios for banks using the IRB methodology, rising min. requirements, in line with the Financial Stability Committee Recommendation of 13 January 2017;
- FX rate: Relatively high exposure to FX risk of its CHF mortgage portfolio (some 30% of loan book). CHF depreciation helps the bank liquidity position, while CHF appreciation shorts the bank's liquidity position;
- Dividend: Slower than expected return to dividend payments, as we expect first dividends to be paid from 2019 net profit;
- Merger related: Given the pending acquisition of Eurobank assets (1.2x P/B), we see a risk of delivery of strategy costs and synergies.
- Regulatory risk: Potential liquidity squeeze in the banking sector (commercial / cooperative segment) and financial institution (SKOK segment) may lead to a larger contribution to the BFG fund.
- Volume growth significantly below/above our expectations;
- Valuation:
 - Higher Risk Free Rate (lowers valuation)
 - Change in the market-wise sentiment to 'risk on', with dividend stocks preferred

Alior Bank:

- Macro related: Risk of different macroeconomic scenario including: i) interest rates; ii) assets quality/cost of risk; iii) volume growth in Poland.
- Dividend: Faster than expected return to dividend payment.
- Volume growth significantly below/above our expectations.
- Strategic targets related: We assume ALR does not deliver on its 2020 strategic target ROE.
- Acquisition related:
 - Although the talks with PEO concerning a potential merger had been cancelled, the press continues to speculate that ALR may be involved in further acquisitions of troubled banks and financial institutions in Poland, including BOS Bank with a low ROE and low capital adequacy ratio (Puls Biznesu, November 8, 2018), and other savings unions, i.e. SKOK Jaworzno (Puls Biznesu, November 28, 2018)
- Regulatory risk – Any new regulatory requirements concerning minimum adequacy ratios.
 - 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
 - ALR could be facing a fine from the KNF regarding the WI Investment. Although it is hard to assess the potential KNF fine, Raiffeisen was recently fined PLN 50m in that case. This would imply 5% of 2018E net profit.
- Asset quality – Relatively higher risk appetite reflected in its higher– than-average cost of risk and NPLs.
- Ownership related: ALR is indirectly state-controlled (via PZU - 32.22% stake), thus we see a risk of non-market oriented decisions.
 - Risk of ongoing changes to the management board (3rd CEO since acquisition)
- Capital needs: Any potential increase in appetite for loan growth (PLN 5bn-PLN 6bn net is expected annually) could trigger a capital increase given its most modest margin in relation to the minimum requirements.
- Valuation:
 - Higher Risk Free Rate (lowers valuation)
 - Change in market-wise sentiment towards dividend stocks.

Bank Handlowy:

- Macro related: Risks of a different macroeconomic scenario including: i) interest rates; ii) assets quality/cost of risk; iii) volume growth in Poland.
- Interest rate related: Material difference in the size and timing of Central Bank interest rate changes versus our base assumption, i.e. a 25bps interest rate rise in 2020. (BHW has the highest sensitivity among Polish banks).
- Volume growth significantly below/above our expectations.
- Equity market development – some 40% of fee income comes from the equity market related business, thus it is sensitive to market conditions.
- Trading income volatility: Above-average sensitivity to trading income, which is volatile in nature, carries upside/downside risk to earnings
- Dividends: Risk that BHW might need to limit dividend payouts (below 75%) due to regulatory changes / possibility that BHW will be able to improve the dividend to above 75%.
- Securities yield curve: Above-average sensitivity of NII to securities income carries risks in the event of a lower/higher than anticipated yield on securities.
- Regulatory risk – Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.



- 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
- Valuation:
 - Higher Risk Free Rate (lowers valuation).
 - Change in market sentiment towards dividend stocks (upside risk).

IMPORTANT DISCLOSURES

Please find updated IMPORTANT DISCLOSURES at: <http://www.haitongib.com/en/what-we-do/research>