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Haitong Bank in a report from August 21 (08:00) keeps Alior Bank at SELL (FV PLN 11.8).

Valuation Methodology

Valuation: We use a Dividend Discount Model (DDM) with a 90% weighting and a Polish banks' peer multiples' analysis with a 10% 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 30bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take 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, and we assume 60% of clients will go to court and 80% will win their 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.

Main assumption changes: We apply a cost of equity of 10.0% (unchanged). We assume a terminal ROE at 5.5% (vs 5.1% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

Forecast revisions: We have lowered our 2020E bottom line estimate to a net loss of PLN 636m from a PLN 154m net loss, by 13% to PLN 15m net profit in 2021E, and by 31% to a net profit of PLN 212m in 2022E.

We have adjusted earnings for: 1) lowering interest rate assumptions; 2) changing assets mix; 3) increasing profitability of the consumer lending business, given better-than-expected development following the CJEU ruling concerning the return of the fee from the early repayment of consumer loans; 4) lowering fees; 5) hiking provisioning for past cases lowering expenses; 6) hiking net provisioning in both the corporate and consumer segment due to macroeconomic assumptions caused by the COVID-19 outbreak.

Our 2020E net loss forecast of PLN 636m differs from a consensus net loss of PLN 403m. At the same time our 2021E net profit of PLN 15m differs from consensus of net loss of PLN 91m and 2022E net profit of PLN 212 is below consensus by -39% respectively. 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.

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.

Competition: Intensified competition for loans/deposits resulting in lower spreads on assets/liabilities.

Volume growth significantly below/above our expectations.

Asset quality – Relatively higher risk appetite reflected in its higher-than-average cost of risk and NPLs. High exposure to the SME and consumer loans segment may cause higher than anticipated provisions at the bottom of the cycle.

Ownership related: ALR is indirectly state-controlled (via PZU and PFR - 32% stake), thus we see a risk of non-market oriented decisions.

- Risk of changes to the management board (4th CEO since acquisition)
- Acquisition related: Although PEO finished talks with ALR with no merger concluded in August'18. However merger reports are back on the agenda (Parkiet daily, 26/05/2020). However, this has been denied by 3 sides: PZU/PEO/ALR.

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.
- Upside risk to the NII impact of the Court of Justice of the EU ruling concerning return a portion of all banks' costs linked to a consumer loan to clients in the event of an early repayment. The bank reported a PLN 94m NII impact in 1H20, thus we see an upside risk to the management guidance of a PLN 320m negative annual impact if the positive development continue.
- ALR has been granting cash loans with one of the largest values (up to PLN 200k, for up to 12 years) and specialises in high ticket consolidation loans. This may prove risky in the wake of unemployment rising. Large ticket loans have lately been on the radar of the supervisory bodies.

Capital needs: Any significant increase in appetite for loan growth could trigger a capital increase.

Strategy related – Alior Bank's previous management board has presented a new 2020-22 strategy in 1Q20. The current acting CEO has indicated (PAP, 19/08/2020) the need for a strategy update following the change in the interest rate environment.

Dividend: Faster than expected return to a dividend payment.

Valuation:

- Higher Risk Free Rate (lowers valuation)
- Change in market-wise sentiment towards dividend stocks.

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