HAITONG

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Haitong Bank in a report from August 13 (08:00) keeps Bank Pekao at BUY (FV PLN 65.8).

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 Bank Pekao. 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 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 9.5% (down from 10%). We assume a terminal ROE for PEO at 7.7% (versus 10% previously). We use a risk-free rate of 3.0% (down from 3.5%, based on the long-term 10Y Polish Government Bond Yield assumption).

Forecast revisions: We have lowered our '20-21E NI by 23% to PLN 1.25bn (-42% YoY) and PLN 1.61bn (+29% YoY), respectively.

We have adjusted earnings for: 1) lowering interest rate assumptions; 2) rising assets following stronger-than-expected deposit growth; 3) minor adjustments in operating expenses; 4) higher net provisioning in both the corporate and consumer segment due to macroeconomic assumptions caused by the COVID-19 outbreak, following mgmt. guidance for 90-110bps rage; 5) increased CHF mortgage portfolio provisioning to 2.3% from 2% annually.
Our earnings expectations differ from consensus by +14%/+19% for '20-21E. 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.

Dividends: Any further cuts to PEO's dividend policy.

Strategic targets related: We assume PEO will not deliver on its 2020 strategic targets (ROE at 11%-12%), partly due to changes in the environment (lower rates, COVID-19 outlook).

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.

CHF loan exposure: The bank stopped granting FX loans in 2003 and acquired most of the denominated portfolio in 2007 from BPH. The total portfolio is some PLN 3bn (2% of portfolio, 3% market share) now, largely CHF-denominated loans. Notably, PEO had 291 lawsuits with a total b/s value of exposure covered at PLN 79m (+26% QoQ) in 2Q20, while it had made provisions of PLN 74m (+26% QoQ, i.e. 2.5% of the outstanding portfolio). The coverage ratio at 94% seems to remain above peers.

Ownership related: PEO is indirectly state controlled (via PZU and PFR controlling) and thus we see a risk of non-market oriented decisions.

Acquisition related: 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. This could possibly put pressure on the dividend, or cancel it entirely depending on the potential deal structure.

- 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.
- According to Reuters agency (04/02/2020) PEO has filed an offer to acquire mBank from Commerzbank.
- In the past there has been speculation in press reports (source: Parkiet Daily 18/05/19) that the bank could potentially become involved in the resolution of Idea Bank's capital-shortage problems - TCR<1%.

Regulatory risk: Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.

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- 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 dividend stocks.

IMPORTANT DISCLOSURES