Warsaw, August 06, 2020

Marta Czajkowska-Bałdyga, Analyst, Haitong Bank

Haitong Bank in a report from August 05 (08:00) downgrades Bank Millennium to NEUTRAL (FV PLN 2.8).

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 Bank Millennium. 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 30bn cumulative loss for thebanking 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 switched 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% (unchanged). We assume a terminal ROE for MIL at 8.3% (vs 8.7% 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 increased our '20-21E NI by 127%/33% to PLN174m (-69% YoY) and PLN523m (+200% YoY), respectively.

We have adjusted our NP for: 1) lower interest rate assumptions, both in the short term with the last NBP reference rate cut by 40bps to 0.1% and a midterm cut to 0.5% from 1.25%; 2) incorporated latest management guidance on positive development in volumes recovery, NII; 3) cost cutting initiatives; 4) adj. guidance concerning acquisition costs & synergies; 5) higher net provisioning for CHF mortgage portfolio (2.2%/2.3% of the CHF book, up from 2% previously) 6) optimistic guidance concerning the underlying cost of risk.

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;

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.
- 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.
- Increase in LGD ratios for banks using the IRB methodology, rising min. requirements, in line with the Financial Stability Committee Recommendation;

FX rate: Relatively high exposure to FX risk of its CHF mortgage portfolio (some 19.4% of loan book). CHF depreciation helps the bank's liquidity position, while CHF appreciation shorts the bank's liquidity position;

CHF mortgage legal risk: Higher/lower number of new cases, higher/lower value per case, higher/lower ratio of lost cases – could lead to higher/lower provisions for court cases vs currently expected 2.2%-2.3% of the portfolio annually.

Dividend: Slower or faster than expected return to dividend payments, as we expect first dividends to be paid from 2021 net profit; Bank Millennium has a dividend policy of distributing between 35% to 50% of net profit, assuming that the recommendations of the KNF regarding the dividend payment are met.

Merger related: Given the recent acquisition of Eurobank assets (1.2x P/B), we see a risk of non-delivery of strategy costs and synergies.

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.

IMPORTANT DISCLOSURES