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Haitong Bank in a report from December 17 (08:00) updates recommendations on following banks:

- PKO BP (BUY, FV PLN 32.9)
- Bank Pekao (BUY, FV PLN 75.9)
- Santander Bank Polska (BUY, FV PLN 210.2)
- mBank (NEUTRAL, FV PLN 187.9)
- ING Bank Śląski (BUY, FV PLN 194.6)
- Bank Millennium (NEUTRAL, FV PLN 3.2)
- Alior Bank (NEUTRAL, FV PLN 17.3)
- Bank Handlowy (NEUTRAL, FV PLN 36.9)
- BNP Paribas Poland (BUY, FV PLN 67)

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 PKO BP. 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 up to PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with historic margin. 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% (down from 10.5%). We assume a terminal ROE for PKO at 8.0% (vs 8.4% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

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 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 up to a PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with historic margin. 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 PEO at 7.6% (versus 7.7% previously). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

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 Santander Bank Polska. 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 up to PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with historic margin. 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% (down from 9%). We assume a terminal ROE at 7.9% (vs 8.1% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

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 mBank. 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 up to PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with historic margin. 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 at 7.1% (vs 6.5% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

ING Bank Śląski
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 ING BSK. 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 up to a PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with historic margin. 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 8.0% (unchanged). We assume a terminal ROE for ING of 9.5% (vs 9.0% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

Bank Millennium
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 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 up to a PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with historic margin. 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% (down from 9.5%). We assume a terminal ROE for MIL at 7.5% (vs 8.3% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

Alior Bank
Valuation: We use a Dividend Discount Model (DDM) with a 20% weighting and a Polish banks' peer multiples' analysis with a 80% 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 up to a PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with historic margin. 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 5.8% (vs 5.5% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

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 up to a PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with historic margin. 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 8.4% (unchanged). We assume a terminal ROE for BHW at 6.1% (vs 6.4% before). We use a risk-free rate of 3.0% (unchanged, based on the long-term 10Y Polish Government Bond Yield assumption).

BNP Paribas 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 BNP Paribas Polska. 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 up to a PLN 40bn cumulative loss for the anking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from KNF on self-regulations of the sector based on the assumption of reaching agreement with clients, that the loan will be switched to PLN at the historical exchange rate and repaid at the WIBOR rate with a historic margin. 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%. We assume a terminal ROE at 7.8%. We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

Risks to Fair Value

PKO BP

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 2023.

Volume growth significantly below/above our expectations.

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.

Assets quality – Different macro assumptions and /or unemployment rate may lead to higher/lower NPL ratio and higher/lower risk costs.

FX rate: Relatively high exposure to FX risk of its CHF mortgage portfolio (PKO BP has a 20.3% market share in the CHF mortgage market with a loan book of PLN 20.3bn accounting for 8.9% of its loan book and 45% of equity).

CHF portfolio: The CHF mortgage risk remains valid. Sharp PLN currency weakening is a disadvantage and may prompt more people to take court action against the banking sector. As for now, we maintain our previous approach to account for this risk, i.e. ongoing cover of court cases with provisioning and the rest of expected PLN 40bn loss for the sector is deducted from valuation, thus no oneoff charge is visible in our forecast. As of 4Q19, management provided a sensitivity analysis of the legal provisioning on the mortgage portfolio, i.e. a 20% change in the number of cases would change the provisions by PLN 62m (i.e. 0.3% of the portfolio) and a change to the horizon by 1 year would add PLN115m (i.e.0.5% of the portfolio).

Dividend: Scenario of dividend pay-out might not materialize in the future or PFSA may soften/temper the dividend pay-out criteria.

Regulatory risk:

o CHF mortgages: The restructuring of foreign currency housing loans may materialize in a different way to our base scenario or/and add additional costs, i.e. spread bill.
o Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.
o 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. This is especially valid in the light of the COVID-19 virus outbreak.

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.

- The press has previously reported (source: Parkiet Daily 18/05/19) that the bank could potentially become involved in the resolution of the Idea Bank capital-shortage problems TCR<1%.
- Risk of CEO departure: There has been press speculation about the potential departure of the CEO (Rzeczpospolita daily 09/11/2019). The market regards Zbigniew Jagiello (more than 10 years as CEO) as a highly skilled manager, responsible for the transition of the old-fashioned stateowned bank into a digital universal bank with a competitive offer to all client segments. If it happens, we believe this could ultimately be a political decision with no justifiable grounds.

Valuation:
o Higher Risk Free Rate (lowers valuation).
o Change in market sentiment to 'risk on', with a preference for dividend stocks (downside).

Bank Pekao
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 2023.

Volume growth significantly below/above our expectations.

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

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 (1.9% of portfolio, 3% market share) now, largely CHF-denominated loans.

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

Santander Bank Polska
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.

Funding costs – Competitive rise in deposit rates could lead to NIM narrowing;

FX rate: Exposure to FX risk of its CHF mortgage portfolio (some 7% of the loan book). Appreciation of CHF may lead to further pressure on its liquidity position.

Lower assets quality: Exposure to segments where the risk is naturally higher, i.e. consumer finance (20% of portfolio) and SME segment (10%) is above the market.

Cost of risk: SCB consumer finance loan book provides above average risk to the retail non-mortgage book cost of risk assumptions.

Employment restructuring: - Santander BP has announced plans for group layoffs. The redundancies should affect up to 2,000 branch and HQ employees, i.e. 18.52% of total staff (as of Sep'20) and will be finished by Dec'22. The bank will reportedly spread the layoffs over the next two years due to specific market conditions related to the pandemic, but this may delay the actual benefits. We estimate the impact of the employment reduction at some PLN 250m (6.5% of the costs base), to be fully recognised in 2023. SPL has confirmed recently our estimates for the cost of layoffs at PLN 120m (4Q20). We see downside/upside risk from a different scenario in terms of either costs or benefits of employment restructuring.

Capital market related: The relatively higher revenue exposure to capital market related fees could be at risk with changing market conditions.

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 2.3% of the portfolio annually.

Regulatory risk:
o 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.
o Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.
o 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:
o Higher Risk Free Rate (lowers valuation).

o Change in the market-wise sentiment to 'risk on', with dividend stocks preferred.

mBank

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 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;

FX rate: Relatively high exposure to FX risk of its CHF mortgage portfolio (some 12% of loan book).

Cost of risk: Sensitivity of NI to changes in the cost of risk is stronger than average. Exposure to segments where the risk is naturally higher, i.e. consumer finance (21% of portfolio) and SME segment (16%) is above the market average.

Dividend: Higher-than-expected near-term dividend - upside risk.

Lower-than-expected near-term dividend - downside risk.

Regulatory risk –
o 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. Different approach to the CHF portfolio provisioning given the large and rising number of court cases.
o Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.
o 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.
o Increase in LGD ratios for banks using the IRB methodology, rising min. requirements, in line with the Financial Stability Committee Recommendation;
o MREL requirement may be set high: mBank reported an estimated 27.94% of the MREL requirement (as a % of TRAE), vs the 22.8% consolidated requirement reported by PKO BP. Meanwhile MBK's TCR ratio stood at 19.5% in 4Q19. In our opinion this would imply that MBK requires more than PLN 6.0bn additional MREL compliant funds by the end of 2022. This risk has been mitigated by recent changes to the capital requirements.

Strategy related – mBank has presented a new 2020-23 strategy – risk of not delivering on its targets.

M&A/ Shareholders related: Risk that the major shareholder Commerzbank (69.3%) will come back to the plan to put mBank up for sale as a part of its restructuring strategy (announced in September'19/dropped May'20). This would pose a risk of deal execution, valuation, continuation of existing strategy.

Volume growth significantly below/above our expectations.

Valuation:
o Higher Risk Free Rate (lowers valuation).
o Change in market sentiment to 'risk on', with dividend stocks preferred.

ING Bank Śląski

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 2023.

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 a rising cost of risk persist.

Lower assets quality: Its exposure to SME segment (17%) where the risk is naturally higher is above the market (12%), and so is ING's corporate book exposure to problematic sectors (4.4% on and off B/S exposure) in 2019 vs. the market at 3.6%. This may cause some risk in the economic downturn.

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.
o Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.
o 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:
o Higher Risk Free Rate (lowers valuation).
o Change in the market-wise sentiment towards stocks with high dividend yield
o Low liquidity

Bank Millennium
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 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 –
o CHF mortgages: The restructuring of foreign currency housing loans a different way to our base scenario or/and additional costs, i.e. spread bill.
o Any new regulatory requirements concerning minimum adequacy ratios and/or dividends;
o 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.
o 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 18.3% 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 3.5% of the portfolio annually.

Dividend: Slower or faster than expected return to dividend payments, as we do not expect a dividend to be paid until the CHF mortgage issue is resolved; Bank Millennium has a dividend policy of distributing between 35% and 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:
o Higher Risk Free Rate (lowers valuation).
o Change in the market-wise sentiment to 'risk on', with dividend stocks preferred.

Alior Bank
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 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.
o Risk of changes to the management board (4th CEO since acquisition)
o 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.
o 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.
o 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.
o 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 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, to be presented in 1Q21.

Dividend: Faster than expected return to a dividend payment.

Valuation:
o Higher Risk Free Rate (lowers valuation)

Bank Handlowy
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 2023.

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% without retained earnings in the mid-term. Our expectations do not include a dividend in 2020 as we are skeptical about any discussions with the regulator.

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

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.

Assets quality – Better assets quality could lead to a lower cost of risk, which would have a positive impact on earnings; Lower assets quality could lead to a higher cost of risk, which would have a negative impact on earnings

Regulatory risk –
o Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.
o 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:
o Higher Risk Free Rate (lowers valuation).
o Change in market sentiment towards dividend stocks (upside risk).

BNP Paribas Polska
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 2023.

Funding costs – Competitive rise in deposit rates could lead to NIM narrowing;

FX rate: Exposure to FX risk of its CHF mortgage portfolio (some 7% of the loan book). Appreciation of CHF may lead to further pressure on its liquidity position.

Lower assets quality: Exposure to segments where the risk is naturally higher, i.e. consumer finance (20% of portfolio) and SME segment (10%) is above the market.

Cost of risk: Consumer finance loan book provides above average risk to the retail non-mortgage book cost of risk assumptions.

Employment restructuring: - BNP Paribas Polska has announced plans for group layoffs. The redundancies should affect up to 800 employees, i.e. 8.6% of total staff (as of Sep'20) and will be finished by 2023. This will come at some PLN 50m costs, likely to be booked in 4Q20. We estimate the impact of employment reduction at some PLN 100m (4.2% of costs base), to be fully recognised in '23E. We see downside/upside risk from a different scenario in terms of either costs or benefits of employment restructuring.

Dividend: Scenario of a dividend pay-out might not materialize in the future or PFSA may soften/temper the dividend pay-out criteria.

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 3.5% of the portfolio annually.

Regulatory risk –
o 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.
o Any new regulatory requirements concerning minimum adequacy ratios and/or dividends.
o 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:
o Higher Risk Free Rate (lowers valuation).
o Change in the market-wise sentiment to 'risk on', with dividend stocks preferred.

IMPORTANT DISCLOSURES