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Haitong Bank in a report from March 18 (08:00) keeps Alior Bank at NEUTRAL (FV PLN 23.3).

### Valuation Methodology

**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 or specific bank guidance where available. KNF lately disclosed its estimates on the conversion costs at PLN 34.5bn, but this included only outstanding loans.

**Main assumption changes:** We apply a cost of equity of 10.0% (unchanged). We extended the model by one year to 2024. We assume a terminal ROE at 6.5% (vs 5.8% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

The difference between our forecasts and consensus figures most likely comes from the highly unpredictable risk costs, and high sensitivity of results to the COR forecast given low pre-provisioning profitability following rate cuts.

### 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 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: PEO finished talks with ALR with no merger concluded in August'18. However merger reports have been 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/downside risk to earnings impact of the Court of Justice of the EU ruling concerning returning 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 210m NII impact in 2020 and PLN 133m in other operating results.
- 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 decline in Tier1/TCR.

Dividend: Faster than expected return to a dividend payment.

Valuation:

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

#### **IMPORTANT DISCLOSURES**

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