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Haitong Bank in a report from May 6 (08:00) keeps PKO Bank Polski at BUY (FV PLN 45.8).

### 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 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 a PLN 40bn cumulative loss for the banking sector stemming from restructuring of the CHF portfolio. We take into account the latest proposal from the KNF on self-regulation 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 historical margin. There will likely be a portion of clients that will not be willing to settle and will go to court demanding cancelation of loan agreements, as well as a portion that will keep the status quo. 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% (unchanged). We extended the valuation by a year, and we assume a terminal ROE for PKO at 10.9% (vs 8.0% before). We use a risk-free rate of 3.0% (based on the longterm 10Y Polish Government Bond Yield assumption).

#### Forecast revisions

We raised our '21-23E NI by +45%/+30%/+21% to PLN 4.79bn /PLN 4.81bn (flat YoY)/PLN 5.15bn (+7% YoY), respectively. We update our forecasts to include a lower risk related to the CHF mortgage portfolio, optimistic mgmt. Comments concerning underlying risk costs, lower NII due to the write down of the FX mortgage portfolio as well as higher fee income and lower costs, mostly on the back of lower reported BFG costs.

Our earnings expectations differ from consensus by +24%/+23%/+12% for '21-23E, respectively. We believe the difference comes mainly from FX mortgage legal risk provisions, which we downgraded following the fund creation approved by the EGM while costs had been booked through 2020 net profit.

### 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.

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: PKO BP has hedged the FX risk connected with FX mortgage conversion as of Dec'20, however the material changes to the FX rate will result in profit/losses on the P&L.

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. As of 4Q20, management provided a sensitivity analysis of the legal provisioning on the mortgage portfolio, i.e. a 1pp change in the number of cases would change the provisions by PLN 65m, 1pp lower probability of winning in court (PLN 14m), 1% increase in the weighted average loss (PLN 13m) and 1pp decline in number of settlements (PLN 27m).

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

Regulatory risk:

- CHF mortgages: The restructuring of FX housing loans may materialize in a different way to our base scenario or/and add 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. This is especially valid in the light of the low interest rates.

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.

- 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:

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

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