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Haitong Bank in a report from September 17 (08:00) keeps Bank Handlowy at NEUTRAL (FV PLN 35.2).

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 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 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 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 8.4% (unchanged). We assume a terminal ROE for BHW at 6.4% (vs 9.0% before). We use a risk-free rate of 3.0% (unchanged, based on the long-term 10Y Polish Government Bond Yield assumption).

Forecast revisions: We have increased our '20-21E NI by 4%/16% to PLN269m (-44% YoY) and PLN400m (+49% YoY), respectively, on the back of stronger retail volumes but lower by 29% to PLN 430m for '22E due to lower mid-term interest rates assumptions.

We have adjusted our net profit for: 1) lower interest rate assumptions; 2) lower lending volumes in corporates and higher in retail; 3) one-off expenses in 2Q20; 4) higher up front net provisioning in 2020, due to macroeconomic assumptions caused by the COVID-19 outbreak.

Our earnings expectations are 3% below consensus for '20E and 35% above for '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.

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:

- 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:

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

IMPORTANT DISCLOSURES

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