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Haitong Bank in a report from November 2 (08:00) upgrades Santander Bank Polska to BUY (FV PLN 153.4).

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 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 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 9.0% (unchanged). We assume a terminal ROE at 8.1% (vs 7.8% before). We use a risk-free rate of 3.0% (based on the long-term 10Y Polish Government Bond Yield assumption).

Forecast revisions: We increased our '20-22E NI by 14%/10%/6% to PLN 1.23bn (-49% YoY)/ PLN 1.65bn (+35% YoY)/ PLN 2.02bn (+22% YoY), respectively. We have adjusted earnings for: 1) change in assets mix with rising market share in high margin - high risk consumer loans replacing lower corporate loans; 2) stronger capital market fees 3) expected employees restructuring provisions (PLN 120m) forecast to be booked in 4Q20; 4) lower '21-22 operating expenses incorporating layoffs scenario; 5) higher net provisioning in consumer segment, 6) moving some provisions to 2021 due to slightly different macro assumptions.

Our net income estimates for 2020-22E are above consensus by 25%/38%/25%, respectively. This is, in our opinion, mainly due to non-reflected restructuring potential, the highly unpredictable effect of the COVID-19 pandemic especially in terms of volumes and risk costs and 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.

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. Based on this, we estimate the cost of this round of layoffs at some PLN 120m, most likely to be booked in 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.

Dividend: Dividend scenario might not materialize. Assuming no dividend would be paid in 2021, our valuation would drop to PLN 149.7 per share (20% upside)

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

- 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.
- 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.

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.

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