Banks | Poland

Alior Bank

Accumulate (from Neutral)

TP: PLN 83

Recommendation upgrade

- **Rating upgrade to Accumulate from Neutral with 12M TP down to PLN 83 from 85**
- **We cut our net profit estimates by 4% in 2015E and lift by 1% in 2016E**
- **Trading at 1.3x 2016E P/BV, in line with peers**

Vestor DOM MAKLERSKI

equity research

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Valuation more attractive

We are upgrading our rating for Alior Bank to Accumulate from Neutral. While we cut our 2015E earnings estimates by 4% and reduce 12M TP to PLN 83 from PLN 85 previously, the recent share price performance (-10% over the last 10 days) has made the valuation attractive, in our view. Alior is the only bank in our universe that, despite a banking tax (0.35% of assets), should report 2016E earnings growth (+11% YoY) supported by consolidation of Meritum and still strong – although decelerating – lending volumes dynamics. The bank is free of CHF loans and in line with other banks exposed to the banking tax. Given double-digit earnings growth, less political risk and upside related to future acquisitions, the valuation at 1.3x 2016 P/BV is attractive, we believe.

3Q15 numbers as expected. Alior's 3Q results came in line with our and market expectations with net profit of PLN 91m (+30% YoY, +4% QoQ). While net fees surprised negatively (6% below consensus), NII, costs and provisions were broadly in line and trading income surprised positively (+10% vs. consensus).

We cut our 2015E earnings estimates by 4%.... On the back of 3Q15 numbers and the management guidance (additional PLN 24m integration costs in 4Q15 and rebounding net fees, +5% QoQ), we cut our 2015E net profit estimates by 4% and expect Alior to report PLN 360m net profit (+12% YoY), 5% below consensus.

… but 2016E appears more attractive comparing to peers. 2016E prospects though appear more attractive - we expect Alior bank to be the only one in our universe of 9 banks, that should report positive earnings dynamics. We expect +11% YoY net profit growth (to PLN 398m) supported by consolidation of Meritum, that should partly offset headwinds including the banking tax or decelerating lending volumes growth. With our 2016E earnings estimates we are 17% below consensus.

No CHF risk, in line with other banks exposed to banking tax. Alior has hardly any exposure to CHF mortgage loans (1% of the book). The bank is also broadly in line with other banks exposed to the banking tax (22% of 2016E ex-tax net profit at 0.35% rate on assets vs. 23% in peers on average).

Valuation turns attractive. At our estimates Alior is trading at 14.3x 2016E P/E and 1.3x P/BV, that is broadly in line with peers. Given double-digit earnings growth, less political risk and upside related to future acquisitions, the valuation offers attractive risk/reward profile.

Figure 1. Alior Bank – Key data, 2012-2017E

	2012	2013	2014	2015E	2016E	2017E
Net profit (PLNm)	211	228	323	360	398	476
YoY change (%)	*38%*	*8%*	*42%*	*12%*	*11%*	*20%*
ROE (%)	4.0%	11.0%	12.4%	10.7%	10.2%	11.0%
P/E (x)	70.1	21.1	16.3	15.8	14.3	12.0
P/BV (x)	2.4	2.2	1.8	1.4	1.3	1.2
DPS (PLN)*	0.0	0.0	0.0	0.0	0.0	0.0

** from the year's earnings. Source: Company data, Vestor DM estimates*

Company data

Rating	Accumulate
Target Price (PLN)	83.0
Market Price (PLN)	75.5
Upside/downside	10%
Previous rating	Neutral
Previous Target Price (PLN)	85
Min (52W)	73
Max (52W)	100
Market cap (PLNm)	6,324
Avg. 3M Turnover (PLNm)	10

Shareholders	%
Alior Lux S a RL & Co. S.C.A	15.2
PZU SA	10.0
Genesis Asset Managers LLP	7.0
OFE Aviva BZ WBK	5.2
Other	62.6

Company description

Alior Bank is universal bank with over 3% market share in loans and deposits. The bank, founded by Carlo Tassara and ex-BPH managers, started its operations in November 2008. It has 2.9m of retail and 0.1m of corporate clients and has the 4th biggest distribution network in Poland (754 branches).

ALR vs WIG 1Yr relative price performance rebased

Source: Bloomberg, Vestor DM

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Over the last twelve months, Vestor issued one neutral recommendation concerning Alior Bank dated 12th January 2015 with target price 82PLN, one reduce recommendation dated 29th January 2015 with the target price 80PLN, second neutral recommendation dated 13th March 2015 with target price 85PLN, third neutral recommendation dated 11th June 2015 with target price 94PLN and another neutral recommendation dated 28th October 2015 with target price 85PLN.

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In preparing this document Vestor applied at least two of the following valuation methods:

1) discounted cash flows (DCF),

2) comparative,

3) target multiple,

4) scenario analysis,

5) dividend discount model (DDM),

6) NAV,

7) Sum of the parts.

8) Discounted residual income model

9) ROE-P/BV model

The discounted cash flows (DCF) valuation method is based on discounting expected future cash flows. The main advantage of the DCF valuation is the fact that this method takes into account all cash streams the issuer is expected to reach and the cost of money over time. From the other hand, DCF valuation method requires a number of assumptions and is very sensitive to changes in parameters used in the in the model. Small changes in inputs can result in large changes in the value of a company.

The comparative valuation method is based on the rule of "one price". The advantages of this method are small number of parameters that need to be estimated, the fact that there is a relatively large number of indicators for companies being compared, the method is well-known among investors and the valuation is based on current market conditions. From the other hand a valuation derived from the comparative valuation method is considerably sensitive to the valuation of the companies classified as peers and can lead to simplification of the picture of the company.

The target multiple valuation approach is based on the assumption that the value of the company should be equal to pre-specified values of selected price multiples. The advantage of this method is its applicability to each company. From the other hand the target multiple approach is a highly subjective method.

The scenario analysis approach is based on the probability weighted valuation for three sets of assumptions: Bear case (20% probability), base case (60% probability) and bull case (20% probability). The base case is based on the assumptions and estimates which we have included in our financial forecasts and DCF valuation. In the bear/bull case scenarios we have analyzed the valuation sensitivity towards negative/positive changes in various assumptions including market size, market shares, profitability, growth, capex, valuation multiples etc. The advantage of this method is presentation of various scenarios and valuation sensitivity. As an disadvantage we find its complication and sensitivity towards probability weights assumption.

The dividend discount model (DDM) valuation uses predicted dividends that are expected to be paid out by the company and discounts them back to present value. The advantages of the DDM valuation method are its applicability to companies with long-term dividend payout history and the fact that it takes into account real cash streams that are expected to receive by equity-owners. From the other side the DDM valuation method requires a number of assumptions regarding dividend payouts.

The net asset value approach considers the underlying value of the company's individual assets net of its liabilities. Some of the advantages of the NAV approach are its applicability to asset holding companies and the fact that data required to perform the valuation are usually easily available. From the other hand the valuation derived from net asset value approach does not take into account future changes in sales or income and can understate the value of intangible assets.

The sum of the parts approach values a company by determining what its divisions would be worth if it was broken up and spun off or acquired by another company. The advantage of this method is a possibility to apply different valuation methods to different divisions. As an disadvantage we find scarcity of comparable basis for the respective business lines.

The discounted residual income model valuation is based on discounted excess equity flows the company is able to deliver. The main advantage of this method is that it is based on return on equity adjusted by cost of equity. The important disadvantage is that it is based on the income statement so does not include actual cash flows, but may fluctuate depending on accounting method.

The ROE-P/BV model valuation is based on the regression line with valuation-to-book value (P/BV) depending on the return on equity the company is able to deliver. The main advantage of the method is that it includes the correlation of valuation with profitability. The main disadvantage is that it does not fully take into account earnings dynamics.

Terminology used in the recommendation:

P/E – price-earnings ratio

PEG - P/E to growth ratio

EPS - earnings per share

P/BV – price-book value

BV – book value

EV/EBITDA – enterprise value to EBITDA

EV – enterprise value (market capitalization plus net debt)

EBITDA – earnings before interest, taxes, depreciation, and amortization

EBIT – earnings before interest and tax

NOPAT – net operational profit after taxation

FCF - free cash flows

ROE – return on equity

WACC - weighted average cost of capital

CAGR – cumulative average annual growth

CPI – consumer price index

COE – cost of equity

L-F-L – like for like

Recommendation definitions:

Buy - indicates a stock's total return to exceed more than 1.5x respective cost of equity over the next twelve months.

Accumulate - indicates a stock's total return to exceed more than respective cost of equity over the next twelve months.

Neutral - indicates a stock's total return to be in range of 0% to respective cost of equity over the next twelve months.

Reduce - indicates a stock's total return to be in range of minus respective cost of equity to 0% over the next twelve months.

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