Banks | Poland

mBank

Sell (from Reduce)

TP: PLN 293

Recommendation downgrade

- **We reduce our TP to PLN 293 from PLN 316 and downgrade our rating to Sell from Reduce**
- **We lift our adjusted net profit estimates by 4% in 2016E, by 2% in 2017E and by 1% in 2018E.**

Vestor DOM MAKLERSKI

equity research

24 June 2016

Valuation implies no CHF-related risks

Over the last 5 days mBank, supported by vanishing Brexit fears, gained almost 12% outperforming WIG Banks index by 4.1pp. According to our estimates the current valuation implies no CHF risk while we believe the probability of forced conversion has increased since our last update. mBank, with PLN 26bn of FX mortgages (16% share in the sector) remains one of the most CHF-exposed banks. We lower our 12M TP to PLN 293 from PLN 316 previously and downgrade our rating to Sell from Reduce. Our new TP includes increased assumption of PLN 10bn CHF conversion cost for the sector (vs. PLN 2bn previously). Even with no risk of CHF conversion losses, we see the current valuation at 13.6x 2016E P/E and 1.0x P/BV as demanding, given only 6% adjusted EPS CAGR in years 2016-2018E and c. 8% ROE.

One of the most CHF-exposed banks. mBank, with c. PLN 26bn of FX mortgage loans, representing 32% of its loan book and 16% of sector FX mortgages, is one of the most CHF exposed Polish banks. While we are still waiting for details of the President's Office CHF-related proposal, we believe the probability of forced conversion has increased since our last update. We now increase our assumption of total cost for the sector to PLN 10bn from PLN 2bn previously and adjust our target price accordingly. The adjustment lowers our TP for mBank by PLN 31.

CHF: no conversion priced in. Assuming potential hit due to FX conversion should reflect the bank's share in sector FX mortgages, PLN 10bn cost for the sector would imply c. PLN 1.3bn loss for mBank, 10% of its equity and 9% of MCAP. According to our estimates though, the current market price does not reflect any CHF conversion at all. With no forced conversion our TP would imply c. 5% downside, with PLN 10bn cost for the sector c. 12% and with PLN 20bn c. 21% downside.

Slight changes to 2016E-2018E net profit estimates. 1Q16 results and management guidance prompted us to lift our adjusted net profit estimates by 4% in 2016E, by 2% in 2017E and by 1% in 2018E. We now expect adjusted earnings to drop 12% YoY in 2016E (to PLN 1,037m) and to rebound in 2017E by 5% YoY to PLN 1,089m. Our 2016E and 2017E adjusted figures are 6% and 5% below consensus, respectively.

Trading at 13.6x P/E and 1.0x P/BV with no discount to peers. At our estimates mBank is trading at 13.6x P/E and 1.0x P/BV, in line with the sector median. Given one of the biggest exposures to inevitable regulatory changes, c. 8% ROE over the next three years and only 6% adjusted EPS CAGR in years 2016-2018 we see the valuation as demanding.

Figure 1. mBank – Key data, 2013-2018E

	2013	2014	2015	2016E	2017E	2018E
Net profit (PLNm)	1 206	1 287	1 301	1 203	1 089	1 163
YoY change (%)	*1%*	*7%*	*1%*	*-8%*	*-9%*	*7%*
Adjusted net profit (PLNm)	1 206	1 287	1 180	1 037	1 089	1 163
YoY change (%)	*1%*	*7%*	*-8%*	*-12%*	*5%*	*7%*
ROE (%)	12.2%	12.1%	11.2%	9.4%	7.9%	8.0%
P/E (x) adjusted	11.7	10.9	11.9	13.6	12.9	12.1
P/BV (x)	1.4	1.3	1.2	1.0	1.0	0.9
DPS* (PLN)	17.0	0.0	0.0	11.4	10.3	11.0
DY* (%)	5.1%	0.0%	0.0%	3.4%	3.1%	3.3%

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

Company data

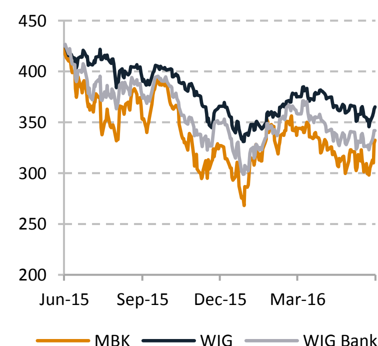
Rating	Sell
Target Price (PLN)	293.0
Market Price (PLN)	333.4
Upside/downside	-12%
Previous rating	Reduce
Previous Target Price (PLN)	316.0
Min (52W)	264.1
Max (52W)	435.0
Market cap (PLNm)	14,082
Avg. 3M Turnover (PLNm)	7.8

Shareholders	%
Commerzbank	69.5%
OFE NN	5.0%
Other	25.5%

Company description

mBank is the fourth largest bank in Poland with almost 8% market share in assets and 276 branches. The bank has a strong exposure to corporate loans (41% of the loan book) and FX mortgage loans (32% vs. 10% PLN mortgage loans). Consumer loans constitute 12% of mBank's loan book.

mBank vs. WIG vs. WIG Banks 12M relative price performance rebased



Source: Bloomberg, Vestor DM

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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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