Banks | Poland

mBank

Sell (from Neutral)

TP: PLN 317

Recommendation downgrade

- **We lift our TP to PLN 317 from PLN 302, but downgrade our rating to Sell from Neutral**
- **We make no material changes to our 2016E and 2017E net profit estimates**
- **Valuation at 15.0x P/E, 1.1.x P/BV we see as high**

Vestor DOM MAKLERSKI

equity research

17 March 2016

Valuation high even with no CHF risk. Sell.

Following 13% gain YTD and 9pp outperformance versus WIG Banks index, we believe mBank's valuation leaves no further upside. Given higher exposure to the banking tax (c. 35% of 2016E net profit vs. 29% for the sector) and no dividend payout till 2017E we see the bank's multiples at 15.0x P/E and 1.1x P/BV as demanding. First, with c. 8% ROE for next three years, we believe the stock should not trade above 1.0x P/BV. Second, we believe that 8% EPS CAGR between 2016-2018E does not justify P/E at 15x. Third, with no dividend from 2015 and c3% forward yield, we see little support for the current stock price. Our new TP of PLN 317 (up from PLN 302) implies 11% downside potential. We note that in our valuation we assume only PLN 2bn negative impact for the sector related to potential forced CHF-conversion. While we think the risk is obviously not as high as PLN 67bn mentioned by the FSA, we believe it is still not immaterial as implied by the current price. We downgrade mBank to Sell from Neutral.

Valuation downside even with no CHF risk. According to FSA Polish banks could take c. PLN 67bn hit on the FX loans conversion bill proposed by the President. With 25% share of FX mortgages in total loans mBank remains strongly exposed to any form of the potential conversion. While we think the risk is obviously not as high as mentioned by the FSA, we believe it is still not immaterial as implied by the current share price.

Higher exposure to the banking tax. While mBank benefits from relatively high share of T-bonds in total assets, due to below average ROA (0.8% in 2016E vs. 1.0% average for peers), it is more exposed to the banking tax than peers. We expect the new levy to stand for c. 35% of 2016E mBank's net profit vs. 29% in banks on average.

No support from dividend. Despite its previous guidance on a dividend payout, the Management decided finally not to pay a dividend neither from 2014 nor from 2015 earnings (in line with our estimates). While the AGM will vote on March 23, we expect no positive surprises given regulatory pressure and weak capital ratios (consolidated 4Q15 Tier I and CAR at 14.3% and 17.3% vs. 16.5% and 17.6% required for payout).

No changes to 2016E earnings estimates. We make no material changes to our earnings estimates and expect 15% YoY adjusted 2016E net profit drop to PLN 1,001m followed by 10% YoY growth in 2017E to PLN 1,101m (both 4% below consensus).

Demanding valuation. At our estimates mBank is trading at 15.0x P/E and 1.1x P/BV. Given c. 8% ROE for next three years and 8% EPS CAGR between 2016-2018E we see the current valuation as demanding.

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

PLNm unless otherwise stated

	2013	2014	2015	2016E	2017E	2018E
Net profit (PLNm)	1 206	1 287	1 301	1 001	1 101	1 164
YoY change (%)	*1%*	*7%*	*1%*	*-23%*	*10%*	*6%*
ROE (%)	12.2%	12.1%	11.2%	7.9%	8.1%	8.1%
P/E (x)	12.4	11.6	11.5	15.0	13.6	12.9
P/BV (x)	1.5	1.4	1.2	1.1	1.1	1.0
DPS* (PLN)	17.0	0.0	0.0	9.5	10.4	11.0
DY* (%)	4.8%	0.0%	0.0%	2.7%	2.9%	3.1%

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

Company data

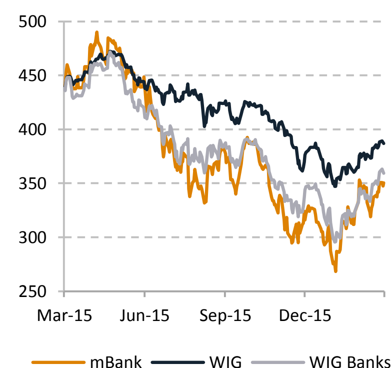
Rating	Sell
Target Price (PLN)	317
Market Price (PLN)	354
Upside/downside	-11%
Previous rating	Neutral
Previous Target Price (PLN)	302
Min (52W)	264
Max (52W)	490
Market cap (PLNm)	14,967
Avg. 3M Turnover (PLNm)	9.4

Shareholders	**%**
Commerzbank AG	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 (43% 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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Buy/Accumulate/Neutral/Reduce/Sell – means that, according to the authors of this document, the stock price may perform materially better/better/neutrally/worse/materially worse than the cost of equity of the respective stock.

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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.

Sell - indicates a stock's total return to be less than minus respective cost of equity over the next twelve months.

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