

BZ WBK

Buy (from Accumulate)

TP: PLN 436

Recommendation upgrade

- We upgrade our rating to a Buy from Accumulate, with TP slightly down to PLN 436 from PLN 442
- We trim our adjusted net profit estimates by 3% both in 2018E and 2019E.

21 February 2018 08:00

Valuation more attractive. Upgrade to a Buy.

Following recent BZ WBK's share price drop related to disposal of Deutsche Bank's stake we upgrade our rating for the bank to a Buy from Accumulate with TP slightly down to PLN 436 from PLN 442 previously. 4Q17 results and the management guidance prompted us to trim our 2018/19E earnings estimates by 3% and lift our expected 2017 dividend payout ratio to 30%. In our view BZ WBK remains one of the most profitable banks in Poland (2018/19E ROE of 11.0/11.3% vs. 9.6/10.5% sector median), offers the best-in-class NIM-CoR profile and takes an advantage of consolidation of the banking sector in Poland what will boost its earnings in the long term. Thus, current valuation at 15.6x 2018E P/E and 1.61x P/BV, with only 3% and 12% premium to peers we see as attractive. While the bank still faces CHF risk, it's less than peers exposed to FX conversion costs.

4Q17 results/take-aways. BZ WBK's 4Q17 numbers (net profit PLN 549m, 19% YoY, -2% QoQ) came broadly in line with our and market expectations. Better financial and other income was offset by higher costs and tax rate. Core revenues were in line with forecasts. In 2018 the management expects stabilization of NIM, higher cost of risk and minor opex growth, although negatively affected by acquisition of Core DBPL.

Small changes to 2018E and 2019E EPS forecasts. On the back of 2017 results and the management guidance we trim our net profit estimates by 3% both in 2018E and 2019E. We still expect decent 14% YoY EPS growth in 2018E followed by 16% YoY increase in 2019E (broadly in line with consensus for both years). In our earnings forecasts we maintain our assumption of 2x25bp interest rates hikes in September-October 2018E.

30% dividend payout from 2017 earnings. Following strong 4Q17 Tier I and CAR ratios the management confirmed that is ready to pay a dividend. We are moderating our payout assumption (to 30% of 2017 stand-alone earnings vs. 0% previously) and expect DPS PLN 5.8, DY 1.5%. We maintain our 2018E DPS assumptions (PLN 10.2, DY 2.6%).

Valuation remains attractive. At our forecasts BZ WBK is trading at 15.6x 2018E P/E and 1.6x P/BV with only 3% and 12% premium to peers, respectively. Given superior profitability, dividend payout and further growth acceleration supported by acquisition of Core DBPL, we see the current valuation as attractive.

CHF risk still on, but included in our TP. Over the last year BZ WBK reduced its FX mortgage exposure to 11% from 15% of total loans. We maintain our assumption of PLN 4.8bn FX conversion sector cost resulting from a quarterly contribution at 0.2% of FX loan book. We note though, that BZ WBK is less than FX peers exposed to additional conversion costs. According to our estimates 0.2% rate would result in "only" PLN 100m hit in the first year (4% of net profit) or c. PLN 400m over the next 5 years (c. 2% of BV). Rate at 0.5% would consume c. 10% of earnings and c. 3% of BV, respectively.

Figure 1. BZ WBK – Key data, 2015-2020E

	2015	2016	2017	2018E	2019E	2020E
Net profit (PLNm)	2 327	2 167	2 213	2 525	2 921	3 228
YoY change (%)	22%	-7%	2%	14%	16%	11%
ROE (%)	13.0%	11.1%	10.6%	11.0%	11.3%	11.2%
P/E (x)	16.5	17.7	17.3	15.6	13.5	12.2
P/BV (x)	2.0	1.9	1.7	1.6	1.4	1.3
DY* (%)	1.8%	1.4%	1.5%	2.6%	3.0%	3.3%

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

Company data

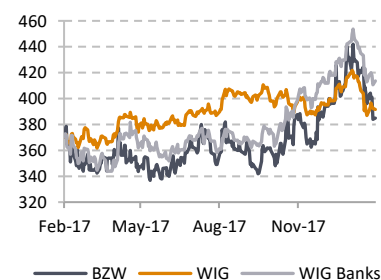
Rating	Buy
Target Price (PLN)	436.0
Market Price (PLN)	386.0
Upside/downside	13%
Previous rating	Accumulate
Previous Target Price (PLN)	442.0
Min (52W)	331.8
Max (52W)	444.8
Market cap (PLNm)	38,323
Avg. 3M Turnover (PLNm)	19.6

Shareholders

	%
Banco Santander	68.1%
Other	31.9%

Company description

BZ WBK is the third largest bank in Poland with 10% market share in loans and deposits and over 570 branches across the country. The bank's loan book is split between corporate (38%), mortgage (34% incl. 11% FX mortgages), consumer (17%) and SME (11%) loans. In 2012 BZ WBK merged with Kredyt Bank, in 2014 completed acquisition of 60% stake in Santander Consumer Bank and in December 2017 announced acquisition of Core Deutsche Bank Polska.

BZ WBK vs. WIG vs. WIG Banks 12M relative price performance rebased

Source: Bloomberg, Vestor DM

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 - ii. supervising their own transactions made by individuals, periodic inspection and assessment of the effectiveness of implemented by Vestor control systems and procedures; conducting the legally required registers and records, primarily registry conflicts of interest associated with a significant risk of damage to client interests;
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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 valuation (including ROE-p/BV model),
- 3) Target multiple,
- 4) Scenario analysis,
- 5) Dividend discount model (DDM),

- 6) net asset value (NAV),
- 7) Sum of the parts,
- 8) Discounted residual income model (DRIM),
- 9) Risk-adjusted net present value (rNPV).

The discounted cash flows valuation method (DCF) is based on discounted expected future cash flows. The method includes all cash flows the issuer is expected to generate in a given period and the cost of money over time. However, the DCF valuation method requires a number of assumptions and is very sensitive to changes in parameters used in the model. Small changes in assumptions may result in material changes in the valuation.

The comparative valuation method is based on the rule of "one price". The advantages of the method include 1) a small number of parameters to be estimated, 2) the fact that there is a relatively large number of indicators for companies being compared, 3) The method is well-known among investors, 4) valuation is based on current market conditions. On the other hand, a comparative valuation is strongly sensitive to the valuation of the companies classified as peers and may lead to a simplified picture of the company valued.

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 simplicity and applicability to almost all of the companies. The target multiple approach is a highly subjective method, though.

The scenario analysis approach is based on the probability weighted valuation for three sets of assumptions: Bear case, base case and bull case with a different probability assigned. The base case is based on the assumptions included in financial forecasts and DCF valuation. The bear/bull case scenarios present a 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. A complexity and sensitivity to probability weights assumption may be found as disadvantages.

The dividend discount model (DDM) valuation is based on discounted future dividends that are expected to be paid out by the company over a period of time. The DDM model includes real cash streams that are expected to be received by shareholders and may be applied to companies with long-term dividend payout history. However, the DDM valuation method requires a number of assumptions.

The net asset value (NAV) approach considers the underlying value of the company's individual assets net of its liabilities. Among the advantages of the NAV approach are its applicability to asset holding companies and the fact that data required are usually easy to reach. On the other hand the NAV approach does not take into account future changes in revenues or income and can underestimate the value of intangible assets.

The sum of the parts approach values a company on the back of valuations of its separate divisions. The method is applicable to companies with very different business profiles, but requires identification of peers for business divisions comparison, what may be difficult to achieve.

The discounted residual income model includes equity at the end of a given financial year, excess equity (return on equity over cost of equity) the company is expected to generate in the estimation period and a discounted residual value post-estimation period. On one hand, the method includes profitability of the company compared to a cost of equity, but on the other hand it is strongly dependent on a number of parameters and assumptions.

The risk-adjusted net present value (rNPV) is a method used to forecast future cash flows in high-risk projects. In biotechnology, rNPV method involves forecasting future cash flows and applying probability rates of different phases of drug development. The main advantage of this method is the fact that it takes into account probability of success. The disadvantage of this method is the large number of assumptions and the high level of computational complexity.

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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Company	Recommendation Date	Analyst	TP	Current price at the time of publication of the recommendation	Recommendation	Time horizon
PKO BP	2017-02-22	Michał Fidelus	32.5	35.1	Reduce	12M
Pekao	2017-02-22	Michał Fidelus	147.0	145.0	Neutral	12M
BZ WBK	2017-02-22	Michał Fidelus	357.0	370.6	Neutral	12M
mBank	2017-02-22	Michał Fidelus	368.0	419.9	Sell	12M
ING BSK	2017-02-22	Michał Fidelus	167.0	177.9	Reduce	12M

Handlowy	2017-02-22	Michał Fidelus	75.0	82.0	Reduce	12M
Millennium	2017-02-22	Michał Fidelus	6.4	7.0	Reduce	12M
Alior	2017-02-22	Michał Fidelus	75.0	66.0	Buy	12M
Getin Noble Bank	2017-02-22	Michał Fidelus	2.56	2.1	Buy	12M
Dom Development	2017-02-23	Marek Szymański	69.0	63.7	Accumulate	12M
LC Corp	2017-02-23	Marek Szymański	2.6	2.0	Buy	12M
Robyg	2017-02-23	Marek Szymański	4.0	3.0	Buy	12M
Eurocash	2017-02-24	Jakub Rafał	36.0	35.0	Hold	12M
KGHM	2017-03-02	Marcin Stebakow	152.0	131.5	Buy	12M
Emperia	2017-03-09	Jakub Rafał	79	73	Accumulate	12M
PKN	2017-03-23	Beata Szparaga	105.0	105.0	Neutral	12M
Lotos	2017-03-23	Beata Szparaga	52.0	57.9	Reduce	12M
Eurocash	2017-03-28	Jakub Rafał	36	32	Accumulate	12M
Altus	2017-04-05	Michał Fidelus	19.0	14.5	Buy	12M
Quercus	2017-04-05	Michał Fidelus	7.2	6.5	Accumulate	12M
Marvipol	2017-04-06	Marek Szymański	17.0	13.3	Not rated	12M
Mex Polska	2017-04-07	Aleksandra Jakubowska	12.1	7.3	Not rated	12M
Archicom	2017-04-19	Marek Szymański	22.5	16.2	Not rated	12M
Grupa Azoty	2017-04-25	Katarzyna Włodarczyk	62.1	68.9	Sell	12M
Mercator Medical	2017-04-27	Aleksandra Jakubowska	25.1	18.0	Not rated	12M
KGHM	2017-05-11	Marcin Stebakow	121	116	Neutral	12M
JSW	2017-05-11	Marcin Stebakow	112	78	Buy	12M
11 Bit Studios	2017-05-12	Jakub Rafał	255.8	177.2	Buy	12M
Warimpex	2017-05-29	Marek Szymański	5.66	5.11	Not rated	12M
Kruk	2017-06-02	Michał Fidelus	316.0	300.9	Neutral	12M
Vigo System	2017-06-12	Beata Szparaga-Waśniewska	468	372	Not rated	12M
Ciech	2017-06-13	Katarzyna Włodarczyk	72.3	65.4	Neutral	12M
Wawel	2017-06-14	Marcin Stebakow	1368.0	1175	Buy	12M
Colian	2017-06-30	Marcin Stebakow	3.48	3.50	Not rated	12M
Marvipol	2017-07-13	Marek Szymański	18.0	12.7	Not rated	12M
PKO BP	2017-07-24	Michał Fidelus	34.0	35.8	Reduce	12M
Pekao	2017-07-24	Michał Fidelus	140.0	128.0	Accumulate	12M
BZ WBK	2017-07-24	Michał Fidelus	349.0	362.5	Reduce	12M
mBank	2017-07-24	Michał Fidelus	380.0	460.0	Sell	12M
ING BSK	2017-07-24	Michał Fidelus	191.0	189.0	Neutral	12M
Handlowy	2017-07-24	Michał Fidelus	71.0	68.1	Neutral	12M
Millennium	2017-07-24	Michał Fidelus	7.1	7.5	Reduce	12M
Alior	2017-07-24	Michał Fidelus	68.0	60.5	Accumulate	12M
Getin Noble Bank	2017-07-24	Michał Fidelus	1.58	1.45	Neutral	12M
Grupa Azoty	2017-07-28	Katarzyna Włodarczyk	75.0	67.6	Accumulate	12M
JSW	2017-08-09	Marcin Stebakow	102.0	90.5	Buy	12M
Ciech	2017-08-10	Katarzyna Włodarczyk	68.0	62.5	Neutral	12M
Lotos	2017-08-21	Beata Szparaga-Waśniewska	56.0	51.0	Neutral	12M
Getback	2017-08-25	Michał Fidelus	26.6	21.8	Accumulate	12M
KGHM	2017-08-28	Marcin Stebakow	153.0	126.0	Buy	12M
Wawel	2017-08-30	Marcin Stebakow	1153	990	Buy	12M
Mercator Medical	2017-09-07	Aleksandra Jakubowska	23.1	18.0	Not rated	12M
Kruk	2017-09-14	Michał Fidelus	340.0	311.0	Accumulate	12M
Bogdanka	2017-09-21	Marcin Stebakow	95.0	78.0	Buy	12M
JSW	2017-09-28	Marcin Stebakow	107	93	Buy	12M
MZN Property	2017-10-04	Aleksandra Jakubowska	2.0	1.45	Not rated	12M
Warimpex	2017-10-11	Marek Szymański	7.3	6.73	Not rated	12M
ATC Cargo	2017-10-13	Marcin Stebakow	3.0	2.0	Not rated	12M
LPP	2017-10-19	Marek Szymański	6962.0	7960.0	Sell	12M
CCC	2017-10-19	Marek Szymański	322.0	265.3	Buy	12M
PKO BP	2017-10-24	Michał Fidelus	35.0	36.7	Reduce	12M
Pekao	2017-10-24	Michał Fidelus	139	125.2	Accumulate	12M
BZ WBK	2017-10-24	Michał Fidelus	370	356	Neutral	12M
mBank	2017-10-24	Michał Fidelus	393	452.5	Reduce	12M
ING BSK	2017-10-24	Michał Fidelus	193	191.2	Neutral	12M
Handlowy	2017-10-24	Michał Fidelus	75.0	70.0	Neutral	12M
Millennium	2017-10-24	Michał Fidelus	7.7	7.55	Neutral	12M
Alior Bank	2017-10-24	Michał Fidelus	80.0	70.2	Buy	12M
Getin Noble	2017-10-24	Michał Fidelus	1.40	1.53	Reduce	12M
Marvipol	2017-10-24	Marek Szymański	19.0	13	Not rated	12M
KGHM	2017-11-23	Marcin Stebakow	134	114.25	Buy	12M
JSW	2017-11-29	Marcin Stebakow	86.8	90.2	Reduce	12M
Vigo System	2017-12-05	Beata Szparaga-Waśniewska	455	305	Not rated	12M
LW Bogdanka	2017-12-07	Marcin Stebakow	75	95	Accumulate	12M
Śnieżka	2017-12-08	Aleksandra Jakubowska	63	69	Not rated	12M
Dom Development	2017-12-14	Marek Szymański	90	83.4	Accumulate	12M
Atal	2017-12-14	Marek Szymański	43	41.0	Neutral	12M
LC Corp	2017-12-14	Marek Szymański	3.3	2.7	Buy	12M
Robyg	2017-12-14	Marek Szymański	4.1	3.5	Accumulate	12M
Lokum Deweloper	2017-12-14	Marek Szymański	23	16.55	Buy	12M
Archicom	2017-12-14	Marek Szymański	23	15.39	Not rated	12M
PKO BP	2018-01-08	Michał Fidelus	45	44.3	Neutral	12M
Pekao	2018-01-08	Michał Fidelus	152	134.3	Buy	12M
BZ WBK	2018-01-08	Michał Fidelus	442	408.4	Accumulate	12M
mBank	2018-01-08	Michał Fidelus	443	496	Sell	12M
ING BSK	2018-01-08	Michał Fidelus	222	215	Neutral	12M
Handlowy	2018-01-08	Michał Fidelus	86	83	Neutral	12M
Millennium	2018-01-08	Michał Fidelus	8.9	9.4	Reduce	12M
Alior	2018-01-08	Michał Fidelus	87	78	Accumulate	12M
Getin Noble Bank	2018-01-08	Michał Fidelus	1.55	1.71	Reduce	12M
PKN	2018-01-09	Beata Szparaga-Waśniewska	117	106.7	Neutral	12M
Lotos	2018-01-09	Beata Szparaga-Waśniewska	54	57.4	Reduce	12M
PKP Cargo	2018-02-14	Marcin Stebakow	68	58.8	Buy	12M