

- We upgrade PKO (to Accumulate from Neutral), ING (to Accumulate from Neutral) and GNB (to Buy from Reduce)...
- ... maintain our rating for PEO (Buy), SPL (Accumulate), MBK (Neutral), MIL (Neutral) and ALR (Buy)...
- ... and downgrade BHW (to Neutral from Buy),

2019E: EPS growth weaker, but still decent

In 2018 YTD WIG Banks index lost 10%. While banks will likely succeed in delivering decent EPS growth this year (we assume 18% YoY), share prices have been negatively affected by global sentiment coupled with fears of deteriorating macro, weak capital markets and rising provisions. In our view though, share price drops made valuations of Polish banks more appealing – at 1YF P/E WIG Banks index is trading with 9/13% discount to 1/5Y average and EPS outlook remains solid. In 2019E we expect 13% YoY aggregate earnings growth driven by better NII only partly offset by higher costs and provisions. GDP growth, although decelerating, is still relatively strong, unemployment rate remains at historical lows, dividend outlook is improving and CHF risk has declined. We upgrade our ratings for PKO (to Accumulate from Neutral), ING (to Accumulate from Neutral) and GNB (to a Buy from Reduce), maintain our ratings for PEO (Buy), SPL (Accumulate), MBK (Neutral), MIL (Neutral) and ALR (Buy) and downgrade our rating for BHW (to Neutral from a Buy).

2019E EPS growth weaker, but still decent. In 2019E we forecast aggregate adjusted net profit of 9 banks in our coverage to increase by 13% YoY (vs. 18% YoY in 2018E). We expect the growth to be driven by rising net interest income (10% YoY vs. 8% in 2018E) coupled with higher net fees (5% YoY vs. 3% in 2018E) and financial and other income (+5% YoY vs. 4% in 2018E). We expect better revenues to be partly offset by rising costs (+6% YoY vs. 4% in 2018E) and provisions (+8% YoY vs. -5% in 2018E). We assume 6% YoY growth of net loans and 5% YoY growth of deposits.

Valuations more appealing. At 1YF P/E of 12.2x WIG-Banks index is currently trading with 9/13/11% discount to 1/5/10Y average and at 1Y P/BV of 1.20x, with 7/15/22% discount, respectively. Given improvement in ROE (we assume 10.1% in 2019E vs. 9.3% in 2018E), decent EPS growth and improving dividend outlook, the valuations sound appealing, we believe.

Pekao our top pick. Out of 9 banks in our coverage PEO (Buy) remains our top pick. On valuation grounds we rate also a Buy ALR and GNB (high risk). We recommend Accumulate PKO, SPL and ING and rate Neutral MIL, BHW and MBK.

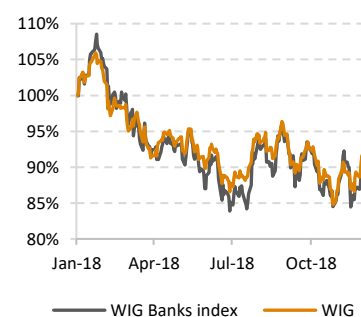
Key risks to our forecasts. Deeper than expected slowdown in macro environment coupled with rising unemployment and continuously weak capital markets appear to be key risk factors to our forecasts. In this note we analyze impact of deterioration in construction segment in Poland on banks' provisions and earnings.

Figure 1. Polish Banks – Changes in ratings and valuations

| Bank | Rating | 12M TP | Current price | Upside/downside | Previous rating | Previous 12M TP |
|------------------|--------------|--------|---------------|-----------------|-----------------|-----------------|
| PKO BP | Accumulate ↑ | 45.0 | 40.6 | 11% | Neutral | 42.0 |
| Pekao | Buy = | 139.0 | 108.6 | 28% | Buy | 148.0 |
| Santander | Accumulate = | 395.0 | 353.0 | 12% | Accumulate | 410.0 |
| mBank | Neutral = | 440.0 | 429.0 | 3% | Neutral | 441.0 |
| ING BSK | Accumulate ↑ | 197.0 | 180.0 | 9% | Neutral | 222.0 |
| Handlowy | Neutral ↓ | 75.6 | 70.0 | 8% | Buy | 81.0 |
| Millennium | Neutral = | 9.7 | 9.1 | 7% | Neutral | 9.3 |
| Alior | Buy = | 70.0 | 55.2 | 27% | Buy | 85.0 |
| Getin Noble Bank | Buy ↑ | 0.76 | 0.31 | 145% | Reduce | 1.55 |

Source: Vestor DM

WIG Banks vs. WIG – relative price performance 12M



Source: Bloomberg, Vestor DM

| Bank | Rating | 12M TP (PLN) |
|-------------|------------|--------------|
| PKO BP | Accumulate | 45.0 |
| Pekao | Buy | 139 |
| Santander | Accumulate | 395 |
| mBank | Neutral | 440 |
| ING BSK | Accumulate | 197 |
| Handlowy | Neutral | 75.6 |
| Millennium | Neutral | 9.7 |
| Alior Bank | Buy | 70.0 |
| Getin Noble | Buy | 0.76 |

Source: Vestor DM

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THE LAST RECOMMENDATION ISSUED TO THE COMPANY CITI BANK HANDLOWY S.A. WAS PUBLISHED ON THE 20TH OF JUNE 2018 AND INCLUDED A BUY RECOMMENDATION.

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A description of the organization mechanisms of Chinese walls aimed to prevent the conflicts of interest:

Vestor has adopted "Procedure of managing conflicts of interest in Vestor Dom Maklerski SA", which defines the procedure for the prevention and effective management of conflicts of interest by eliminating the risk of the possible damage relating to interest of the customer, as well as specify the means and procedures for managing such conflicts of interest. Responsibilities in the matter of prevention, management and monitoring in the event of a conflict of interest are performed by designated organizational entity whose employees have the following tools that ensure proper execution of these tasks: (i) access to all documents of both the Company and the subsidiary company, (ii) the right to request provide explanations for all employees, (iii) the ability to analyze own transactions concluded by the Related persons.

Vestor applies the following mechanisms to prevent conflicts of interest, and in the case of such a conflict - to manage and monitor them in order to prevent potential negative effects on the interests of customers:

a) Independence of managing: to ensure operational independence of each organizational unit Vestor, which means in particular that (i) there is no possibility of negative affecting by third parties on the exercise of employee actions related to the conduct of the Vestor activity, (ii) the scope of tasks the organizational unit is assigned to the organizational unit, and as a rule does not intersect with the scope of other organizational units;

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c) Effective supervision: providing supervision of employees performing as part of its core brokerages activities tasks for and on behalf of clients in the field of activities Vestor, activities which cause or may result in a conflict of interest between clients, or the interests of the client and Vestor in including:

i. the internal reporting system is to provide immediate information to the persons responsible for overseeing compliance with the principles set out in the Regulations for the event of a conflict of interest or risk of its origin;

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;

d) Refusal of action: the right to refuse the Vestor activity to the client, if given the commitment to specific activity on behalf of another client Vestor cannot effectively manage potential conflicts of interest, or prevent this regulatory restrictions or internal regulations;

e) The division of functions: the organization of employees' tasks are aimed at eliminating cases simultaneously or one after the other following the exercise of the employee's duties within the various services provided by the Vestor, if that could have a negative impact on the proper management of conflicts of interest;

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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.

The recommendation system of Vestor is based on determination of target prices and their relations to current prices of financial instruments; in addition, when recommendations are addressed to a wide range of recipients, two methods of valuation are required.

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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|---------|----------------------------|---------------------|---------------------------|--------|--|----------------|--------------|
| 78/2017 | KGHM | 2017-11-23 | Marcin Stebakow | 134 | 114.25 | Buy | 12M |
| 79/2017 | JSW | 2017-11-29 | Marcin Stebakow | 86.8 | 90.2 | Reduce | 12M |
| 80/2017 | Vigo System | 2017-12-05 | Beata Szparaga-Waśniewska | 455 | 305 | Not rated | 12M |
| 81/2017 | LW Bogdanka | 2017-12-07 | Marcin Stebakow | 75 | 95 | Accumulate | 12M |
| 82/2017 | Śnieżka | 2017-12-08 | Aleksandra Jakubowska | 63 | 69 | Not rated | 12M |
| 83/2017 | Dom Development | 2017-12-14 | Marek Szymański | 90 | 83.4 | Accumulate | 12M |
| 84/2017 | Atal | 2017-12-14 | Marek Szymański | 43 | 41.0 | Neutral | 12M |
| 85/2017 | LC Corp | 2017-12-14 | Marek Szymański | 3.3 | 2.7 | Buy | 12M |
| 86/2017 | Robyg | 2017-12-14 | Marek Szymański | 4.1 | 3.5 | Accumulate | 12M |
| 87/2017 | Lokum Deweloper | 2017-12-14 | Marek Szymański | 23 | 16.55 | Buy | 12M |
| 88/2017 | Archicom | 2017-12-14 | Marek Szymański | 23 | 15.39 | Not rated | 12M |
| 1/2018 | PKO BP | 2018-01-08 | Michał Fidelus | 45 | 44.3 | Neutral | 12M |
| 2/2018 | Pekao | 2018-01-08 | Michał Fidelus | 152 | 134.3 | Buy | 12M |
| 3/2018 | BZ WBK | 2018-01-08 | Michał Fidelus | 442 | 408.4 | Accumulate | 12M |
| 4/2018 | mBank | 2018-01-08 | Michał Fidelus | 443 | 496 | Sell | 12M |
| 5/2018 | ING BSK | 2018-01-08 | Michał Fidelus | 222 | 215 | Neutral | 12M |
| 6/2018 | Handlowy | 2018-01-08 | Michał Fidelus | 86 | 83 | Neutral | 12M |
| 7/2018 | Millennium | 2018-01-08 | Michał Fidelus | 8.9 | 9.4 | Reduce | 12M |
| 8/2018 | Alior | 2018-01-08 | Michał Fidelus | 87 | 78 | Accumulate | 12M |
| 9/2018 | Getin Noble Bank | 2018-01-08 | Michał Fidelus | 1.55 | 1.71 | Reduce | 12M |
| 10/2018 | PKN | 2018-01-09 | Beata Szparaga-Waśniewska | 117 | 106.7 | Neutral | 12M |
| 11/2018 | Lotos | 2018-01-09 | Beata Szparaga-Waśniewska | 54 | 57.4 | Reduce | 12M |
| 12/2018 | PKP Cargo | 2018-02-14 | Marcin Stebakow | 68 | 58.8 | Buy | 12M |
| 13/2018 | BZ WBK | 2018-02-21 | Michał Fidelus | 436 | 385.8 | Buy | 12M |
| 14/2018 | Wielton | 2018-02-23 | Marcin Górnik | 15.3 | 12.36 | Buy | 12M |
| 15/2018 | Selvita | 2018-03-20 | Beata Szparaga-Waśniewska | 85 | 59 | Not rated | 12M |
| 16/2018 | JSW | 2018-03-22 | Marcin Stebakow | 99 | 95.3 | Neutral | 12M |
| 17/2018 | Marvipol Development | 2018-03-26 | Marek Szymański | 8.9 | 8.7 | Not rated | 12M |
| 18/2018 | Kruk | 2018-03-28 | Michał Fidelus | 286 | 208 | Buy | 12M |
| 19/2018 | British Automotive Holding | 2018-03-28 | Marek Szymański | 10.5 | 8.3 | Not rated | 12M |
| 20/2018 | Aplisens | 2018-04-04 | Michał Wojciechowski | 15.1 | 12.9 | Buy | 12M |
| 21/2018 | Wielton | 2018-04-05 | Marcin Górnik | 16.0 | 13.7 | Buy | 12M |
| 22/2018 | KGHM | 2018-04-16 | Marcin Stebakow | 110.0 | 92.0 | Buy | 12M |
| 23/2018 | LPP | 2018-04-18 | Marek Szymański | 9000 | 8965 | Neutral | 12M |
| 24/2018 | CCC | 2018-04-18 | Marek Szymański | 310 | 272 | Buy | 12M |
| 25/2018 | mBank | 2018-04-19 | Michał Fidelus | 441 | 439 | Neutral | 12M |
| 26/2018 | AC | 2018-04-23 | Marcin Górnik | 38.5 | 40.8 | Reduce | 12M |
| 27/2018 | MZN Property | 2018-05-08 | Aleksandra Jakubowska | 2.2 | 1.9 | Not Rated | 12M |
| 28/2018 | Pekao | 2018-05-16 | Michał Fidelus | 148 | 118.7 | Buy | 12M |
| 29/2018 | Archicom | 2018-05-24 | Marek Szymański | 23.0 | 15.9 | Not Rated | 12M |
| 30/2018 | PKO BP | 2018-05-25 | Michał Fidelus | 42.0 | 38.9 | Neutral | 12M |
| 31/2018 | Warimpex | 2018-05-28 | Marek Szymański | 8.3 | 6.0 | Brak | 12M |
| 32/2018 | Handlowy | 2018-06-20 | Michał Fidelus | 81.0 | 67.0 | Buy | 12M |
| 33/2018 | Dom Development | 2018-06-25 | Marek Szymański | 90.0 | 86.0 | Neutral | 12M |
| 34/2018 | Atal | 2018-06-25 | Marek Szymański | 43.0 | 37.0 | Accumulate | 12M |
| 35/2018 | LC Corp | 2018-06-25 | Marek Szymański | 3.0 | 2.4 | Buy | 12M |
| 36/2018 | Lokum Deweloper | 2018-06-25 | Marek Szymański | 25.0 | 18.8 | Buy | 12M |
| 37/2018 | CCC | 2018-07-16 | Marek Szymański | 280.0 | 204.0 | Buy | 12M |
| 38/2018 | LPP | 2018-07-16 | Marek Szymański | 9200.0 | 9105.0 | Neutral | 12M |
| 39/2018 | PKN | 2018-07-19 | Beata Szparaga-Waśniewska | 104.0 | 81.06 | Buy | 12M |
| 40/2018 | CD Projekt | 2018-07-25 | Maciej Hebda | 231.0 | 208.00 | Accumulate | 12M |
| 41/2018 | 11 bit studios | 2018-07-25 | Michał Wojciechowski | 511.0 | 426.0 | Buy | 12M |
| 42/2018 | PlayWay | 2018-07-25 | Maciej Hebda | 195.0 | 149.0 | Buy | 12M |
| 43/2018 | Millennium | 2018-07-30 | Michał Fidelus | 9.3 | 8.9 | Neutral | 12M |
| 44/2018 | BZ WBK | 2018-08-02 | Michał Fidelus | 410.0 | 378.2 | Accumulate | 12M |
| 45/2018 | Synektik | 2018-08-07 | Beata Szparaga-Waśniewska | 20.0 | 14.9 | Buy | 12M |
| 46/2018 | ML System | 2018-08-28 | Maciej Hebda | 38.6 | 33.3 | Not rated | 12M |
| 47/2018 | CD Projekt | 2018-08-29 | Maciej Hebda | 228.0 | 219.2 | Neutral | 12M |
| 48/2018 | 11 bit studios | 2018-09-03 | Michał Wojciechowski | 386.0 | 380.0 | Neutral | 12M |
| 49/2018 | Alior | 2018-09-05 | Michał Fidelus | 85.0 | 66.9 | Buy | 12M |
| 50/2018 | British Automotive Holding | 2018-09-05 | Marek Szymański | 2.2 | 1.9 | Not rated | 12M |
| 51/2018 | Wielton | 2018-09-12 | Marcin Górnik | 15.5 | 9.7 | Buy | 12M |
| 52/2018 | Atal | 2018-09-13 | Marek Szymański | 41.0 | 31.5 | Buy | 12M |
| 53/2018 | PKN | 2018-09-14 | Beata Szparaga-Waśniewska | 109.0 | 99.4 | Neutral | 12M |
| 54/2018 | Ten Square Games | 2018-09-20 | Maciej Hebda | 116.0 | 96.5 | Buy | 12M |
| 55/2018 | Archicom | 2018-09-21 | Marek Szymański | 20.5 | 13.2 | Not rated | 12M |
| 56/2018 | Marvipol | 2018-09-21 | Marek Szymański | 8.0 | 3.5 | Not rated | 12M |
| 57/2018 | PlayWay | 2018-09-25 | Maciej Hebda | 177 | 151 | Buy | 12M |
| 58/2018 | JSW | 2018-10-01 | Marcin Górnik | 72.7 | 66.2 | Neutral | 12M |
| 59/2018 | Bogdanka | 2018-10-01 | Marcin Górnik | 69.2 | 60.0 | Accumulate | 12M |
| 60/2018 | 4fun Media | 2018-10-29 | Michał Wojciechowski | 20.5 | 13.0 | Not rated | 12M |
| 61/2018 | Elemental Holding | 2018-11-14 | Marcin Górnik | 1.8 | 1.1 | Not rated | 12M |
| 62/2018 | CD Projekt | 2018-11-15 | Maciej Hebda | 202 | 146.5 | Buy | 12M |
| 63/2018 | Lokum Deweloper | 2018-11-15 | Marek Szymański | 26.0 | 17.4 | Buy | 12M |
| 64/2018 | CCC | 2018-11-16 | Marek Szymański | 260 | 182 | Buy | 12M |
| 65/2018 | 11 bit studios | 2018-11-19 | Michał Wojciechowski | 270 | 247 | Neutral | 12M |
| 66/2018 | LC Corp | 2018-11-22 | Marek Szymański | 3.2 | 2.5 | Buy | 12M |
| 67/2018 | ML System | 2018-11-22 | Maciej Hebda | 35.3 | 27.1 | Not rated | 12M |
| 68/2018 | LPP | 2018-11-26 | Marek Szymański | 8600 | 7850 | Accumulate | 12M |
| 69/2018 | PlayWay | 2018-11-27 | Maciej Hebda | 172 | 140 | Buy | 12M |
| 70/2018 | Atal | 2018-12-07 | Marek Szymański | 38.0 | 29.7 | Buy | 12M |
| 71/2018 | Dom Development | 2018-12-07 | Marek Szymański | 75.0 | 65.60 | Accumulate | 12M |
| 72/2018 | Archicom | 2018-12-07 | Marek Szymański | 19.0 | 11.9 | Not rated | 12M |