Banks | Poland

Alior Bank

Buy (from Neutral)

TP: PLN 62

Recommendation upgrade

- **We lift our 12M TP to PLN 62 from PLN 61.6 and upgrade our rating to a Buy from Neutral**
- **We expect net profit to decline to PLN 24m in 2017E and to rebound to PLN 513m in 2018E.**

Vestor DOM MAKLERSKI equity research

30 June 2016

Buying long-term growth prospects

We slightly lift our 12M TP to PLN 62 from PLN 61.6 previously, but due to share price drop we upgrade our rating for Alior Bank to a Buy from Neutral. In our earnings estimates we incorporate consolidation of Core-BPH assets starting in 2017E. While the next year will be tough for Alior (we assume a net profit of only PLN 24m negatively affected by integration costs), we expect a significant rebound in 2018E (to PLN 513m) and further strong growth in 2019E (to PLN 826m, +61% YoY, ROE of 11.8%) reflecting all of the expected synergies and making Alior one of the most profitable banks in Poland. Equally, with net loans rising at 14% CAGR in years 2016-2019E Alior remains one of the fastest growing banks in Poland. Given no CHF risk and promising long-term growth prospects we see the current valuation at 1.1x P/BV as attractive.

Alior remains one of the fastest growing banks in Poland. In years 2012-2015 Alior's loan book, driven by organic growth and supported by consolidation of Meritum, grew at 29% CAGR, materially above the sector. After acquisition of Core-BPH Alior remains on a rapid growth path: in years 2016-2019E we expect loans to grow at 14% CAGR.

Tough 2017E, rebounding 2018E and very strong 2019E. While 2017E will be tough for Alior (we assume a net profit of only PLN 24m negatively affected by PLN 520m integration costs), we expect a significant rebound in 2018E (net profit of PLN 513m) and further strong growth in 2019E (net profit of PLN 826m, +61% YoY, ROE of 11.8%) reflecting all of the expected synergies and making Alior one of the most profitable banks in Poland.

A chance for a positive surprise coming from integration costs and synergies. In our base case scenario we assume PLN 650m integration costs to be spread between 2017E (80%) and 2018E (20%) and synergies at PLN 122m and PLN 200m, respectively. Looking at the recent M&A transactions on the Polish banking market we see a chance, that both integration costs and expected synergies may prove to surprise positively. In all the recent deals the level of integration costs stood for 35-50% of cost base of the acquired banks vs. c. 65% guided by the Management and assumed in our estimates. Also, in the recent transactions cost synergies came at c. 10-30% of cost base in the first year and c. 20-40% in the second year vs. our assumption of 17% and 23%, respectively.

1.1x P/BV for promising long term growth prospects we see as attractive. At our estimates Alior is trading at 1.1x 2017E P/BV, broadly in line with peers. Given no CHF risk and promising long-term growth prospects driven by consolidation of Core- BPH and loan book rising at 14% CAGR in 2016-2018E we see the current valuation as attractive.

Figure 1. Alior Bank – Key data, 2014-2019E

	2014	2015	2016E	2017E	2018E	2019E
Net profit (PLNm)	323	310	339	24	513	826
YoY change (%)	*42%*	*-4%*	*9%*	*-93%*	*nm*	*61%*
ROE (%)	12.4%	9.5%	7.1%	0.4%	8.1%	11.8%
P/E (x)	10.3	11.7	19.9	286.4	13.1	8.2
P/BV (x)	1.3	1.1	1.1	1.1	1.0	0.9
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

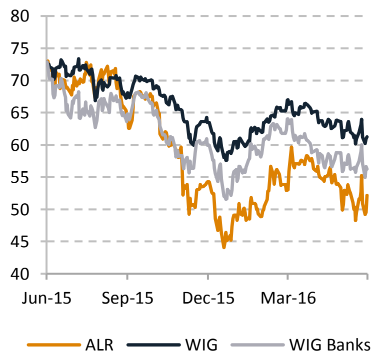
Rating	Buy
Target Price (PLN)	62.0
Market Price (PLN)	52.2
Upside/downside	18.8%
Previous rating	Neutral
Previous Target Price (PLN)	61.6
Min (52W)	43.7
Max (52W)	74.2
Market cap (PLNm)	6,700
Avg. 3M Turnover (PLNm)	14.8

Shareholders	%
PZU	29.2%
Other	70.8%

Company description

Alior Bank is a universal bank with c. 3% market share in sector assets. The bank, founded by Carlo Tassara and ex-BPH managers, started its operations in November 2008. In June Alior completed acquisition of Meritum Bank, a retail oriented bank with c. PLN 2.5bn of loans (10% of Alior's loan book). In April 2016 Alior announced acquisition of non-mortgage business of Bank BPH (PLN 8.2bn of loans, 27% of Alior loan book).

Alior Bank 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.

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,

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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