Banks | Poland

Alior Bank

Buy (maintained)

TP: PLN 52

Recommendation update

- **We cut our 12M TP for Alior to PLN 52 from PLN 70 and maintain a Buy rating**
- **We cut our net profit estimates by 25% in 2019E and by 14% in 2020E**

Vestor DOM MAKLERSKI

equity research

5 September 2019 07:35

It is time to rebound.

We reduce our 12M TP for Alior to PLN 52 from PLN 70 previously and maintain our Buy rating. While 2018 was a difficult year for Alior, 1H19 appears to be even harder. Over the last quarters the bank has been suffering from increased corporate provisions and – given incoming macroeconomic slowdown – risk of further deterioration in asset quality is still on. As a result of weak 1H19 numbers incl. increased BFG contribution we cut our 2019/20E net profit estimates by 25/14%. While the Management states 1H19 cost of risk was inflated by one-off items, in our earnings estimates we assume provisions to remain broadly flat in 2020E and to grow by 11% YoY in 2021E. In our view though, much of the company risk is already reflected in the share price. At our estimates Alior is trading at 6.4x 2020E P/E and 0.65x P/BV. Comparing to historical levels, current valuation offers 16/43% discount to 1/3Y average at 1YF P/E and 27/39% discount at 1YF P/BV. While Alior may no longer be perceived as a growth story, given no regulatory (CHF) risk, the valuation looks tempting, in our view.

Disappointing 1H19 numbers, rapid growth of provisions. 1H19 net profit of Alior came in at barely PLN 139m, down 61% YoY, driven not only by rising BFG contribution, but also by a massive growth of provisions (60% YoY), mainly in corporate segment. While the Management states these were inflated by one-off items, in our earnings estimates we assume provisions to remain broadly flat in 2020E and to grow by 11% YoY in 2021E.

Deep cuts in 2019/20E estimates. On the back of 1H19 numbers we cut our 2019/20E net profit estimates by 25/14%. After 15% YoY EPS growth in 2019E we assume 33% YoY rebound in 2020E driven by rising, although decelerating, net interest income (7% YoY vs. 9% YoY in 2019E). Our forecasts are 6/3% below consensus, respectively.

No longer a growth story? Given 1H19 experiences Alior will have to gradually redefine its business model, we believe. Recent quarters proved again, that there is no superior growth without increased provisioning. Thus, in our earnings estimates we assume provisions to remain high over the next two years and loan growth and NII to decelerate.

Alior is trading at historical lows... At our 2020E estimates Alior is trading at 6.4x P/E and 0.65x P/BV. Comparing to historical levels, current valuation offers 16/43% discount to 1/3Y average at 1YF P/E and 27/39% discount at 1YF P/BV.

… and valuation sounds appealing even in adverse cost of risk scenario. According to our estimates 10bp growth in provisioning implies c. 6% net profit drop. As a result, if 2020E cost of risk was 20/40bp higher than we currently expect, Alior would be trading at 7.5/8.6x 2020E P/E what still – in our view - sounds appealing.

Figure 1. Alior Bank – Key data, 2016-2021E

	2016	2017	2018	2019E	2020E	2021E
Net profit (PLNm)	575	471	713	607	807	865
YoY change (%)	*86%*	*-18%*	*51%*	*-15%*	*33%*	*7%*
ROE (%)	11.8%	7.3%	10.8%	8.9%	10.7%	10.4%
P/E (x)	8.9	10.9	7.3	8.5	6.4	6.0
P/BV (x)	0.8	0.8	0.8	0.7	0.7	0.6
DPS (PLN)*	0.0	0.0	0.0	0.0	1.2	1.3
DY (%)*	0.0%	0.0%	0.0%	0.0%	3.1%	3.3%

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

Company data

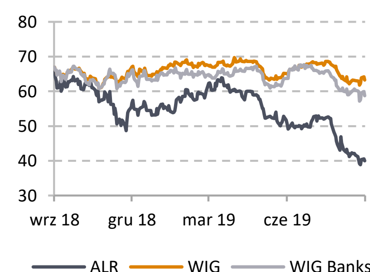
Rating	Buy
Target Price (PLN)	52.0
Market Price (PLN)	39.7
Upside/downside	31%
Previous rating	Buy
Previous Target Price (PLN)	70.0
Min (52W)	37.9
Max (52W)	69.1
Market cap (PLNm)	5,186

Shareholders	%
PZU	31.3%
OFE Aviva BZ WBK	7.3%
OFE NN	7.1%
BlackRock Inc	5.7%
Other	48.6%

Company description

Alior Bank is a universal bank with c. 4% market share in sector assets. The bank started its operations in 2008 and over the last years has been one of the most rapidly growing banks in Poland. The growth was supported by acquisitions: in 2016 Alior completed acquisition of Meritum Bank (a retail oriented bank with c. PLN 2.5bn of loans standing for c. 10% of Alior's loan book) and in 2017 it finalized merger with Core 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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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;

b) Independence of remuneration: Vestor prevents a direct relationship between the amount of salaries of employees performing specific activities in the field of brokerage activity, with remuneration or profits achieved by persons performing another kind that constitute or may constitute a source of conflict of interest;

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;

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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 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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