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## CEE Equity Research

Banks, Poland

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### Capital shortage and what's next?

#### Reiterated Outperform, TP marginally up to PLN7.1

Bank Millennium remains a complex case to put a price tag on. It has reported a net loss for 7 consecutive quarters driven by CHF-mortgage provisions, despite having one of the strongest banking franchises in Poland. Costs of moratoria are likely to push 3Q22 solvency ratio c. PLN500mn below the minimum hurdle. MIL was not meeting the MREL requirements as of 2Q22.

We have reiterated Outperform recommendation and slightly increased TP to PLN7.1 (vs 7.0 before).

**Final scenarios for CHF mortgage portfolio remains an unknown.** At the end of 1H22 MIL have put aside cumulative PLN4.2bn provisions against gross portfolio of PLN11.4bn (or CHF2.4bn), implying 36.3% coverage. MIL is likely to report 80% coverage at the end of 2023E (PLN6.8bn provisions against PLN8.6bn of the gross portfolio), assuming sustained pace of settlements and quarterly provisioning similar to what we have seen in previous quarters. As of 2Q22 MIL was sued by 13.9k clients, with the loss estimated by MIL at PLN4.9bn. According to our estimates the scenario with loan cancellation and no remuneration for banks would cost MIL PLN11 bn. A number of important verdicts is about to be issued, including September verdict on NBP average rates addressing abusive clauses (mBank) and two decisions to which MIL is a party expected in October – CJEU hearing on remuneration for capital and Supreme Court verdict for remuneration for capital.

**Capital shortage.** We estimate 3Q22 CT1 shortage around PLN500mn depending on the provisions for moratoria and CHF-portfolio. Additionally MIL reports MREL below minimum requirements (min is 15.55% for now and 20.42% at the end of 2023). During 2Q22 analyst call, MIL CEO stated that share issue is not an option that is being analysed.

**PLN800mn banking tax and FWK (Borrower's Support Fund) savings in 2022-23E.** The launch of the repair program will give banks savings of c. PLN550mn on banking tax and c. PLN250mn on FWK fund contributions. We expect MIL to exit the recovery program in 1Q24.

**Even higher NII.** We assume MIL to see 3.1% deposit cost in 4Q22 (vs 1.1% reported in 2Q22) and further deferral of asset repricing (4Q22 yield on loans at 9.7% (vs. 6.8% in 2Q22).

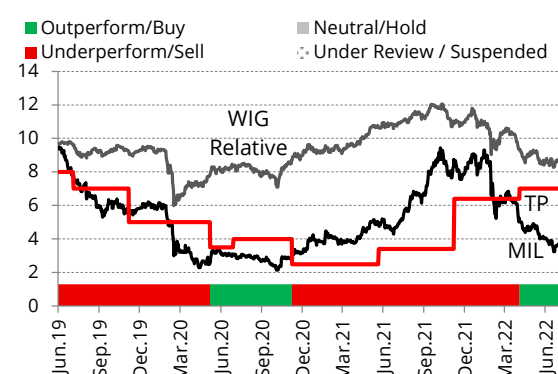
**Valuation and risks.** Our Dec'23 TP is at PLN7.10 and is a weighted average of DDM pointing to the value of PLN10.6 and Comparative Valuation pointing to PLN8.4 (all per share) less the impact of CHF-mortgage portfolio at PLN2.4 per share. Risks in our view include parliamentary elections scheduled for 2023, various scenarios for CHF-mortgage portfolios and WIBOR/deposits costs.

#### Bank Millennium: Financial summary and ratios

PLNm (year to December)	2020	2021	2022E	2023E	2024E
P/E (adjusted)	5.4x	3.7x	1.7x	1.7x	2.1x
P/E (reported)	180.8x	-3.1x	-3.6x	11.3x	2.8x
P/BV	0.5x	0.6x	0.9x	0.8x	0.7x
Dividend Yield	0.0%	0.0%	0.0%	0.0%	0.0%
EPS (adjusted) (PLN)	0.63	0.91	1.99	1.9	1.6
BVPS (PLN)	7.5	5.5	3.8	4.0	4.8
Net Income (adj. PLN mn)	767	1,110	2,409	2,365	1,951
Net Income (PLN mn)	23	-1,332	-1,151	365	1,451

Source: Company data, Santander Brokerage Poland estimates

Recommendation	Outperform
Dec'23 Target Price (PLN)	7.10
Current price (PLN, 26 July 2022)	4.300
Market cap. (PLNm)	4,124.6
Avg. daily turnover (PLNm)	6.4
Free float	49.9%
Number of shares (mn)	1,213



The chart measures relative performance against the WIG index.

Main shareholders	% of votes
Banco Comercial Portugues	50.1%
OFE Nationale-Nederlanden	8.2%
OFE Aviva Santander	6.0%
OFE PZU „Złota Jesień”	5.7%
OFE PKO BP Bankowy	3.0%

Source: Bloomberg, Santander Brokerage Poland

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**Fig. 1. Valuation summary\* (PLN/share)**

Recommendation	Outperform
<b>Dec'23 Target Price (PLN)</b>	<b>7.10</b>
Current price (PLN)	3.400
Prospective upside (%)	109

\*Our Target Price is calculated as rounded average of DDM Valuation (50%) and Comp. Valuation (50%) less the impact of CHF mortgage portfolio.

DDM valuation (PLN/share)	10.6
Discounted dividends (PLN/share)	0.0
Terminal value (PLN/share)	10.6
Terminal ROE (%)	31.65
g (%)	2.00
CoE (%)	10.00
RFR (%)	4.00
Beta (x)	1.20
ERP (%)	5.0

Comp. Valuation PLN/share	8.4
Net Income (PLN mn, next 12 months)	2,540
Applied P/E (x)	4.0
P/E peers (x)	5.5

**CHF impact/ share -2.4**

**Fig. 2. DDM Valuation sensitivity (PLN/share)**

ROE->	27.6%	29.6%	31.6%	33.6%	35.6%
<b>0.0%</b>	7.9	8.5	9.1	9.8	10.4
<b>1.0%</b>	8.4	9.1	9.8	10.5	11.2
<b>g</b> <b>2.0%</b>	9.1	9.9	10.6	11.4	12.2
<b>3.0%</b>	10.0	10.8	11.7	12.6	13.5
<b>4.0%</b>	11.1	12.1	13.2	14.2	15.2

**Fig. 3. DDM Valuation sensitivity (PLN/share)**

ERP->	3.0%	4.0%	5.0%	6.0%	7.0%
<b>3.0%</b>	22.1	16.5	12.9	10.3	8.5
<b>3.5%</b>	19.4	14.8	11.7	9.5	7.9
<b>RFR</b> <b>4.0%</b>	17.3	13.4	10.6	8.8	7.3
<b>4.5%</b>	15.4	12.1	9.8	8.1	6.8
<b>5.0%</b>	13.9	11.1	9.1	7.5	6.4

**Fig. 4. Our forecast vs Bloomberg consensus**

	Bloomberg consensus			Our assumptions vs cons.		
	2022E	2023E	2024E	2022E	2023E	2024E
Net income	-1,098	161	1,522	5%	127%	-5%
DPS (PLN)	0.00	0.00	0.00	n.a.	n.a.	n.a.
ROE (%)	-11.0	6.2	20.5	16.3 pp	1 pp	6.5 pp

**Fig. 5. Comps Valuation sensitivity (PLN/share)**

Fair P/E (x)	1.0x	2.0x	3.0x	4.0x	6.0x	8.0x
vs. peers (%)	-82	-64	-45	-27	9	45
Sensitivity	2.1	4.2	6.3	8.4	12.6	16.7

**Fig. 6. Ratios, Assumptions and Forecasts**

P&L (PLNmnn)	2020	2021	2022E	2023E	2024E
NII	2,583	2,713	4,793	5,191	4,912
F&C	746	831	848	856	865
Trading Income	337	-63	-243	-150	46
Total Revenue	3,578	3,558	5,450	5,877	5,803
Cost	-1,753	-1,642	-2,329	-2,072	-2,164
NLLP	-621	-299	-373	-825	-645
<b>CHF prov.</b>	-714	-2,305	-2,015	-2,000	-500
Pre-tax Profit	490	-688	-717	980	2,494
Banking tax	-279	-313	-169	0	-395
<b>Net Income</b>	<b>23</b>	<b>-1,332</b>	<b>-1,151</b>	<b>365</b>	<b>1,451</b>
Net Income (adj.)	767	1,110	2,409	2,365	1,951

PLNbn	2020	2021	2022E	2023E	2024E
Total Assets	97.8	103.9	111.2	117.6	124.2
Bonds	20.0	19.5	20.4	21.8	23.7
Loans	74.1	78.6	82.2	87.2	92.0
Loans growth (%)	6	6	5	6	5
Deposits	82.1	91.5	99.6	105.7	111.4
Equity	9.1	6.7	4.6	4.9	5.9
Mortgage loans	40.9	44.2	46.5	50.6	54.3
CHF mortgages	13.6	11.8	10.9	10.1	9.3
Other retail loans	14.5	16.2	16.6	17.4	18.1
Corporate loans	19.5	20.2	21.4	22.4	23.5

NIM ratios (%)	2020	2021	2022E	2023E	2024E
Asset yield	3.26	2.89	6.22	6.97	6.35
Funding cost	0.64	0.14	1.78	2.48	2.35
NIM	2.70	2.76	4.57	4.65	4.16

Risk ratios (%)	2020	2021	2022E	2023E	2024E
Stage 3 ratio	4.5	4.1	4.1		
Stage 3 coverage	50.6	52.7	51.5		
Cost of risk	0.77	0.42	0.46	0.97	0.72

Du Pont (%)	2020	2021	2022E	2023E	2024E
NII/assets	2.64	2.69	4.46	4.54	4.06
CoR/assets	-0.63	-0.30	-0.35	-0.72	-0.53
F&C/assets	0.76	0.82	0.79	0.75	0.72
Other rev/assets	-0.47	-2.27	-2.05	-1.90	-0.39
Costs/assets	-1.79	-1.63	-2.17	-1.81	-1.79
Taxes&other	-0.48	-0.64	-0.40	-0.54	-0.86
ROA	0.02	-1.32	0.28	0.32	1.20
Leverage (x)	10.9	12.8	19.0	24.0	22.5
ROE (reported)	0.3	-16.9	5.3	7.7	27.0

Capital & dividends	2020	2021	2022E	2023E	2024E
Tier-1 (PLNbn)	8.4	6.9	5.8	4.8	5.1
Tier-2 (PLNbn)	1.5	1.5	1.5	1.5	1.5
TCR (PLNbn)	4.1	4.0	4.1	4.4	4.6
RWA (PLNmnn)	51.1	54.2	56.7	54.8	57.7
CT1 ratio (%)	16.5	14.0	11.2	8.8	8.8
CAR ratio (%)	19.5	17.1	14.1	11.6	11.5
Div. payout (%)	0.0	0.0	0.0	0.0	0.0
Dividend (PLNmnn)	0	0	0	0	0
No. of shares (mn)	1,213	1,213	1,213	1,213	1,213

Source for all tables: Company data, Bloomberg, Santander Brokerage Poland estimates NOTE: historical valuation ratios based on eoy prices

2Q22 net loss

MIL reported one-off adjusted 1Q22 net income of:

- MIL informed that expected 3Q22 capital shortage should be around 118-174bn depending on what level of moratoria provisions (75-90%) will be booked.
- Loans increased 1%q/q (in line with market), deposit contracted 1% q/q (mostly on 3% q/q contraction in corporate deposits) vs flat market
- Mortgage originations increased 12% q/q to PLN2.2bn, cash loans new sales increased 26^ q/q to PLN1.4bn
- Major P&L items came close to expectations
- Solvency ratios deteriorated 30bps stronger than expected on quarterly loss, revaluation of bonds and increase in RWA.

**Fig. 7. Quarterly results review**

MIL P&L (PLN mn)	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22qoq (%)yoy (%)		2Q22E	vs. EPAP cons.vs cons.			
Net Interest Income	622	655	669	767	961	1,179	23	80	1,161	2	1,163	1
Fees & commissions	205	209	202	215	221	206	-7	-2	200	3	204	1
Trading Income	25	9	-92	-6	-60	-73	21	-897	-40			
Other	15	49	67	-53	38	25	-35	-50	43			
<b>Total Revenue</b>	<b>867</b>	<b>922</b>	<b>846</b>	<b>923</b>	<b>1,160</b>	<b>1,337</b>	<b>15</b>	<b>45</b>	<b>1,364</b>	<b>-2</b>	<b>1,361</b>	<b>-2</b>
Personnel Costs	-206	-205	-202	-202	-218	-227	4	11	-234	-3		
General Expenses	-170	-124	-150	-181	-217	-397	83	220	-418	-5		
D&A	-51	-49	-50	-51	-52	-53	2	7	-52	1		
<b>Operating Expenses</b>	<b>-427</b>	<b>-379</b>	<b>-402</b>	<b>-434</b>	<b>-486</b>	<b>-677</b>	<b>39</b>	<b>79</b>	<b>-704</b>	<b>-4</b>	<b>-701</b>	<b>-3</b>
<b>Operating Income</b>	<b>440</b>	<b>544</b>	<b>443</b>	<b>489</b>	<b>674</b>	<b>660</b>	<b>-2</b>	<b>21</b>	<b>660</b>	<b>0</b>		
NLLP	-76	-57	-83	-82	-83	-71	-15	23	-75	-6	-74	-4
CHF provisions	-533	-514	-526	-732	-499	-515	3	0	-524	-2	-524	-2
<b>Pre-tax Profit</b>	<b>-170</b>	<b>-27</b>	<b>-166</b>	<b>-325</b>	<b>91</b>	<b>74</b>	<b>-19</b>	<b>-374</b>	<b>60</b>	<b>23</b>		
CIT	-66	-96	-66	-102	-132	-127	-3	32	-117	9		
Banking tax'	-75	-77	-79	-82	-82	-87	6	13	-83	4		
<b>Net Income</b>	<b>-311</b>	<b>-200</b>	<b>-311</b>	<b>-509</b>	<b>-122</b>	<b>-140</b>	<b>15</b>	<b>-30</b>	<b>-140</b>	<b>0</b>	<b>-143</b>	<b>-2</b>
NI excl. one-offs	225	321	258	306	485	637	31	98	531	20		

Balance Sheet (PLN bn)	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22qoq (%)yoy (%)		2Q22E	vs. E			
Net client lending	75.3	75.8	77.3	78.6	78.7	79.3	1	5	79.5	0		
Bonds	23.1	22.2	21.3	18.2	18.0	18.0	0	-19	20.4	-11		
Customer deposits	88.3	90.0	90.3	91.4	97.3	96.1	-1	7	99.0	-3		
Total assets	104.0	104.1	103.8	103.9	109.8	108.9	-1	5	111.5	-2		
Equity ex minorities	8.7	8.4	8.0	6.7	6.2	5.8	-7	-31	5.8	0		

Key Ratios (%)	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22qoq (%)yoy (%)		2Q22E	vs. E			
Net Interest Margin	2.57	2.64	2.70	3.11	3.91	4.60	70 bp	196 bp	4.48	13 bp		
Cost to Income	-49	-41	-48	-47	-42	-51	-9 pp	-10 pp	-52	1 pp		
Cost of risk (bp)	-41	-30	-44	-42	-42	-36	6 bp	-5 bp	-38	2 bp		
Loans to deposits	85	84	86	86	81	83	2 pp	-2 pp	80	2 pp		
ROE	-14.0	15.0	12.6	16.7	30.1	42.6	12 pp	28 pp	35.4	7 pp		
CAR	19.4	18.7	18.2	17.1	16.0	15.2	-0.8 pp	-3.5 pp	15.5	-0.3 pp		
CT1	16.3	15.6	15.1	14.0	12.9	12.1	-0.7 pp	-3.5 pp	12.4	-0.3 pp		

Source: Company data, Santander Brokerage Poland estimates

### Forecasts changes

We fine-tune our forecast for Bank Millennium. The largest changes are done on NIM, based on numbers reported in 2Q22.

Our previous forecasts were published on Jun 9<sup>th</sup>, 2022.

**Fig. 8. Bank Millennium – Forecasts changes**

P&L (PLN mn)	2022E			PLN mn	2023E			PLN mn
	New	Old	%		New	Old	%	
NII	4,793	4,131	16	661	5,191	4,360	19	831
F&C	848	853	-1	-5	856	861	-1	-5
Trading Income	-243	-225	8	-18	-150	-150	0	0
Total Revenue	5,450	4,782	14	668	5,877	5,051	16	826
Cost	-2,329	-1,839	27	-491	-2,072	-1,920	8	-153
NLLP	-373	-409	-9	36	-825	-822	0	-3
CHF-provisions	-2,015	-1,999	1	-15	-2,000	-2,000	0	0
Pre-tax Profit	-717	535	-234	-1,252	980	310	217	671
Banking tax	-169	-337	-50	168	0	-358	-100	358
Net Income	-1,151	67		-1,218	365	-482	-176	847
Net Income (adj.)	2,409	1,831	32	578	2,365	1,488	59	876

NIM ratios (%)	2022E	2022E	%	2023E	2023E	%
Asset yield	6.22	5.65	0.58	6.97	6.34	0.63
Funding cost	1.78	1.87	-0.09	2.48	2.62	-0.15
NIM	4.57	3.90	0.67	4.65	3.85	0.80
		0			0	

Du Pont (%)	2022E	2022E	%	2023E	2023E	%
NII/assets	4.46	3.81	0.65	4.54	3.76	0.78
CoR/assets	-0.35	-0.38	0.03	-0.72	-0.71	-0.01
F&C/assets	0.79	0.79	0.00	0.75	0.74	0.01
Other rev/assets	-2.05	-2.03	-0.02	-1.90	-1.87	-0.03
Costs/assets	-2.17	-1.69	-0.47	-1.81	-1.65	-0.16
Taxes&other	-0.40	-0.43	0.03	-0.54	-0.68	0.14
ROA	0.28	0.06	0.22	0.32	-0.42	0.73
Leverage (x)	19.0	19.3	-0.2	24.0	26.7	-2.6

Source: Santander Brokerage Poland estimates

**Fig. 9. Bank Millennium – Forecasts changes**

PLN bn	2022E			PLN bn	2023E			PLN bn
	New	Old	%		New	Old	%	
Total Assets	111.2	113.2	-2	-2	117.6	118.9	-1	-1
Bonds	20.4	19.4	5	1	21.8	20.1	8	2
Loans	82.2	82.8	-1	-1	87.2	87.7	-1	0
Loans growth (%)	5	5			6	6		
Deposits	99.6	102.4	-3	-3	105.7	108.5	-3	-3
Equity	4.6	4.6	1	0	4.9	4.1	19	1
Mortgage loans	46.5	47.5	-2	-1	50.6	51.5	-2	-1
CHF mortgages	10.9	10.9	0	0	10.1	10.0	0	0
Other retail loans	16.6	16.7	-1	0	17.4	17.5	-1	0
Corporate loans	21.4	21.1	2	0	22.4	22.0	2	0

Source: Santander Brokerage Poland estimates

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**Outperform** - Total return 10% above benchmark. Upside of approximately  $\geq 15\%$ .

**Neutral** - Total return 0%-10% above benchmark. Upside of approximately 5%-15%.

**Underperform** - Total return below benchmark. Upside of approximately  $< 5\%$ .

NOTE: The relevant benchmark for European Equities (including CEE Equities) is the 1Y German Bund rate +ERP (5.5%).

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Target prices set from January to June are for December 31st of the current year. Target prices set from July to December are for December 31st of the following year.

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In preparing this report Santander Brokerage Poland applied at least one of the following valuation methods: discounted cash flows (DCF), comparative, mid-cycle, dividend discount model (DDM), residual income, warranted equity method (WEV), SOTP valuation, liquidation value.

**The discounted cash flows (DCF) valuation method** is based on expected future discounted cash flows. One advantage of the DCF valuation method is that it takes into account all cash streams reaching Issuer and the cost of money over time. Some disadvantages of the DCF valuation method are that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.

**The comparative valuation method** is based on the economic rule of "one price". Some advantages of the comparative valuation method are that the analyst need only estimate a small number of parameters; the valuation is based on current market conditions; the relatively large accessibility of indicators for companies being compared; and that there is an extensive knowledge of the comparative method among investors. Some disadvantages of valuation by the comparative method are the considerable sensitivity of the results of the valuation on the choice of companies to the comparative group; the method can lead to a simplification of the picture of the company which in turn can lead to omitting certain important factors (e.g. growth dynamics, extra-operational assets, corporate governance, the repeatability of results, differences in applied accounting standards); and the uncertainty of the effectiveness of a market valuation of companies being compared.

**The mid-cycle multiple valuation** is based on long-term average valuation multiples of a sector or a peer group. The methodology aims to calculate a fair, through the cycle value of the company. Among its shortfalls is that at peaks and/or troughs of the cycle, the implied fair value may deviate substantially from the market's value of an analysed stock as well as the methods' reliance on the quality of external data (we usually use Bloomberg or Damodaran databases).

Simplicity and average through-cycle value allowing to capture over- as well as under-valuation of a given stock are the main advantages of this methodology.

**The dividend discount model (DDM) valuation** is based on the net present value of the future dividends that are expected to be paid out by the company. Some advantages of the DDM valuation method are that it takes into account real cash flows to equity-owners and that the methodology is used in respect to companies with long dividend payout history. Main disadvantage of the DDM valuation method is that dividend payouts are based on a large number of parameters and assumptions, including dividend payout ratio.

**Residual income method** is conceptually close to the discounted cash flows method (DCF) for non-financial stocks, the difference being that it is based on expected residual income (returns over COE) rather than expected future cash flows. One advantage of this valuation method is that it captures the excess of profit potentially available to shareholders and the cost of money over time. Main disadvantage of the valuation method is that a large number of parameters and assumptions need to be estimated; and the valuation is sensitive to changes in those parameters.

**The warranted equity method (WEV)** is based on the formula  $P/BV = (\text{two year forward ROE less sustainable growth rate}) / (\text{Cost of equity less sustainable growth rate})$  which allows estimating a fair value (FV) of a given stock in two years' time. Subsequently the FV is discounted back to today. The main advantage of the WEV method is that it is a transparent one and based on relatively short term forecasts, hence substantially reducing the margin of forecasting error. The main disadvantage in our view is that the model is based on the principle that stock price should converge towards its fair value implied by company's ROE and COE.

**SOTP valuation** - different assets of a company are being valued according to different valuation methods, and the sum of these valuations represents the final valuation of the company. SOTP valuation advantages / disadvantages are identical to advantages and disadvantages of the specific valuation methods used.

**Liquidation value method** - liquidation value is the estimated amount of money that an asset or company could be quickly sold for, such as if it were to go out of business. Then, the estimated assets value is adjusted for liabilities and liquidation expenses. One advantage of this valuation method is its simplicity. This method does not account for intangible assets as goodwill, which is the main disadvantage.

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