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Special comment

**Banks**

Poland

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BPH

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The Merger**Current Price: PLN 49.0**

The revised parameters of the upcoming merger and group strategy, released today, have done little to change the position of BPH. The parameters of the merger are practically unchanged vs. what was published in September last year. The new strategy assumes growth will be slower, but this is something that could have been expected in the new macroeconomic environment. What is more, we believe that the plans published today are also ambitious in the current circumstances, given the volume-growth prospects in the banking sector. The execution of these plans will lead to an increase in efficiency as well as greater scale of business and higher profitability, which is commendable. In our opinion, whether the targets are achieved hinges above all on the volumes the new bank is able to secure, and on how this compares to its plans. Expenses are an important factor also, but given BPH's experience as regards cost-cutting and post-merger restructuring, we see volumes as the decisive factor. GE made a tender offer for the remaining BPH stock, as it is set to exceed the 66% interest threshold. The price in the offer is PLN 42/per share (0.75x Q1'09 BV), which is 14% less than the current market price. We believe the reaction to the tender offer will be lukewarm.

Strategy for the New Bank**Volumes**

We considered the strategic targets for the new bank very ambitious already at the time of their publication, i.e. in September of last year; after what happened in the financial market last fall, it became clear that they are unrealistic. Today, a new strategic plan has been released which is based on revised macroeconomic assumptions. The Bank wants to become the 5th player in the sector (currently it is no. 9 in terms of assets, no. 6 in loans and no. 13 in deposits). It wants to become a universal bank, and one of the leaders in the SME-sector (a bank of first choice) and for medium-sized corporations.

The Bank's volume-acquisition plans for the next three years are very ambitious. We forecast a '12/'09 CAGR of 6% for the deposit market as a whole; the Bank's target is 15% per year. In case of the loan portfolio, growth targets are more moderate vs. the what is expected for the whole market (9% vs. 8%). This will make it possible to reduce the loans/deposits ratio (estimated at 240% for 2009 – GEMB has no client deposits), but BPH will continue to depend on wholesale financing. The 2012 target for the deposit portfolio is PLN 19bn, for loans – PLN 39bn (loans/deposits ratio at nearly 2.1). During that time, assets are to increase by 6% per annum on average, to reach PLN 47bn at the end of 2012. Given the expected increase in the scale of the business, this entails wholesale financing at close to the current level (ca. PLN 20bn).

The increase in volumes is to be accompanied by a change in market shares in individual segments. In the retail segment, the offensive will focus on consumer finance (increase of the share of the credit card market from 10% to 11%, and from 6% to 8% in cash loans), with a reduction of market share in mortgages (from 8% to 7%). Significant increase of the market share is expected in SME loans (from 6% to 10%) as well as loans to medium-sized corporations (from 0% to 2%). In addition, the Bank wants to become an important player in investment and treasury products, increasing its exposure in this area from 2% to 7% of the market. The Bank's share of the total market for deposits and current accounts is to increase from 2% to 4%. The plans as far as volumes and market shares are concerned clearly indicate that the Bank will want to repeat the success of the old BPH.

Financial Targets

The Bank's financial targets for 2012 include a ROE of at least 17%, with the ROA at 2%, capital adequacy ratio at ca. 10% and the cost/income ratio at under 50%. Even when we remember that the targets have been significantly reduced, they should be treated as ambitious.

The Bank also released its estimate of the key items of the profit and loss account and the balance sheet as of the end of 2008, assuming that the merger will proceed under the planned parameters. According to the data as of year-end 2008, the merged entity would have equity of PLN 3.755bn, and the transaction will generate goodwill of PLN 1.165bn. Assets amount to PLN 37bn, and client loans to PLN 29.7bn.

Based on volume and financial ratio estimates, we estimate the expected net income in FY2012 at ca. PLN 900m. This is based in the assumption that the ratio of equity minus goodwill to assets will be 10% (the Bank wants its capital adequacy ratio to be at 10% or higher). These assumptions are conservative, given the possibility of obtaining subordinated wholesale financing from the strategic investor.



Our estimates are based on the Bank's individual target ratios, but on a different equity base (cf. the high goodwill on the balance sheet). We estimate that the Bank's net income target for FY2012 is PLN 900m, which is 40-45% of the forecasted increase in equity. Thus, the significant improvement in efficiency and profitability will take place in 2012.

Net income estimates based on strategic assumptions (mln PLN)

	Założenia:	2008	2009F	2010F	2011F	2012F	'09 net income as percentage of the increase in equity
equity		3755	5102.1	5338.3	5588.7	5854.1	
goodwill		1165	1165	1165	1165	1165	
assets	'12/'08 CAGR at 6%	37142	39371	41733	44237	46891	
equity to assets							12.5%
ROA	=>2%	2012 net income:				911.3	43.4%
ROE - estimated from the ROA						15.9%	
ROE - estimated from the ROA (equity adjusted for goodwill)						20.0%	
ROE	=> 17%	2012 net income:				972.6	46.3%
ROA based on ROE						2.1%	
ROE for equity minus goodwill						21.3%	
ROE	=> 17% (equity minus goodwill)	2012 net income:				774.6	36.9%
ROA						1.7%	

Source : BRE Bank Securities, BPH

Given the historical return on assets across the sector, the 2% target appears fairly optimistic, although a realistic one given the projected efficiency (CIR under 50%). The sector's cost/income ratio used to be higher, which drove the ROA down.

The Bank is planning to increase its operating efficiency also through restructuring. After the merger, synergies are to bring in savings of PLN 240m beginning in 2012, with the estimated one-off cost of the process at PLN 85m (in 2008-2009).

The integration plans also include a rationalization of the joined branch network. Combined, BPH and GEMB are currently operating through a network of 319 own branches, 150 partner branches, 11 corporate banking centers, 18 SME centers, 250 mobile agents dedicated to SME accounts, 2700 agencies, and 3300 payment-plan outlets. The expansion plans for the merged network are reasonable, and will not require huge capital expenditure. The number of own branches will increase by 18, and the bulk of retail-account acquisition efforts will be undertaken by partner branches (+200). Further, the new bank will add seven new SME banking centers, and expand the mobile agent network. In turn, the number of consumer finance agencies will be reduced to 2300, and the payment-plan network will be trimmed to 2800 outlets. As a result of streamlining, the merged bank will boost its presence in two core market segments: SME- and retail banking, without incurring excessive capital expenditure and overheads.

Merger Technicalities

The GEMB/BPH merger plan includes new guidelines for the achievement of medium-term strategic objectives. The integration metrics have not changed much, and the higher exchange ratio of 1.189 BPH shares for each share of GEMB stems from changes in the size of GEMB's equity since September. BPH is going to swap almost 66.9 million of its own shares ('Merger Stock') for 55.246 million GEMB shares, thus gaining a 100% stake in GEMB. The 18.9 million BPH shares currently held by GEMB will be retired as soon as possible after the Merger Stock offering, without affecting the ownership structure. As a result of these operations, the merged bank will have an equity share volume of 76.7 million, and the following ownership structure: GE (strategic investor): 87.2%, UniCredit: 1.9% (down from current 5.1%), State Treasury: 1.4% (down from 3.68%).

Today, both banks filed all necessary documents and records, including an Information Memorandum, with the Polish Financial Supervision Authority (KNF). Next, the banks will hold special shareholders' meetings toward the end of the third quarter, to approve the share placements and the terms of the merger. The KNF is expected to give its OK some time in the fourth quarter, and the legal integration is expected to be completed at the same time. The merged bank is scheduled to be listed on the Warsaw Stock Exchange by the end of 2009.

Since GEMB is going to exceed a 66% ownership threshold as a result of the merger, it announced a tender offer on outstanding BPH shares today, at PLN 42/share. The tender offer will last from 19 August to 17 September. The tender price is higher than the three-month and six-month volume weighted averages (PLN 38.73 and PLN 34.16 a share respectively), but over 14% lower than the current market price (PLN 49/share). A per-share price of PLN 42 represents 0.75 of BPH's aggregate book value as of 31 March 2009. We suspect that some investors will not be willing to sell their shares at a below-market price. In our view, the prospects outlined by the ambitious (in light of both our growth projections for the bank industry, and its own underlying scenario) merger strategy can produce more upside.

The two shareholders who are expected to take opportunity to sell are UniCredit and the State Treasury. At the tender price, UniCredit's 5.1% stake in BPH is equivalent to almost PLN 62m, and the Treasury's 3.68% stake is worth PLN 44.4m.



The shares sold in response to the tender offer will not increase BPH's equity supply, however, the difference between the market price and the tender price may encourage selling through the WSE, causing a short-term pressure on BPH's stock value.

GE vowed to the KNF that it would keep BPH listed on the Warsaw stock exchange, and promised to increase its free float from 25% to 87.2% (plus any shares tendered after the merger) in two years, provided that such an increase does not expose GE to unreasonable financial losses, and unless it is impossible for other reasons. GE did not reveal any specifics as to how it plans to increase the free float, but we can think of three ways: (i) to sell the shares on the stock market, (ii) to park the stock, (iii) to dilute the shares (probably about 12.5 million of them) through a public offering. That said, since this is a scenario for a distant future, it is not going to affect BPH's current trading price.



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**List of abbreviations and ratios contained in the report.**

EV – net debt + market value (EV – economic value)
EBIT – Earnings Before Interest and Taxes
EBITDA – EBIT + Depreciation and Amortisation
PBA – Profit on Banking Activity
P/CE – price to earnings with amortisation
MC/S – market capitalisation to sales
EBIT/EV – operating profit to economic value
P/E – (Price/Earnings) – price divided by annual net profit per share
ROE – (Return on Equity) – annual net profit divided by average equity
P/BV – (Price/Book Value) – price divided by book value per share
Net debt – credits + debt papers + interest bearing loans – cash and cash equivalents
EBITDA margin – EBITDA/Sales

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HOLD – we expect that the rate of return from an investment will range from -5% to +5%
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