

25 September 2008

Special comment

**Banks**

Poland

Marta Jeżewska
 (48 22) 697 47 37
 marta.jezewska@dibre.com.pl

BPH

BPHW.WA; BPH.PW

Merger Plan**Suspended****Current Price: PLN 69.6**

The BPH / GE Money Bank (GEMB) Merger Plan provides that BPH will issue 47.94 million shares ("Merger Issue Shares"), increasing the number of capital-stock shares to 76.66 million. The resulting free float (currently 9.76m shares representing 34% of total MCAP) will represent 12.74% of total MCAP. Calculated based on yesterday's closing price (PLN 69.6/share, PLN 2bn MCAP), the value of the new bank after the Merger Issue figures to PLN 5.3 billion. Yesterday, GEMB and BPH also announced a Strategy Plan for the new bank for the period of 2009 through 2011, which sets a FY2011 ROE target of not less than 20%. Generally speaking, the strategic objectives are very ambitious, but it is hard to assess their feasibility without knowing the operating parameters of GEMB, which reported a considerable drop in net income in H108 (from PLN 207.4m in H107 to PLN 97.9m). What is more, we are unable to determine the amount of net income that the new bank would have to generate in 2011 to achieve a ROE of 20% without knowing the price of the new shares - a piece of information which is also necessary to calculate the amount of goodwill which will arise on the transaction. Simply put, we are missing vital data: the offering price and GEMB's financial statements.

According to the merger schedule, the two banks will make all necessary KNF filings this week, and their shareholders will meet in December to approve the Merger Plan. The last of the KNF approvals are expected in the first quarter of 2009, followed by completion of the legal merger, after which the new bank will go on as one organization undergoing operational integration.

What the ownership structure is going to be after the merger is unclear, except that GE wants to reduce its interest in the new bank to 75% max. Right after the merger, GE's stake in the new entity will be a little over 87%, and the firm is considering different ways of trimming it, including a diluting stock offering, which we think is unlikely. Another possible but unlikely solution is to sell the shares on the market below the purchase price. A more probable scenario is that GE will "park" the shares in one of its companies, or issue convertible bonds (a solution tested in the past with Bank Handlowy). GE has not disclosed exactly how big an interest it wants to keep in the merged bank. To avoid making a tender offer, it would have to cut its stake to a maximum of 66%. In case of a tender offer, GE would be required to offer a price at least equal to the price at which it bought the shares in the last 12 months, or to their average price over the last six months. If the tender offer had been announced before 20 July (the end date of GE's previous tender offer), the price would have been PLN 89.02 a share. GE has yet to reveal whether it is going to keep 75%, or 66% of the merged bank.

According to the 2009-2011 Strategy Plan, the merged bank aspires to becoming a key player in consumer finance and SME banking, and the number-five bank in the most attractive markets. To achieve this goal, the bank plans to develop new products and keep up to speed with its service range, and intends further to open 220 new branches (adding to the 530 already existing), manage 450 franchise outlets, and operate through 450 mobile salespeople, 4000 agents, and 2300 sales outlets (car loans).

The financial targets set for FY2011 include a ROE of 20%, a cost-to-income ratio below 50%, and a capital adequacy ratio of over 10%. Pre-tax synergies are expected to reach PLN 282m. These targets were set based on an assumption of average annual asset growth rate of 19% (from PLN 42bn at year-end 2009 to PLN 59bn in 2011).

BPH is taking over a 100% stake in GEMB in exchange for 47 million new shares and 19 million "Treasury Shares". GEMB's total price includes the price of its 66% stake in BPH ("Treasury Shares"). We can assume that the Treasury Shares are the same shares that are held by GEMB. BPH's equity after the merger will be equal to current equity plus the total value of the new shares, which we are unable to estimate without knowing their issue price. The goodwill created by the transaction will be the difference between the total offering price and the current value of GEMB equity excluding the BPH shares.

The amount of goodwill will determine the amount of the merged bank's equity. Goodwill is not taken into account in CAR calculations. According to our ballpark estimates, for CAR to reach the target 10%, equity would have to be equal to ca. 10% of total assets less goodwill. This is not a completely reliable estimation because of lack of data about the ratio of risk-weighted assets to total assets and subordinated debt, but it gives an idea of the future amount of the new bank's equity. Given the scale of post-merger operations, we reckon that ROA will hover around 2%. The table below shows our net-income forecasts depending on assumed FY2011 ROA.

Net income depending on target ROA

ROA	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%
average assets in 2011	54728	54728	54728	54728	54728	54728	54728	54728	54728	54728	54728	54728	54728	54728
Net income	656.7	711.5	766.2	820.9	875.6	930.4	985.1	1039.8	1094.6	1149.3	1204.0	1258.7	1313.5	1368.2

Source: BRE Bank Securities, BPH

GEMB posted a ROA of 3.2% in 2007, and 1.2% in H108. In Q108, net income was PLN 74.3m, and ROA stood at 1.9%. Based on this, we agree that a long-term ROA of around 2% is a feasible objective for the new bank. If ROA were to meet 2%, net income would have to rise well above PLN 1 billion.

Key strategic objectives

	GEMB as of	BPH as of	Merger as of	targets:		
	Aug. 1st 2008	Aug. 1st 2008	Aug. 1st 2008	2009F	2010F	2011F
Equity/Assets	3628	1517	n/a	n/a	n/a	n/a
Assets	18547	12209	30756	42000	49980	59476
Loans	16236	7138	23373			
Deposits	12948	7512	20460			
Asset growth				36.6%*	19.0%	19.0%
ROE						>20%
C/I ratio						< 50%

Source: BRE Bank Securities, BPH, * growth from 1 Aug. 2008 to 31 Dec. 2009

GEMB's net income for H108 amounted to PLN 97.9m. Assuming flat growth in H208 (with net income again around PLN 100m), the FY08E P/E ratio for the transaction is 23. Note, however, the huge decrease in the bank's bottom-line income compared to 2007, when PLN 207.4m was posted in H107 and the full-year figure reached PLN 422m, implying a FY07 P/E of 10.7. We do not know what caused such a significant deterioration in earnings because we do not have access to necessary financial information, but we know that, of the first-half net-income figure of PLN 97.9m, PLN 74.3m was generated in the first quarter, suggesting that the second quarter saw an even more dramatic fall. Without complete accounts, we are not able to analyze the quality of GEMB's earnings, and the full financial statements are scheduled to appear in the Information Memorandum which will probably will not be released for months (we expect right before the merger process enters its final stage, after the KNF has given all approvals).

BPH posted a net income of PLN 76m in H108, and the bottom-line figure was affected by a number of one-offs; The bank incurred losses by closing financial positions which remained open after the spin-off, and generated gains from IT services outsourced from Pekao. After the outsourcing agreement expires, the bank will not be able to offset costs with these gains (among other things because of the merger), though it will be able to make some savings. If we assume that the net-income figure posted in H108 did not include one-offs, BPH's ROA for the period would approximate 1.2%.

The total supply of BPH shares depends on UniCredit's plans with respect to its stake, which consists of 29 million shares (pre- merger issue) representing an interest of a little over 5%, valued at PLN 94-95m at the current price level.

FY08E P/E estimates for the new bank based on a MCAP of PLN 5.3bn

net income (PLN m)	200	250	300	350	400	450	500	550	600	650	700	750	800	850
P/E	26.7	21.3	17.8	15.2	13.3	11.9	10.7	9.7	8.9	8.2	7.6	7.1	6.7	6.3

Source: BRE Bank Securities, BPH

BPH's earnings results post-spin-off (PLN m)

	1Q07	2Q07	1Q08	2Q08	Q/Q	YTD
Net loans	37078	38214	6501	7142	9.9%	15.8%
Deposits	40759	41889	6055	6756	11.6%	20.2%
Assets	61227	60781	12604	12127	-3.8%	-6.9%
Net interest income	107	107	154	147	-4.2%	37.3%
Net fee income	88	95	87	99	13.3%	4.1%
Trading income	3	2	-7	-30	n/a	n/a
Income f/banking operations	199	204	235	216	-7.9%	5.8%
Other net operating income	3	-8	33	38	14.9%	-606.6%
Banking income	202	197	268	254	-5.0%	29.3%
Total costs	-130	-139	-192	-200	4.1%	43.7%
Operating income before provisions	72	57	75	54	-28.3%	-5.7%
Provisions	-13	-4	-8	-9	20.3%	154.9%
Operating income	58	54	68	45	-33.9%	-16.6%
Pre-tax income	58	54	68	45	-33.9%	-16.6%
Tax	-12	-15	-15	-9	-39.3%	-39.0%
Net income	39	26	47	29	-39.3%	9.5%

Source: BRE Bank Securities, BPH



Michał Marczak tel. (+48 22) 697 47 38
Managing Director
Head of Research
michal.marczak@dibre.com.pl
Strategy, telco, mining, metals, media

Research Department:

Marta Jeżewska tel. (+48 22) 697 47 37
Deputy Director
marta.jezewska@dibre.com.pl
Banks

Analysts:

Kamil Kliszcz tel. (+48 22) 697 47 06
kamil.kliszcz@dibre.com.pl
Fuels, chemicals, retail

Piotr Grzybowski tel. (+48 22) 697 47 17
piotr.grzybowski@dibre.com.pl
IT Distributors, IT, media

Maciej Stokłosa tel. (+48 22) 697 47 41
maciej.stoklosa@dibre.com.pl
Construction

Sales and Trading:

Piotr Dudziński tel. (+48 22) 697 48 22
Director
piotr.dudzinski@dibre.com.pl

Marzena Łempicka-Wilim tel. (+48 22) 697 48 95
Deputy Director
marzena.lempicka@dibre.com.pl

Traders:

Emil Onyszczyk tel. (+48 22) 697 49 63
emil.onyszczyk@dibre.com.pl

Grzegorz Stępień tel. (+48 22) 697 48 62
grzegorz.stepien@dibre.com.pl

Tomasz Dudź tel. (+48 22) 697 49 68
tomasz.dudz@dibre.com.pl

Michał Jakubowski tel. (+48 22) 697 47 44
michal.jakubowski@dibre.com.pl

Tomasz Jakubiec tel. (+48 22) 697 47 31
tomasz.jakubiec@dibre.com.pl

Grzegorz Strublewski tel. (+48 22) 697 48 76
grzegorz.strublewski@dibre.com.pl

"Private Broker"

Jacek Szczepański tel. (+48 22) 697 48 26
Director
jacek.szczepanski@dibre.com.pl

Paweł Szczepanik tel. (+48 22) 697 49 47
Sales
pawel.szczepanik@dibre.com.pl

Dom Inwestycyjny
BRE Banku S.A.
ul. Wspólna 47/49
00-950 Warszawa
www.dibre.com.pl

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

Recommendations of BRE Bank Securities S.A.

A recommendation is valid for a period of 6-9 months, unless a subsequent recommendation is issued within this period. Expected returns from individual recommendations are as follows:

BUY – we expect that the rate of return from an investment will be at least 15%

ACCUMULATE – we expect that the rate of return from an investment will range from 5% to 15%

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

REDUCE – we expect that the rate of return from an investment will range from -5% to -15%

SELL – we expect that an investment will bear a loss greater than 15%

Recommendations are updated at least once every nine months.

The present report expresses the knowledge as well as opinions of the authors on day the report was prepared. The opinions and estimates contained herein constitute our best judgement at this date and time, and are subject to change without notice. The present report was prepared with due care and attention, observing principles of methodological correctness and objectivity, on the basis of sources available to the public, which BRE Bank Securities S.A. considers reliable, including information published by issuers, shares of which are subject to recommendations. However, BRE Bank Securities S.A., in no case, guarantees the accuracy and completeness of the report, in particular should sources on the basis of which the report was prepared prove to be inaccurate, incomplete or not fully consistent with the facts.

This document does not constitute an offer or invitation to subscribe for or purchase any financial instruments and neither this document nor anything contained herein shall form the basis of any contract or commitment whatsoever. It is being furnished to you solely for your information and may not be reproduced or redistributed to any other person. This document nor any copy hereof is not to be distributed directly or indirectly in the United States, Australia, Canada or Japan.

Recommendations are based on essential data from the entire history of a company being the subject of a recommendation, with particular emphasis on the period since the previous recommendation.

Investing in shares is connected with a number of risks including, but not limited to, the macroeconomic situation of the country, changes in legal regulations as well as changes on commodity markets. Full elimination of these risks is virtually impossible.

BRE Bank Securities S.A. bears no responsibility for investment decisions taken on the basis of the present report or for any damages incurred as a result of investment decisions taken on the basis of the present report.

It is possible that BRE Bank Securities S.A. renders, will render or in the past has rendered services for companies and other entities mentioned in the present report.

BRE Bank Securities S.A., its shareholders and employees may hold long or short positions in the issuers' shares or other financial instruments related to the issuers' shares. BRE Bank Securities S.A., its affiliates and/or clients may conduct or may have conducted transactions for their own account or for account of another with respect to the financial instruments mentioned in this report or related investments before the recipient has received this report.

Copying or publishing the present report, in full or in part, or disseminating in any way information contained in the present report requires the prior written agreement of BRE Bank Securities S.A. Recommendations are addressed to all Clients of BRE Bank Securities S.A.

The activity of BRE Bank Securities S.A. is subject to the supervision of the Polish Financial Supervision Commission.

BRE Bank Securities S.A. serves as animator in relation to the shares of the following companies: Certyfikaty Skarbiec Nieruchomości, Erbud, Es-System, Macrologic, Mieszko, Mondy, Monnari Trade, Nepentes, Optopol, Pemug, Polimex-Mostostal, Seco Warwick, Torfarm, Unibep

BRE Bank Securities S.A. receives remuneration from issuers for services rendered to the following companies: ABG Spin, Agora, Ambra, Bakalland, BRE Bank, DZ Bank Polska, Elektrobudowa, Elzab, Enap, Erbud, Es-System, Farmacol, GTC, Huta Ferrum, Inter Groclin, Komputronik, Macrologic, Mennica Polska, Mieszko, Mondy, Nepentes, Odratrans, Optopol, Pemug, PGF, PGNiG, Polimex-Mostostal, Polmos Lublin, Polnord, Prokom Software, Provimi-Rolimpex, Seco Warwick, Skarbiec Nieruchomości, Sygnity, Techmex, Unibep.

In the last 12 months BRE Bank Securities S.A. has been an offering agent of the issuer's shares in a public offering for the following companies: Optopol, Nepentes, Seco Warwick, Sygnity, Unibep.

Asseco Poland provides IT services to BRE Bank Securities.

Individuals who did not participate in the preparation of recommendations, but had or could have had access to recommendations prior to their publication, are employees of BRE Bank Securities S.A. authorised to access the premises in which recommendations are prepared, other than the analysts mentioned as the authors of the present recommendations.

Strong and weak points of valuation methods used in recommendations:

DCF – acknowledged as the most methodologically correct method of valuation; it consists in discounting financial flows generated by a company; its weak point is the significant susceptibility to a change of forecast assumptions in the model.

Comparative – based on a comparison of valuation multipliers of companies from a given sector; simple in construction, reflects the current state of the market better than DCF; weak points include substantial variability (fluctuations together with market indices) as well as difficulty in the selection of the group of comparable companies.