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Special comment

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Banks

Poland

PKO BP

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Hold

(Reiterated)

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

Q1'10 Results

Current price: PLN 40.15; Target price: PLN 40.1

At PLN 720m, net profit exceeded our PLN 665m forecast by 8% and the PLN 690m consensus by just 4%. The main source of this surprise were expenses, which were nearly 7% lower than forecasted by us and market consensus (PLN 1014m vs. PLN 1088m and PLN 1082m, respectively). Loan-loss provisions were in line with our expectations (PLN 425m vs. PLN 429m), but lower than in the consensus forecast (PLN 449m). We consider these earnings good, but without impact on our outlook on the bank. After Q1'10, PKO BP has attained 23% of our FY target. At the moment, we see no grounds for a revision of our FY forecasts, which entail average quarterly profit of nearly PLN 0.8bn in the coming quarters. The Bank will have to increase its revenue and cut its provisions in order to attain such a result at the time of rising expenses. With our PLN 3.1bn net profit forecast for FY 2010, the Bank is trading at an FY10 P/E of 16.7 and FY10 P/BV of 2.3, which is the highest valuation in the industry next to Pekao, which, on the FY 2010 net profit forecast of PLN 2.7bn is trading at an FY10 P/E of 16.4 and FY10 P/BV of 2.3.

Actual vs. forecasted earnings

(PLN m)	Q1'10F	Difer	Q1'10	Change	Q1'09	2010F	Change	2009	Q1/2010F
Interest income	1 469	0.3%	1 474	23.6%	1 193	6 224	23.2%	5 051	23.7%
Fee income	718	1.1%	725	31.9%	550	2 915	12.8%	2 583	24.9%
NIM	3.8%	-	3.8%	-	3.5%	3.8%	-	3.5%	-
Income f. banking oper.	2 308	0.4%	2 317	10.4%	2 099	9 637	12.0%	8 607	24.0%
Operating expenses	-1 088	-6.8%	-1 014	-6.2%	-1 082	-4 436	4.5%	-4 244	22.9%
Operating income*	1 260	5.7%	1 332	25.3%	1 063	5 462	18.1%	4 624	24.4%
Provisions	-429	-0.8%	-425	13.8%	-374	-1 538	-8.5%	-1 681	27.6%
Pre-tax income	831	8.6%	903	29.9%	695	3 925	33.4%	2 943	23.0%
Net-income	665	8.3%	720	33.2%	541	3 101	34.5%	2 306	23.2%

Source: BRE Bank Securities, PKO BP
** before provisions*

Income-wise, there was little divergence from our forecasts in quantity or structure. We believe PKO BP's strength this year will be interest income (new volumes, improved deposit margin).

Interest income figured to PLN 1.47bn, in line with our expectations, and representing a 24% y/y improvement, partially attributable to the introduction of hedge accounting in Q2'09. Since mid-2009, the Bank's interest income includes transactions hedging interest income (for loans denominated in foreign currencies). In Q1'10, this factor accounted for PLN 155m of the income. In order to make interest income comparable y/y, we need to take into account a PLN 0.2bn income from this source which in Q1'09 was recognized in trading income. At the same time, interest income increased from PLN 1.33bn in Q3'09 and PLN 1.42bn in Q4'09 (when hedge accounting was already in use). This improvement vs. H2 2009 was attained through a gradual increase in the deposit margin and the growth of loan volumes, at margins higher than in the past (which also had a positive impact on the margin on existing loans). In our opinion, in FY 2010 interest income will be the fastest-growing component of PKO BP income thanks to rising new loan volumes, leading to double-digit growth in assets (+12% y/y). We believe the Bank might be able to keep the loan margin at a higher level throughout the year. At the same time, its earnings will be under pressure in the next quarter due to the decline in market rates (3M WIBOR) and pressure on deposit margins. The Bank will be able to transfer the change in market rates onto term deposit pricing, but its deposit margin on current accounts will fall. We agree with the Management that net interest margin will stabilize at levels close to those seen in Q1'10, and that the increase in income will come from higher volumes and a low comparative base in H1'09.

At PLN 725m, fee income was very close to our PLN 718m forecast. There also were few differences structure-wise. The uptrend in this area (+32% y/y) is a consequence of increasing income from transaction fees (accounts, transfers, cards) due to price hikes introduced last year. We believe this factor will be of diminishing importance as far as the rate of growth in the following quarters is concerned (the hikes were introduced in Q2'09, which means that the growth rate vs. H2'09 is not as high). In addition to the growing income from transactions, another important factor is the increase in loan insurance fees (+PLN 40m in Q1'09, to PLN 158m). This is affected by the Bank's offering in the area of cash loans.

Trading income declined to PLN 117m (vs. PLN 120m forecasted), from PLN 160m in Q4'09 and PLN 356m in Q1'09 (here we should take into account ca. PLN 0.2bn on account of interest income hedges). The main driver of trading income are F/X gains/losses. Therefore, we attribute this decline in trading income to lower client activity in this area.

Expenses were the most impressive aspect of PKO BP's first-quarter results. Total costs amounted to PLN 1014m after an 11% drop from Q409 and a 6.2% decrease from Q109. In addition to seasonal reductions (we expected a 5% q/q decrease to PLN 1082m), the bank incurred lower non-payroll expenses than in Q109, while maintaining payroll expenses at the same level (through gradual downsizing). PKO BP's Management have announced plans to continue reducing non-payroll expenses, and to keep overall costs under tighter control, with a view to bringing the cost/income ratio below 45% in 2012 (we expect the ratio to decrease to 40.4%). In our opinion, however, non-payroll expenses will increase in in future quarters.

Operating expenses

(PLN m)	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10
Payroll expenses	555	604	587	683	573	523	579	632	567
Non-payroll expenses	291	353	353	441	393	356	333	384	329
D&A expenses	102	106	107	114	115	114	116	124	119
total	948	1062	1047	1238	1082	994	1029	1140	1014

Source: PKO BP, BRE Bank Securites

First-quarter provisions were in line at PLN 425m (we forecasted PLN 429m), and were mostly comprised of reserves for retail loan losses; costs of risk in the corporate segment have declined.

Loan-loss provisions

(PLN m)	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10
retail	-80	-57	-226	-449	-270	-352	-268	-388	-386
corporate	6	-106	-28	-183	-73	-58	-106	-157	-39
other	48	13	3	-71	-31	20	9	-8	0
total	-27	-150	-251	-702	-374	-390	-364	-553	-425

Source: PKO BP, BRE Bank Securites

At the bank itself, the standalone bad-debt provisions amounted to PLN 389m, of which PLN 252m pertained to consumer loans, PLN 90m was for home loans, PLN 66m was set aside to cover corporate loans, and PLN 19m related to other loans. We want to point out the dramatic increase in home-loan charge-offs, from an average PLN 37m in 2009 and just PLN 25m in Q409. Assuming that the PLN 90m provisions cover "new" business, the cost of risk figures to 70 bps. We expect the upward trend in this segment's provisions to continue in future quarters. Provisions for consumer loans increased to PLN 252m in Q1 from PLN 201m in Q409 and a 2009 average of PLN 171m, and they are expected to remain high at least until the end of the first half of the year. At the level of the whole PKO BP family, we noticed a positive trend in the reduced loan-loss reserves booked by Ukrainian operations (a decrease from PLN 81.3m in Q109 and PLN 68m in Q409 to PLN 23.5m in Q1 2010). That said, banking in the Ukraine is still generating losses for PKO BP (a PLN 22.3m net loss in Q1 2010) because of weak sales.

PKO BP is one of leaders in volume expansion, with continuing growth observed across all business areas. Q1 2010 assets displayed a 12% increase vs. Q109 and a flat increase vs. Q409, fueled by loan sales (+11% y/y) as well as deposits (+11% y/y). The ratio of loans to deposits remains below 100% (96% in Q1), and we suspect that it will stay in the 90%-100% range over a long term. On fast-expanding volumes, PKO BP's market share has increased over the past year (total receivable loans in the bank sector increased 2% in Q1 2010, with household loans rising 6%, and corporate loans declining 9% compared to Q1 2009).

Loan portfolio

(PLN m)	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	Q/Q	Y/Y
Consumer loans	20 776	21 118	21 847	22 933	23 483	24 169	2.9%	14.4%
Home loans	45 589	48 766	48 850	50 266	52 472	53 335	1.6%	9.4%
Business loans	37 138	39 431	40 058	41 632	43 991	44 161	0.4%	12.0%
Interest	522	515	501	517	564	590	4.6%	14.5%
Gross loans	**104 026**	**109 830**	**111 256**	**115 348**	**120 510**	**122 255**	**1.4%**	**11.3%**
Reserves	-2 918	-3 290	-3 457	-3 531	-3 937	-4 362	10.8%	32.6%
Net loans	**101 108**	**106 540**	**107 799**	**111 817**	**116 573**	**117 892**	**1.1%**	**10.7%**

Source: PKO BP, BRE Bank Securites

PKO BP's Q1 2010 deposits were a little under 2% lower than in the preceding quarter, and 11% higher than in the same period a year ago. The quarter-on-quarter contraction was a result of a decline in corporate deposits vis-à-vis a high comparable base. The strong year-on-year growth indicates that, as well as in loans, the bank is increasing its share in the market for deposits (overall sector deposits were 6% higher in Q1 2010, with household deposits up 9.5%, and corporate deposits up 10% compared to Q1 2009).

Overview of quarterly results

(PLN m)	1Q09	2Q09	3Q09	4Q09	1Q10	Q/Q	Y/Y
Net loans	106 540	107 799	111 817	116 573	117 892	1.1%	10.7%
Deposits	110 372	114 116	117 888	125 073	122 951	-1.7%	11.4%
Assets	139 388	142 259	146 579	156 479	156 696	0.1%	12.4%
Net interest income	1 193	1 108	1 332	1 417	1 474	4.0%	23.6%
Net fee income	550	622	701	710	725	2.2%	31.9%
F/X gains/losses	356	349	108	160	117	-26.4%	-67.0%
Income from banking operations	2 099	2 080	2 142	2 287	2 317	1.3%	10.4%
Other net operating income	46	110	64	40	29	-28.2%	-36.7%
Banking revenues	2 145	2 190	2 206	2 327	2 346	0.8%	9.4%
Operating. D&A expenses	-1 082	-994	-1 029	-1 140	-1 014	-11.0%	-6.2%
Operating income before provisions	1 063	1 196	1 177	1 187	1 332	12.2%	25.3%
Provisions	-374	-390	-364	-553	-425	-23.1%	13.8%
Equity in income of associates	5	-6	2	-1	-4	-	-
Pre-tax income	695	800	814	633	903	42.5%	29.9%
Tax	-152	-183	-172	-124	-184	48.3%	20.6%
Minority interests	-2	-7	-4	7	1	-87.9%	-
Net income	541	610	639	516	720	39.4%	33.2%

Source: PKO BP, BRE Bank Securites

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, Energy, Retail

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

Maciej Stokłosa tel. (+48 22) 697 47 41
maciej.stoklosa@dibre.com.pl
Construction, Real-Estate Developers

Jakub Szkopek tel. (+48 22) 697 47 40
jakub.szkopek@dibre.com.pl
Manufacturers

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 Onyszczuk tel. (+48 22) 697 49 63
emil.onyszczuk@dibre.com.pl

Grzegorz Stępien 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

Foreign Markets Unit:

Adam Prokop tel. (+48 22) 697 48 46
Foreign Markets Manager
adam.prokop@dibre.com.pl

Michał Rożmiej tel. (+48 22) 697 48 64
michal.rozmiej@dibre.com.pl

Jakub Słotkowicz tel. (+48 22) 697 48 64
jakub.slotkowicz@dibre.com.pl

Jacek Wrześniewski tel. (+48 22) 697 49 85
jacek.wrzesniewski@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*

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