

# mBank SA (MBK.WA)

## A Larger Incarnation of Alior – Neutral Maintained

- **Fairly Valued Quality** — We view mBank as a larger incarnation of Alior, perceived by some investors as the most innovative Polish bank. However, given emerging macro-economic challenges and potential risks related to the bank's FX mortgage exposure, we increase our assumed cost of equity to 10.25% from 10.0%, lower our TP to ZI 492 from ZI 498 and reiterate our Neutral rating on the share.
- **Emerging Retail Leader** — We like the bank's business model of acquiring new clients through its best-in-class transactional on-line platform and to cross-sell not only consumer loans but also investment and insurance products. We think this makes mBank shares potentially attractive to long-term investors that appreciate strong brands (see: [What Works in Equity Markets](#)). We think it will also make it, over longer term, Poland's largest retail bank.
- **FX Mortgage Risks** — The implementation of "Hungarian-style" solutions for FX mortgages in Poland would be very damaging for mBank. We see the risk of conversion of FX mortgages to Zloty at below market exchange rates as low but an unfavourable decision on the FX spread cannot be ruled out (for details see [Polish Financial Weekly](#)).
- **Macro Headwinds** — On July 30, 2014, Citi economists maintained their GDP forecasts of 3.4% in 2014 and 3.6% in 2015 (see [GEOS](#)). But later they have warned that Russia's ban on fruit and vegetable imports could shave 0.3-0.4% off GDP. They also see a rising probability that rates will be cut, unless 2Q GDP growth surprises to the upside (i.e. remains above 3%) or July inflation remains above 0%. They will review GDP forecasts and interest rate scenarios in mid-August, after the release of GDP and CPI data (see: [Poland Macro Flash](#)). Reflecting the higher probability of lower rates, we have lowered our NII forecast by 0.4% this year, 3% next year and 2% in 2016. This has led us to reduce our EPS estimates by 0.1%, 3% and 1%, respectively (for details see Fig. 20).

- Estimate Change
- Target Price Change

|                             |               |
|-----------------------------|---------------|
| Neutral                     | 2             |
| Price (04 Aug 14)           | ZI461.35      |
| Target price                | ZI492.00      |
|                             | from ZI498.00 |
| Expected share price return | 6.6%          |
| Expected dividend yield     | 5.1%          |
| Expected total return       | 11.8%         |
| Market Cap                  | ZI19,472M     |
|                             | US\$6,254M    |

### Price Performance (RIC: MBK.WA, BB: MBK.PW)



### mBank SA (PLN)

| Year to 31 Dec         | 2012A   | 2013A   | 2014E   | 2015E   | 2016E   |
|------------------------|---------|---------|---------|---------|---------|
| Net Income (ZIM)       | 1,197.3 | 1,206.4 | 1,335.9 | 1,447.3 | 1,720.3 |
| Diluted EPS (ZI)       | 28.43   | 28.62   | 31.65   | 34.28   | 40.76   |
| Diluted EPS (Old) (ZI) | 28.43   | 28.62   | 31.70   | 35.44   | 41.23   |
| PE (x)                 | 16.2    | 16.1    | 14.6    | 13.5    | 11.3    |
| P/BV (x)               | 2.0     | 1.9     | 1.8     | 1.7     | 1.6     |
| DPS (ZI)               | 10.00   | 17.16   | 23.72   | 25.72   | 30.57   |
| Net Div Yield (%)      | 2.2     | 3.7     | 5.1     | 5.6     | 6.6     |
| ROE (%)                | 13.6    | 12.2    | 12.6    | 12.9    | 14.7    |

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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| Fiscal year end 31-Dec                   | 2012           | 2013           | 2014E          | 2015E          | 2016E          |
|--|----------------|----------------|----------------|----------------|----------------|
| <b>Valuation Ratios</b>                  |                |                |                |                |                |
| P/E adjusted (x)                         | 16.2           | 16.1           | 14.6           | 13.5           | 11.3           |
| P/E reported (x)                         | 16.2           | 16.1           | 14.6           | 13.5           | 11.3           |
| P/BV (x)                                 | 2.0            | 1.9            | 1.8            | 1.7            | 1.6            |
| P/Adjusted BV diluted (x)                | 2.0            | 1.9            | 1.8            | 1.7            | 1.6            |
| Dividend yield (%)                       | 2.2            | 3.7            | 5.1            | 5.6            | 6.6            |
| <b>Per Share Data (ZI)</b>               |                |                |                |                |                |
| EPS adjusted                             | 28.43          | 28.62          | 31.65          | 34.28          | 40.76          |
| EPS reported                             | 28.43          | 28.62          | 31.65          | 34.28          | 40.76          |
| BVPS                                     | 227.69         | 242.55         | 259.75         | 270.30         | 285.34         |
| Tangible BVPS                            | 217.34         | 231.75         | 247.88         | 257.24         | 270.98         |
| Adjusted BVPS diluted                    | 227.69         | 242.55         | 259.56         | 270.30         | 285.34         |
| DPS                                      | 10.00          | 17.16          | 23.72          | 25.72          | 30.57          |
| <b>Profit &amp; Loss (ZIm)</b>           |                |                |                |                |                |
| Net interest income                      | 2,280          | 2,226          | 2,480          | 2,687          | 3,053          |
| Fees and commissions                     | 787            | 835            | 957            | 1,008          | 1,109          |
| Other operating Income                   | 505            | 613            | 571            | 601            | 636            |
| <b>Total operating income</b>            | <b>3,571</b>   | <b>3,674</b>   | <b>4,008</b>   | <b>4,296</b>   | <b>4,798</b>   |
| Total operating expenses                 | -1,578         | -1,678         | -1,805         | -1,855         | -1,923         |
| <b>Oper. profit bef. provisions</b>      | <b>1,993</b>   | <b>1,995</b>   | <b>2,203</b>   | <b>2,441</b>   | <b>2,875</b>   |
| Bad debt provisions                      | -445           | -478           | -496           | -614           | -719           |
| Non-operating/exceptionals               | -84            | 0              | 0              | 0              | 0              |
| <b>Pre-tax profit</b>                    | <b>1,465</b>   | <b>1,518</b>   | <b>1,707</b>   | <b>1,827</b>   | <b>2,156</b>   |
| Tax                                      | -267           | -309           | -367           | -375           | -431           |
| Extraord./Min. Int./Pref. Div.           | -1             | -3             | -4             | -4             | -5             |
| <b>Attributable profit</b>               | <b>1,197</b>   | <b>1,206</b>   | <b>1,336</b>   | <b>1,447</b>   | <b>1,720</b>   |
| Adjusted earnings                        | 1,197          | 1,206          | 1,336          | 1,447          | 1,720          |
| <b>Growth Rates (%)</b>                  |                |                |                |                |                |
| EPS adjusted                             | 5.4            | 0.7            | 10.6           | 8.3            | 18.9           |
| Oper. profit bef. prov.                  | 2.5            | 0.1            | 10.4           | 10.8           | 17.8           |
| <b>Balance Sheet (ZIm)</b>               |                |                |                |                |                |
| <b>Total assets</b>                      | <b>102,145</b> | <b>104,283</b> | <b>112,280</b> | <b>122,336</b> | <b>132,572</b> |
| Avg interest earning assets              | 97,994         | 100,722        | 105,779        | 114,688        | 124,607        |
| Customer loans                           | 69,475         | 70,582         | 76,299         | 83,489         | 91,842         |
| Gross NPLs                               | 3,632          | 4,424          | 4,807          | 5,009          | 5,051          |
| <b>Liab. &amp; shar. funds</b>           | <b>102,145</b> | <b>104,283</b> | <b>112,280</b> | <b>122,336</b> | <b>132,572</b> |
| Total customer deposits                  | 57,984         | 61,674         | 67,148         | 74,109         | 81,519         |
| Reserve for loan losses                  | 2,529          | 2,371          | 2,613          | 2,947          | 3,246          |
| Shareholders' equity                     | 9,594          | 10,229         | 10,963         | 11,409         | 12,043         |
| <b>Profitability/Solvency Ratios (%)</b> |                |                |                |                |                |
| ROE adjusted                             | 13.6           | 12.2           | 12.6           | 12.9           | 14.7           |
| Net interest margin                      | 2.33           | 2.21           | 2.34           | 2.34           | 2.45           |
| Cost/income ratio                        | 44.2           | 45.7           | 45.0           | 43.2           | 40.1           |
| Cash cost/average assets                 | 1.6            | 1.6            | 1.7            | 1.6            | 1.5            |
| NPLs/customer loans                      | 5.2            | 6.3            | 6.3            | 6.0            | 5.5            |
| Reserve for loan losses/NPLs             | 69.6           | 53.6           | 54.4           | 58.8           | 64.3           |
| Bad debt prov./avg. cust. loans          | 0.6            | 0.7            | 0.7            | 0.8            | 0.8            |
| Loans/deposit ratio                      | 119.8          | 114.4          | 113.6          | 112.7          | 112.7          |
| Tier 1 capital ratio                     | 13.0           | 14.2           | 14.4           | 13.8           | 13.6           |
| Total capital ratio                      | 18.7           | 19.4           | 17.7           | 15.9           | 15.2           |

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## A Larger Incarnation of Alior

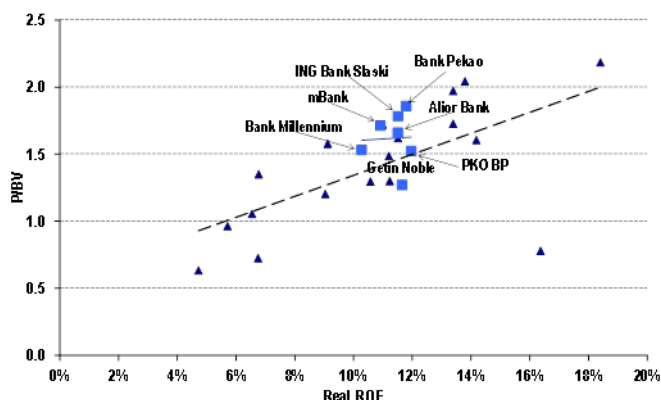
Figure 1. Polish Banks – Market Multiples

| Company          | RIC     | Current Price | Rating | Target Price | P/E   |       |       | P/BV  |       |       | ROE   |       |       | Dividend Yield |       |       |
|------------------|---------|---------------|--------|--------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|----------------|-------|-------|
|                  |         |               |        |              | 2014E | 2015E | 2016E | 2014E | 2015E | 2016E | 2014E | 2015E | 2016E | 2014E          | 2015E | 2016E |
| PKO BP           | PKO.WA  | 36.30         | 2      | 43.0         | 13.9  | 11.3  | 10.5  | 1.7   | 1.5   | 1.4   | 12.4% | 14.0% | 13.9% | 3.60%          | 4.41% | 4.74% |
| PEKAO            | PEO.WA  | 171.50        | 2      | 193.0        | 16.4  | 13.6  | 12.2  | 1.9   | 1.9   | 1.8   | 11.7% | 13.8% | 15.1% | 5.83%          | 7.29% | 7.87% |
| Bank Millennium  | MILP.WA | 7.79          | 3      | 6.9          | 14.6  | 12.9  | 11.4  | 1.6   | 1.5   | 1.4   | 11.6% | 12.3% | 12.9% | 3.42%          | 3.88% | 4.38% |
| ING BSK          | INGP.WA | 130.95        | 2      | 124.2        | 16.4  | 13.5  | 12.4  | 1.9   | 1.8   | 1.7   | 11.7% | 13.5% | 14.0% | 4.58%          | 5.56% | 6.04% |
| mBank            | MBK.WA  | 492.0         | 2      | 486.0        | 14.6  | 13.5  | 11.4  | 1.8   | 1.7   | 1.6   | 12.6% | 12.9% | 14.7% | 5.12%          | 5.55% | 6.60% |
| Getin Noble Bank | GNB.WA  | 2.89          | 3H     | 3.2          | 13.0  | 9.8   | 9.4   | 1.4   | 1.3   | 1.2   | 11.6% | 13.7% | 12.9% | 1.53%          | 3.57% | 5.32% |
| Alior Bank       | ALRR.WA | 79.45         | 2H     | 87.7         | 16.9  | 13.5  | 10.9  | 1.9   | 1.7   | 1.5   | 12.5% | 13.5% | 14.5% | 0.00%          | 0.00% | 0.00% |
| BNPP Polska      | BNP.WA  | 54.50         | 2      | 67.1         | 16.9  | 11.2  | 8.6   | 0.9   | 0.8   | 0.7   | 5.1%  | 7.4%  | 8.9%  | 0.00%          | 0.00% | 0.00% |
| Median           |         |               |        |              | 15.5  | 13.2  | 11.1  | 1.7   | 1.6   | 1.4   | 11.7% | 13.5% | 14.0% | 3.51%          | 4.15% | 5.03% |
| Average          |         |               |        |              | 15.3  | 12.4  | 10.9  | 1.6   | 1.5   | 1.4   | 11.2% | 12.6% | 13.4% | 3.01%          | 3.78% | 4.37% |

Price as of August 1<sup>st</sup>, 2014

Source: Citi Research

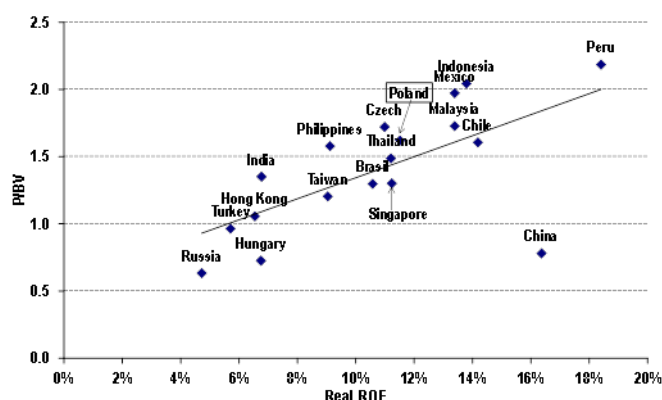
Figure 2. Polish Banks – P/BV and Real ROE\*, 2015E



\*At median, inflation adjusted; prices as of August 1<sup>st</sup>, 2014

Source: Citi Research estimates

Figure 3. GEM Banks – P/BV and Real ROE\*, 2015E



\*At median, inflation adjusted; prices as of August 1<sup>st</sup>, 2014

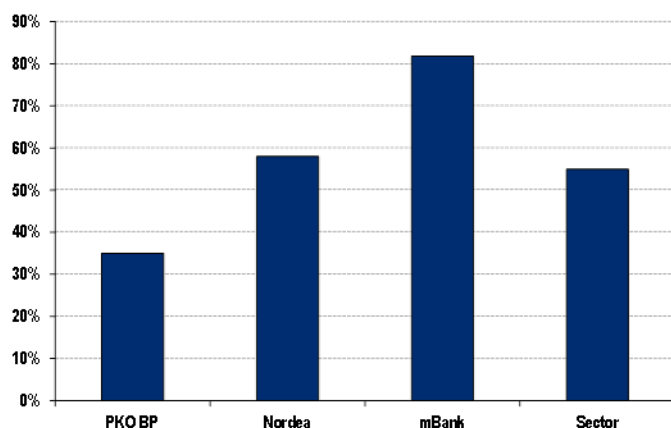
Source: Citi Research estimates

## High Quality

### An emerging leader in retail banking in Poland

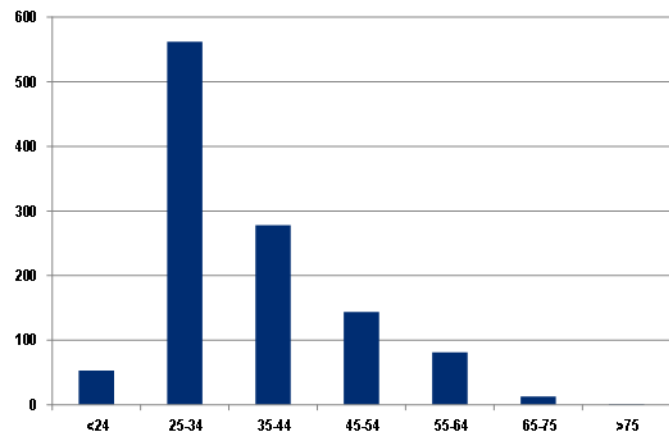
According to our estimates, mBank leads in terms of number of retail clients younger than 44 years (see Fig. 4). To become the biggest retail bank in Poland, mBank needs only to maintain its current young client base and the pace of new client acquisition. Mortgage loans are taken mostly by young people (see Fig. 5) and thus the activity in mortgage lending is necessary to increase the client base. Recently, due to low market share in rising Zloty-denominated mortgages, the bank has been losing market share in mortgage loans (Fig. 6) but the recent pick-up in mortgage production (+76% yoy in 2Q14 – see Fig 24) bodes well for the future.

Figure 4. Polish Banks – Share of Clients Below 44 Years Old, 2013 (Percentage)



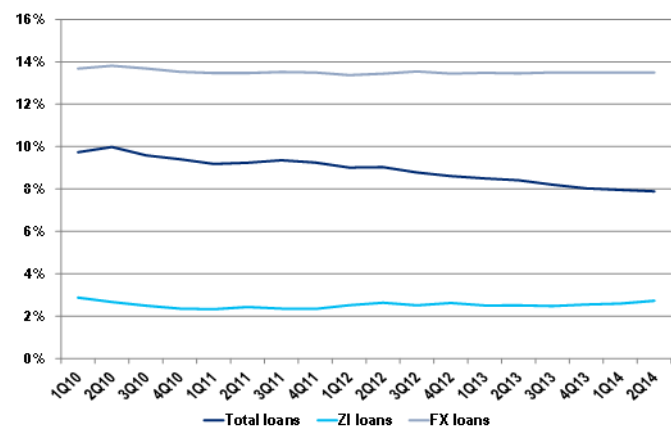
Source: Company reports

Figure 5. Poland – Split of Number of New Mortgage Loans According to the Debtor Age, 2013 (Thousands)



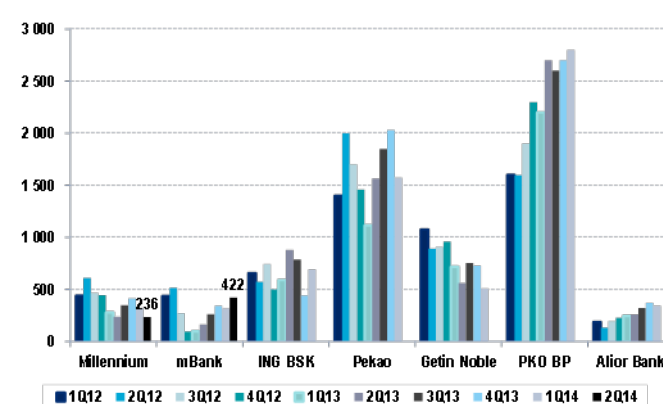
Source: BIK

Figure 6. mBank – Market Share in Mortgage Loans, 1Q10-2Q14 (Percentage)



Source: Company reports, NBP and Citi Research

Figure 7. Polish Banks – Quarterly Mortgage Production, 1Q12-2Q14 (Polish Zloty in million)



Source: Company reports

## More Than Just a Bank

mBank's business model is to acquire new clients through its best-in-class transactional on-line platform and cross-sell not only consumer loans but also investment products. We appreciate the significant increase in sales of investment products and in assets under administration – see Fig. 31-32 – and we think mBank is one of the financial institutions best positioned for an expected acceleration in growth of demand for investment products (see: [Polish Financial Services - Investment Products – Trust Is the Name of the Game](#)) and insurance (the bank notes the relatively high share of stand-alone products in insurance sales – see Fig 33-34).

## Following Alior's Footsteps

We appreciate mBank's business model and view the bank as a larger incarnation of Alior, perceived by some investors as the most innovative Polish bank. We note that mBank has followed in Alior's footsteps three times:

- The implementation of Alior Sync has inspired mBank to launch its new internet banking platform "New mBank";
- Following the Alior's joint-venture with T-Mobile in December 2013, in March 2014 mBank announced a joint-venture with the other leading Polish telecom, Orange Polska;
- In June 2014 mBank started granting loans to clients of Allegro, the biggest Polish online auction website, following Alior, which previously was the only bank present on the platform.

## FX Mortgage Risk

Due to mBank's declining but still relatively high exposure to FX mortgages (c30% of total loans), we continue to see the bank as at risk to legal and political action related to FX mortgages.

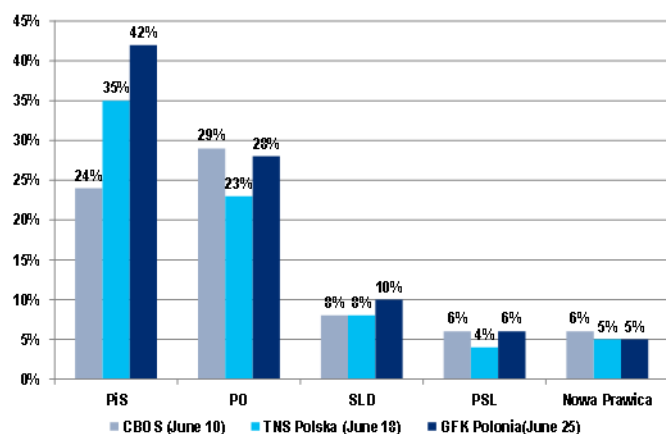
Recently the bank lost a class action law suit regarding the way it set the interest rate on part of its FX mortgage book. The bank has also lost a few individual cases regarding the same topic. mBank has declared it would appeal to the Supreme Court to finally clarify rulings on this topic.

We think the potential loss related to the claims of 1,247 clients who have sued the bank in the class action suit (ZI c5m according to PAP and ZI 7m according to Bankier.pl - we think that these amounts include only client losses since January 2009 to February 2010 and the total costs for banks may exceed ZI 30m) are covered by provisions (mBank's new provisions for future obligations, including potential litigation costs, reached ZI 52m in 2012, ZI 43m in 2013 and ZI 38m in 1H14). If all 26,000 clients with the products in question sue the bank, the costs may exceed ZI 600m. The bank has reached settlement with many of the involved clients and thus we view losses of this magnitude as improbable but further litigation by other customers, encouraged by the positive outcome of the class action suit, seems very likely.

Implementation of any "Hungarian-style" solution to FX mortgage in Poland, through client court actions or new legislation, would be very damaging for mBank. The main opposition party, PiS, favours "Hungarian style" economic policies and, according to the most recent polls, has 12pp-14pp higher support than the ruling PO. We see the risk of legislation forcing the conversion of FX mortgages to Zloty at unfavourable exchange rates as low due to potential opposition from debtors that have decided on Zloty-denominated mortgages and have paid higher interest rates to avoid FX risk.

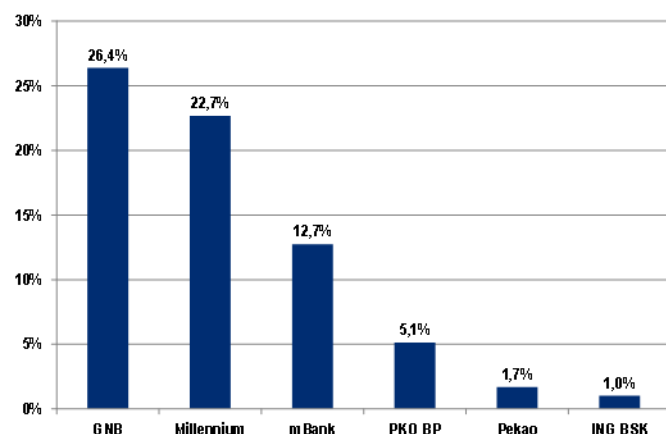
In our opinion, unfavourable court rulings on the FX spread are more likely, given that in Poland, like in Hungary, the spread was and is charged despite the lack of actual foreign currency exchange (the vast majority of FX-loans were paid to the real-estate seller in Zloty and are paid back by clients in Zloty and they are only denominated in FX). We note that in June Millennium was sued in the first class action suit related to that topic: 2,273 clients demand ZI 45m due to, in their opinion, illegally charged FX spreads (for details see [Polish Financial Weekly - Will Clients Sue Polish Banks for Unfair FX Rates?](#)).

Figure 8. Poland – Election Polls, July 2014 (Percentage)



Source: GfK Polonia, TNS Polska and CBOS

Figure 9. Polish Banks – Impact on the Bank Equity of the Potential Court Ruling Regarding FX Mortgage Spreads\*, 1Q14 (Percentage)



\*Average spreads June 6th, 2005-2014; Equity as of 1Q14

Source: Company reports, banks and Citi Research

## Dupont Analysis

mBank's ROE declined less than the industry benchmark (defined as the average ratios of large listed banks, i.e. we excluded Alior and BNPP Polska from our Polish coverage universe) and we expect it will reach 12.7% in 2014 vs. 15.3% in 2011 (we forecast the industry benchmark ROE to drop from 16.5% to 12.0%, respectively). The decline in the bank's ROE was caused by the decline in the equity leverage (equity as the percentage of assets rose to c9.8% from 8.1% in 2011).

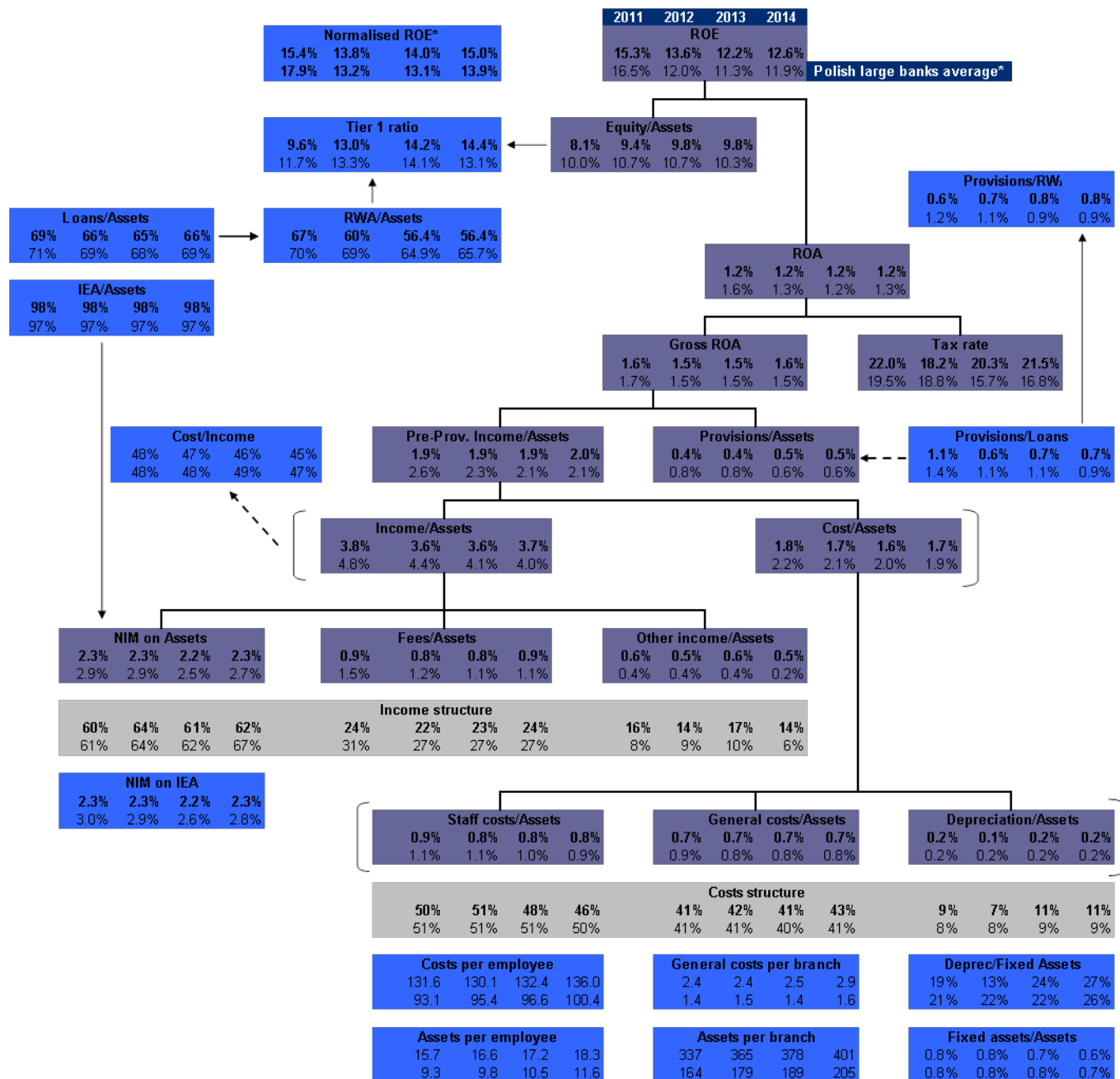
The core revenues as the percentage of average total assets declined in 2012 but in 2014 are on track to recover to the 2011 level (net interest income to 2.3%, net fees to 0.9%) and only financial and other income, according to our estimates, will be lower in 2014 than in 2011 (0.5% of average assets vs. 0.6%) and income to assets ratio will decline insignificantly from 3.8% to 3.7%, respectively but still is lower than the industry benchmark (we forecast it to decline to 4.0% from 4.8%).

mBank continues to benefit from the high share of mortgage loans and its modern distribution model (see – [Polish Banks - Follow Client Flows: Time to Close Branches?](#)) and its costs to assets ratio (1.7% in 2014, according to our estimates) is below the industry average (1.9%) but the gap has shrunk (in 2011 the ratios were, respectively, 1.8% and 2.2%). The bank's cost of risk also remains below the industry average (0.5% of assets vs. 0.6%) but, like in the case of costs, the difference between mBank and the industry has declined (in 2011 the ratios were 0.4% and 0.8%).

In the coming years we expect mBank to increase its ROE to 14.8% in 2017 from 12.7% in 2014, i.e. to remain c7bp above the industry benchmark. According to our estimates, the increase in profitability will be driven by:

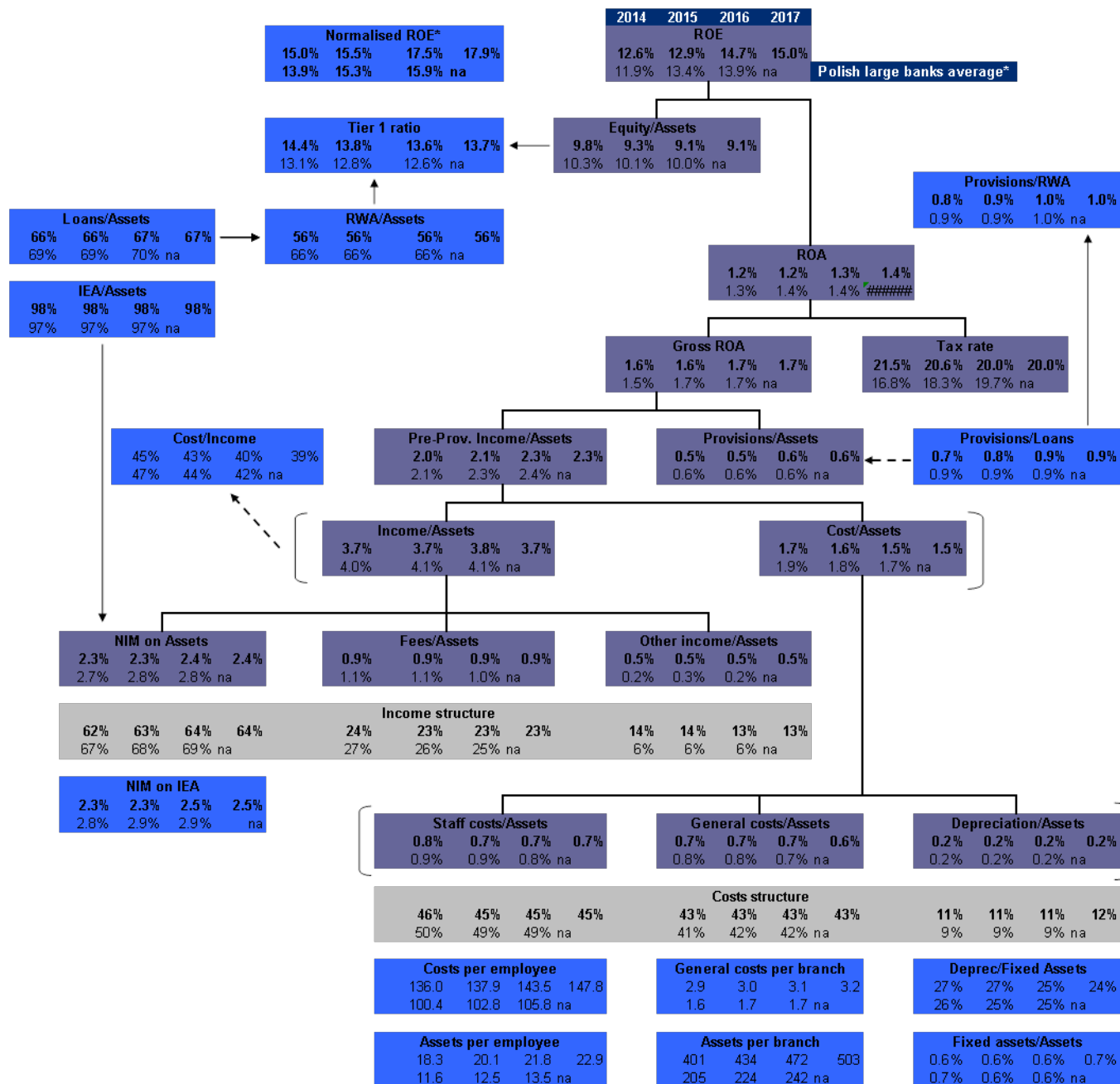
- An improvement in asset mix (the replacement of low-margin FX mortgages by higher-margin Zloty mortgages, the rising share of loans to smaller corporate clients), leading to higher NIM and higher cost of risk;
- Growth in total assets, leading to lower cost-to-assets and higher equity-to-assets ratios.

Figure 10. mBank – ROE Decomposition, 2011-2014E (Percentage)



Source: Company reports and Citi Research

Figure 11. mBank – ROE Decomposition, 2014E-2017E (Percentage)



Source: Company reports and Citi Research

## Valuation

Figure 12. mBank – Valuation Table Summary

|                                    |              |
|------------------------------------|--------------|
| EVA                                | 459.9        |
| Warranted Equity Valuation         | 483.6        |
| Warranted Equity Valuation - ROTE  | 492.0        |
| <b>Average</b>                     | <b>478.5</b> |
| Price Target (PLUG)                | 492.0        |
| Current share price                | 463.0        |
| Upside / (Downside)                | 6.6%         |
| DPS (2014E)                        | 23.72        |
| Dividend yield (%)                 | 5.1%         |
| <b>Total Expected Return (ETR)</b> | <b>11.8%</b> |

Source: Citi Research

Figure 13. mBank – Warranted Equity Valuation – ROTE

|                                |              |
|--------------------------------|--------------|
| Sustainable ROTE               | 15.80%       |
| COE                            | 10.25%       |
| Growth                         | 4.50%        |
| Target P/TBPS multiple         | 1.97         |
| 2017E TEPS                     | 282.9        |
| 2016E Target Value Per Share   | 555.9        |
| Months to Discount to Aug 2015 | 28           |
| <b>Discounted</b>              | <b>442.7</b> |
| 2015E DPS                      | 25.7         |
| Months to Discount to Aug 2015 | 10           |
| <b>Discounted</b>              | <b>23.7</b>  |
| 2016E DPS                      | 30.6         |
| Months to Discount to Aug 2015 | 22           |
| <b>Discounted</b>              | <b>25.6</b>  |
| Value per share                | 492.0        |
| Upside / (Downside)            | 6.3%         |

Source: Citi Research

Figure 14. mBank – Warranted Equity Valuation

|                                |              |
|--------------------------------|--------------|
| Sustainable ROE                | 15.00%       |
| COE                            | 10.25%       |
| Growth                         | 4.50%        |
| Target P/BV multiple           | 1.83         |
| <b>2017E BVPS</b>              | <b>298.7</b> |
| 2017E Target Value Per Share   | 545.4        |
| Months to Discount to Aug 2015 | 28           |
| <b>Discounted</b>              | <b>434.3</b> |
| 2015E DPS                      | 25.7         |
| Months to Discount to Aug 2015 | 10           |
| <b>Discounted</b>              | <b>23.7</b>  |
| 2016E DPS                      | 30.6         |
| Months to Discount to Aug 2015 | 22           |
| <b>Discounted</b>              | <b>25.6</b>  |
| Value per share                | 483.59       |
| Upside / (Downside)            | 4.4%         |

Source: Citi Research

## Changes in Forecasts

Taking into account 2Q14 results, we have lowered our EPS estimates by 0.1% this year, 3% the next year and 1% in 2016. There were two main drivers of the changes:

- Firstly, reflecting the higher probability of lower rates, we lower our NII forecasts by 0.4%, 3% and 2%, respectively;
- Secondly, taking into account higher general costs in 2Q14, attributed by the bank to higher marketing spend and investment in new projects, we raise our projections of administrative costs by 3%, 2% and 2%, respectively.

Figure 15. mBank – OLD/NEW P&L Estimates, 2014E-2016E

| GROUP                                | 2014E           |                 |              | 2015E           |                 |              | 2015E           |                 |              |
|--------------------------------------|-----------------|-----------------|--------------|-----------------|-----------------|--------------|-----------------|-----------------|--------------|
|                                      | OLD             | NEW             | Diff.        | OLD             | NEW             | Diff.        | OLD             | NEW             | Diff.        |
| Net Interest Income                  | 2,491.1         | 2,480.3         | -0.4%        | 2,777.0         | 2,687.0         | -3.2%        | 3,106.0         | 3,052.9         | -1.7%        |
| Net Fee & Commission Income          | 963.4           | 957.1           | -0.7%        | 1,008.0         | 1,008.0         | 0.0%         | 1,108.8         | 1,108.8         | 0.0%         |
| Financial Income                     | 81.8            | 111.3           | 36.1%        | 88.0            | 88.0            | 0.0%         | 100.0           | 100.0           | 0.0%         |
| Other Income                         | 415.4           | 459.2           | 10.6%        | 471.8           | 513.5           | 8.8%         | 494.6           | 536.4           | 8.5%         |
| <b>Total Revenue</b>                 | <b>3,951.7</b>  | <b>4,008.0</b>  | <b>1.4%</b>  | <b>4,344.7</b>  | <b>4,296.4</b>  | <b>-1.1%</b> | <b>4,809.4</b>  | <b>4,798.1</b>  | <b>-0.2%</b> |
| Labour Costs                         | -837.9          | -830.2          | -0.9%        | -852.3          | -841.9          | -1.2%        | -880.0          | -871.9          | -0.9%        |
| General Costs                        | -722.5          | -780.7          | 8.0%         | -773.5          | -805.5          | 4.1%         | -799.8          | -832.7          | 4.1%         |
| Depreciation                         | -187.5          | -193.9          | 3.4%         | -199.0          | -208.0          | 4.5%         | -208.9          | -218.3          | 4.5%         |
| <b>Operating Expenses</b>            | <b>-1,747.9</b> | <b>-1,804.7</b> | <b>3.3%</b>  | <b>-1,824.8</b> | <b>-1,855.3</b> | <b>1.7%</b>  | <b>-1,888.7</b> | <b>-1,923.0</b> | <b>1.8%</b>  |
| <b>Operating Profit</b>              | <b>2,203.8</b>  | <b>2,203.3</b>  | <b>0.0%</b>  | <b>2,520.0</b>  | <b>2,441.1</b>  | <b>-3.1%</b> | <b>2,920.7</b>  | <b>2,875.2</b>  | <b>-1.6%</b> |
| Provision Charge                     | -510.8          | -496.4          | -2.8%        | -633.6          | -614.3          | -3.0%        | -741.4          | -718.8          | -3.0%        |
| Profit/(Loss) from Equity Investees  | 0.0             | 0.0             | na           | 0.0             | 0.0             | na           | 0.0             | 0.0             | na           |
| <b>Profit Before Tax</b>             | <b>1,693.1</b>  | <b>1,706.9</b>  | <b>0.8%</b>  | <b>1,886.4</b>  | <b>1,826.8</b>  | <b>-3.2%</b> | <b>2,179.3</b>  | <b>2,156.3</b>  | <b>-1.1%</b> |
| Minorities                           | -4.0            | -4.5            | 11.9%        | -4.0            | -4.0            | 0.0%         | -4.7            | -4.8            | 2.2%         |
| Tax                                  | -352.3          | -366.5          | 4.0%         | -387.6          | -375.5          | -3.1%        | -435.9          | -431.3          | -1.1%        |
| Discontinued operations (after tax)  | 0.0             | 0.0             | na           | 0.0             | 0.0             | na           | 0.0             | 0.0             | na           |
| <b>Net Profit</b>                    | <b>1,336.7</b>  | <b>1,335.9</b>  | <b>-0.1%</b> | <b>1,494.8</b>  | <b>1,447.3</b>  | <b>-3.2%</b> | <b>1,738.8</b>  | <b>1,720.3</b>  | <b>-1.1%</b> |
| EPS (ZI)                             | 31.7            | 31.7            | -0.1%        | 35.4            | 34.3            | -3.3%        | 41.2            | 40.8            | -1.1%        |
| DPS (ZI)                             | 23.8            | 23.7            | -0.2%        | 26.6            | 25.7            | -3.3%        | 30.9            | 30.6            | -1.1%        |
| Average Diluted Number of Shares (m) | 42.2            | 42.2            | 0.1%         | 42.2            | 42.2            | 0.1%         | 42.2            | 42.2            | 0.1%         |

Source: Citi Research

Figure 16. mBank – Key P&L Data, 2008-2017E (Polish Zloty in million)

| GROUP                                | 2008          | 2009          | chg         | 2010          | chg         | 2011          | chg        | 2012          | chg        | 2013          | chg       | 2014E         | chg        | 2015E         | chg        | 2016E         | chg        | 2017E         | chg       |
|--------------------------------------|---------------|---------------|-------------|---------------|-------------|---------------|------------|---------------|------------|---------------|-----------|---------------|------------|---------------|------------|---------------|------------|---------------|-----------|
| Net Interest Income                  | 1,392         | 1,658         | 19%         | 1,811         | 9%          | 2,149         | 19%        | 2,280         | 6%         | 2,226         | -2%       | 2,480         | 11%        | 2,687         | 8%         | 3,053         | 14%        | 3,255         | 7%        |
| Net Fee & Commission Income          | 552           | 595           | 8%          | 746           | 25%         | 840           | 13%        | 787           | -6%        | 835           | 6%        | 957           | 15%        | 1,008         | 5%         | 1,109         | 10%        | 1,164         | 5%        |
| Financial Income                     | -35           | -9            | -73%        | 86            | na          | 42            | -51%       | 78            | 84%        | 139           | 79%       | 111           | -20%       | 88            | -21%       | 100           | 14%        | 100           | 0%        |
| Other Income                         | 640           | 608           | -5%         | 482           | -21%        | 533           | 11%        | 427           | -20%       | 474           | 11%       | 459           | -3%        | 513           | 12%        | 536           | 4%         | 563           | 5%        |
| <b>Total Revenue</b>                 | <b>2,549</b>  | <b>2,851</b>  | <b>12%</b>  | <b>3,125</b>  | <b>10%</b>  | <b>3,564</b>  | <b>14%</b> | <b>3,571</b>  | <b>0%</b>  | <b>3,674</b>  | <b>3%</b> | <b>4,008</b>  | <b>9%</b>  | <b>4,296</b>  | <b>7%</b>  | <b>4,798</b>  | <b>12%</b> | <b>5,082</b>  | <b>6%</b> |
| Labour Costs                         | -739          | -645          | -13%        | -744          | 15%         | -810          | 9%         | -808          | 0%         | -808          | 0%        | -830          | 3%         | -842          | 1%         | -872          | 4%         | -898          | 3%        |
| General Costs                        | -607          | -641          | 5%          | -636          | -1%         | -661          | 4%         | -657          | -1%        | -682          | 4%        | -781          | 14%        | -806          | 3%         | -833          | 3%         | -861          | 3%        |
| Depreciation                         | -203          | -259          | 27%         | -237          | -9%         | -251          | 6%         | -196          | -22%       | -188          | -4%       | -194          | 3%         | -208          | 7%         | -218          | 5%         | -229          | 5%        |
| <b>Operating Expenses</b>            | <b>-1,550</b> | <b>-1,545</b> | <b>0%</b>   | <b>-1,617</b> | <b>5%</b>   | <b>-1,723</b> | <b>7%</b>  | <b>-1,661</b> | <b>-4%</b> | <b>-1,678</b> | <b>1%</b> | <b>-1,805</b> | <b>8%</b>  | <b>-1,855</b> | <b>3%</b>  | <b>-1,923</b> | <b>4%</b>  | <b>-1,988</b> | <b>3%</b> |
| <b>Operating Profit</b>              | <b>999</b>    | <b>1,307</b>  | <b>31%</b>  | <b>1,507</b>  | <b>15%</b>  | <b>1,841</b>  | <b>22%</b> | <b>1,909</b>  | <b>4%</b>  | <b>1,995</b>  | <b>5%</b> | <b>2,203</b>  | <b>10%</b> | <b>2,441</b>  | <b>11%</b> | <b>2,875</b>  | <b>18%</b> | <b>3,094</b>  | <b>8%</b> |
| Provision Charge                     | -269          | -1,097        | 308%        | -635          | -42%        | -373          | -41%       | -445          | 19%        | -478          | 7%        | -496          | 4%         | -614          | 24%        | -719          | 17%        | -772          | 7%        |
| Associate Income                     | 0             | 0             | na          | 0             | na          | 0             | na         | 0             | na         | 0             | na        | 0             | na         | 0             | na         | 0             | na         | 0             | na        |
| <b>Profit Before Tax</b>             | <b>730</b>    | <b>209</b>    | <b>-71%</b> | <b>873</b>    | <b>317%</b> | <b>1,467</b>  | <b>68%</b> | <b>1,465</b>  | <b>0%</b>  | <b>1,518</b>  | <b>4%</b> | <b>1,707</b>  | <b>12%</b> | <b>1,827</b>  | <b>7%</b>  | <b>2,156</b>  | <b>18%</b> | <b>2,322</b>  | <b>8%</b> |
| Minorities                           | -32           | -2            | -95%        | -19           | 1108%       | -9            | -51%       | -1            | -94%       | -3            | 348%      | -4            | 71%        | -4            | -10%       | -5            | 19%        | -5            | 8%        |
| Tax                                  | -108          | -79           | -27%        | -212          | 168%        | -323          | 52%        | -267          | -17%       | -309          | 16%       | -367          | 19%        | -375          | 2%         | -431          | 15%        | -464          | 8%        |
| Discontinued operations (after tax)  | 268           | 0             | na          | 0             | na          | 0             | na         | 0             | na         | 0             | na        | 0             | na         | 0             | na         | 0             | na         | 0             | na        |
| <b>Net Profit</b>                    | <b>858</b>    | <b>129</b>    | <b>-85%</b> | <b>642</b>    | <b>398%</b> | <b>1,135</b>  | <b>77%</b> | <b>1,197</b>  | <b>5%</b>  | <b>1,206</b>  | <b>1%</b> | <b>1,336</b>  | <b>11%</b> | <b>1,447</b>  | <b>8%</b>  | <b>1,720</b>  | <b>19%</b> | <b>1,852</b>  | <b>8%</b> |
| EPS (Zl)                             | 25.5          | 3.8           | -85%        | 16.9          | 342%        | 27.0          | 59%        | 28.4          | 5%         | 28.6          | 1%        | 31.7          | 11%        | 34.3          | 8%         | 40.8          | 19%        | 43.9          | 8%        |
| DPS (Zl)                             | 0.0           | 0.0           | na          | 0.0           | na          | 0.0           | na         | 10.0          | na         | 17.2          | 72%       | 23.7          | 38%        | 25.7          | 8%         | 30.6          | 19%        | 32.9          | 8%        |
| Average Diluted Number of Shares (m) | 33.6          | 33.6          | 0%          | 37.9          | 13%         | 42.1          | 11%        | 42.1          | 0%         | 42.2          | 0%        | 42.2          | 0%         | 42.2          | 0%         | 42.2          | 0%         | 42.2          | 0%        |

Source: Company reports and Citi Research

Figure 17. mBank – Key Balance Sheet Data, 2008-2017E (Polish Zloty in million)

| GROUP                                 | 2008          | 2009          | chg        | 2010          | chg        | 2011          | chg        | 2012           | chg        | 2013           | chg       | 2014E          | chg       | 2015E          | chg        | 2016E          | chg        | 2017E          | chg       |
|---------------------------------------|---------------|---------------|------------|---------------|------------|---------------|------------|----------------|------------|----------------|-----------|----------------|-----------|----------------|------------|----------------|------------|----------------|-----------|
| Cash and NBP Balances                 | 2,522         | 3,796         | 51%        | 2,364         | -38%       | 1,038         | -56%       | 4,819          | 364%       | 1,650          | -66%      | 1,766          | 7%        | 1,890          | 7%         | 2,022          | 7%         | 2,163          | 7%        |
| Interbank placements                  | 6,104         | 2,531         | -59%       | 2,511         | -1%        | 4,009         | 60%        | 3,945          | -2%        | 3,471          | -12%      | 3,124          | -10%      | 2,812          | -10%       | 2,531          | -10%       | 2,277          | -10%      |
| Financial Assets & Securities         | 15,760        | 16,120        | 2%         | 21,555        | 34%        | 19,197        | -11%       | 23,947         | 25%        | 28,454         | 19%       | 31,196         | 10%       | 34,360         | 10%        | 36,462         | 6%         | 38,624         | 6%        |
| <b>Net client lending</b>             | <b>52,142</b> | <b>52,469</b> | <b>1%</b>  | <b>59,370</b> | <b>13%</b> | <b>67,746</b> | <b>14%</b> | <b>66,947</b>  | <b>-1%</b> | <b>68,210</b>  | <b>2%</b> | <b>73,686</b>  | <b>8%</b> | <b>80,542</b>  | <b>9%</b>  | <b>88,596</b>  | <b>10%</b> | <b>93,026</b>  | <b>5%</b> |
| Fixed assets                          | 814           | 786           | -3%        | 778           | -1%        | 832           | 7%         | 774            | -7%        | 710            | -8%       | 781            | 10%       | 859            | 10%        | 944            | 10%        | 1,039          | 10%       |
| Other assets                          | 5,262         | 5,323         | 1%         | 3,474         | -35%       | 5,967         | 72%        | 1,713          | -71%       | 1,787          | 4%        | 1,728          | -3%       | 1,874          | 8%         | 2,017          | 8%         | 2,071          | 3%        |
| <b>Total Assets</b>                   | <b>82,605</b> | <b>81,024</b> | <b>-2%</b> | <b>90,051</b> | <b>11%</b> | <b>98,790</b> | <b>10%</b> | <b>102,145</b> | <b>3%</b>  | <b>104,283</b> | <b>2%</b> | <b>112,280</b> | <b>8%</b> | <b>122,336</b> | <b>9%</b>  | <b>132,572</b> | <b>8%</b>  | <b>139,200</b> | <b>5%</b> |
| Interbank borrowing                   | 28,791        | 27,024        | -6%        | 28,727        | 6%         | 27,391        | -5%        | 21,111         | -23%       | 19,224         | -9%       | 19,032         | -1%       | 19,984         | 5%         | 19,784         | -1%        | 19,190         | -3%       |
| <b>Client deposits</b>                | <b>37,750</b> | <b>42,791</b> | <b>13%</b> | <b>47,420</b> | <b>11%</b> | <b>54,244</b> | <b>14%</b> | <b>57,984</b>  | <b>7%</b>  | <b>61,674</b>  | <b>6%</b> | <b>67,148</b>  | <b>9%</b> | <b>74,109</b>  | <b>10%</b> | <b>81,519</b>  | <b>10%</b> | <b>85,595</b>  | <b>5%</b> |
| Other liabilities                     | 12,016        | 6,938         | -42%       | 6,827         | -2%        | 9,168         | 34%        | 13,432         | 47%        | 13,129         | -2%       | 15,105         | 15%       | 16,800         | 11%        | 19,185         | 14%        | 21,764         | 13%       |
| Minorities                            | 154           | 151           | -2%        | 168           | 11%        | 24            | -86%       | 24             | 2%         | 27             | 11%       | 32             | 16%       | 36             | 13%        | 40             | 13%        | 45             | 13%       |
| <b>Equity (ex Minorities)</b>         | <b>3,894</b>  | <b>4,120</b>  | <b>6%</b>  | <b>6,909</b>  | <b>68%</b> | <b>7,963</b>  | <b>15%</b> | <b>9,594</b>   | <b>20%</b> | <b>10,229</b>  | <b>7%</b> | <b>10,963</b>  | <b>7%</b> | <b>11,409</b>  | <b>4%</b>  | <b>12,043</b>  | <b>6%</b>  | <b>12,605</b>  | <b>5%</b> |
| <b>Total liabilities &amp; Equity</b> | <b>82,606</b> | <b>81,024</b> | <b>-2%</b> | <b>90,051</b> | <b>11%</b> | <b>98,790</b> | <b>10%</b> | <b>102,145</b> | <b>3%</b>  | <b>104,283</b> | <b>2%</b> | <b>112,280</b> | <b>8%</b> | <b>122,336</b> | <b>9%</b>  | <b>132,572</b> | <b>8%</b>  | <b>139,200</b> | <b>5%</b> |
| <b>Interest Earning Assets</b>        | <b>79,973</b> | <b>78,431</b> | <b>-2%</b> | <b>87,631</b> | <b>12%</b> | <b>96,330</b> | <b>10%</b> | <b>99,658</b>  | <b>3%</b>  | <b>101,787</b> | <b>2%</b> | <b>109,772</b> | <b>8%</b> | <b>119,603</b> | <b>9%</b>  | <b>129,610</b> | <b>8%</b>  | <b>136,091</b> | <b>5%</b> |
| BVPS (Zl)                             | 116           | 123           | 6%         | 164           | 34%        | 189           | 15%        | 228            | 20%        | 243            | 7%        | 260            | 7%        | 270            | 4%         | 285            | 6%         | 299            | 5%        |

Source: Company reports and Citi Research

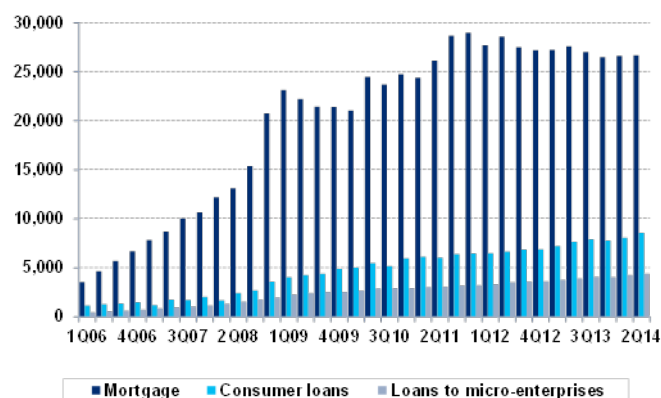
Figure 18. mBank – Key Ratios, 2008-2017E (Percentage)

| GROUP                      | 2008   | 2009   | 2010   | 2011   | 2012   | 2013   | 2014E  | 2015E  | 2016E  | 2017E  |
|----------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| NIM on AIEA                | 2.09%  | 2.09%  | 2.18%  | 2.34%  | 2.33%  | 2.21%  | 2.34%  | 2.34%  | 2.45%  | 2.45%  |
| NIM on Total Ave. Assets   | 2.01%  | 2.03%  | 2.12%  | 2.28%  | 2.27%  | 2.16%  | 2.29%  | 2.29%  | 2.40%  | 2.40%  |
| NF&C/Total Income          | 21.6%  | 20.9%  | 23.9%  | 23.6%  | 22.0%  | 22.7%  | 23.9%  | 23.5%  | 23.1%  | 22.9%  |
| NF&C/Deposits              | 1.5%   | 1.4%   | 1.6%   | 1.5%   | 1.4%   | 1.4%   | 1.4%   | 1.4%   | 1.4%   | 1.4%   |
| Cost/Income                | 60.8%  | 54.2%  | 51.8%  | 48.3%  | 46.5%  | 45.7%  | 45.0%  | 43.2%  | 40.1%  | 39.1%  |
| Cost/Avg. Assets           | 2.2%   | 1.9%   | 1.9%   | 1.8%   | 1.7%   | 1.6%   | 1.7%   | 1.6%   | 1.5%   | 1.5%   |
| Effective tax rate         | 14.9%  | 37.7%  | 24.3%  | 22.0%  | 18.2%  | 20.3%  | 21.5%  | 20.6%  | 20.0%  | 20.0%  |
| Dividend Payout Ratio      | 0.0%   | 0.0%   | 0.0%   | 0.0%   | 35.2%  | 60.0%  | 75.0%  | 75.0%  | 75.0%  | 75.0%  |
| Provisions/Avg Net Loans   | 0.63%  | 2.10%  | 1.14%  | 0.59%  | 0.66%  | 0.71%  | 0.70%  | 0.80%  | 0.85%  | 0.85%  |
| Equity/Assets              | 4.9%   | 5.3%   | 7.9%   | 8.1%   | 9.4%   | 9.8%   | 9.8%   | 9.4%   | 9.1%   | 9.1%   |
| Loans/Deposits             | 138.1% | 122.6% | 125.2% | 124.9% | 115.5% | 110.6% | 109.7% | 108.7% | 108.7% | 108.7% |
| Loans/Total Assets         | 63.1%  | 64.8%  | 65.9%  | 68.6%  | 65.5%  | 65.4%  | 65.6%  | 65.8%  | 66.8%  | 66.8%  |
| ROE                        | 23.8%  | 3.2%   | 11.6%  | 15.3%  | 13.6%  | 12.2%  | 12.6%  | 12.9%  | 14.7%  | 15.0%  |
| ROA                        | 1.24%  | 0.16%  | 0.75%  | 1.20%  | 1.19%  | 1.17%  | 1.23%  | 1.23%  | 1.35%  | 1.36%  |
| NPLs/Total Loans           | 2.2%   | 4.7%   | 5.3%   | 4.7%   | 5.2%   | 6.3%   | 6.3%   | 6.0%   | 5.5%   | 5.0%   |
| Provision Coverage of NPLs | 73.5%  | 76.7%  | 74.6%  | 72.7%  | 69.6%  | 53.6%  | 54.4%  | 58.8%  | 64.3%  | 70.3%  |
| RWA/Total Assets           | 71.3%  | 67.2%  | 62.6%  | 66.8%  | 60.4%  | 56.4%  | 56.4%  | 56.4%  | 56.4%  | 56.4%  |
| Tier I Ratio (%)           | 5.6%   | 6.6%   | 10.4%  | 9.6%   | 13.0%  | 14.2%  | 14.4%  | 13.8%  | 13.6%  | 13.7%  |
| CAR                        | 10.0%  | 11.5%  | 15.9%  | 15.0%  | 18.7%  | 19.4%  | 17.7%  | 15.9%  | 15.2%  | 14.8%  |
| Group Employees            | 6,133  | 5,566  | 6,018  | 6,294  | 6,138  | 6,073  | 6,136  | 6,075  | 6,075  | 6,075  |

Source: Company reports and Citi Research

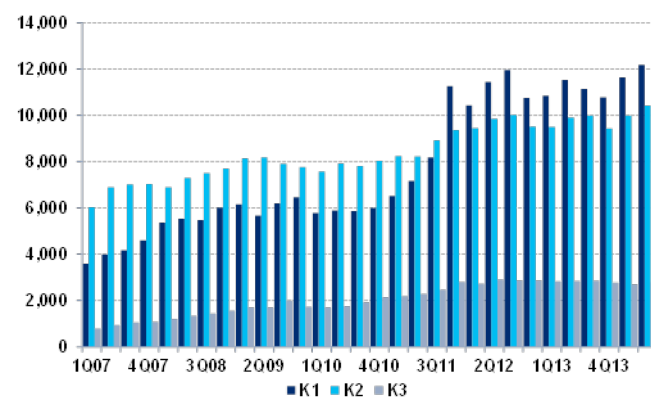
## The Recent Trends Illustrated Client Acquisition and Lending

Figure 19. mBank – Retail Loans, 1Q06-2Q14 (Percentage/Polish Zloty in million)



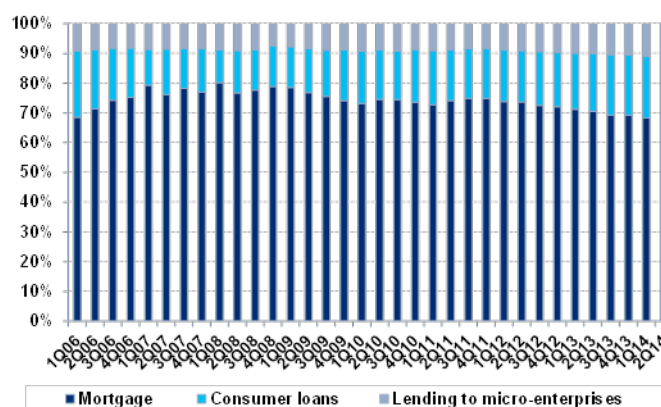
Source: Company Reports and Citi Research

Figure 20. mBank – Corporate Loans, 1Q07-2Q14 (Percentage/Polish Zloty in million)



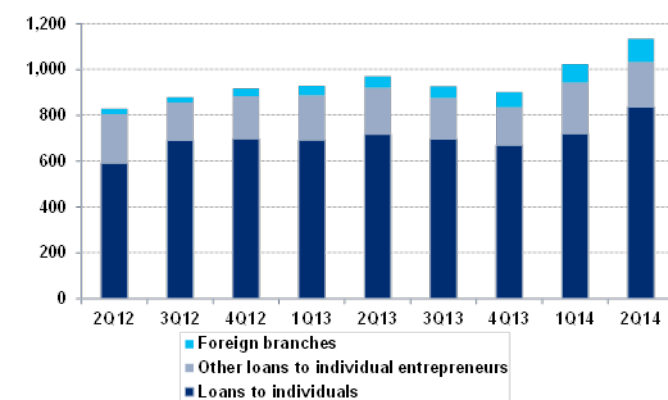
Source: Company Reports and Citi Research

Figure 21. mBank – Structure of Retail Loans, 1Q06-2Q14 (Percentage)



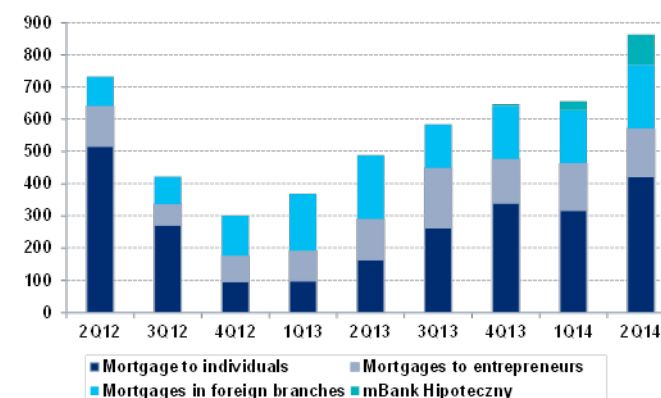
Source: Company Reports and Citi Research

Figure 22. mBank – Structure of Non-Mortgage Production, 2Q11-2Q14 (Polish Zloty in million)



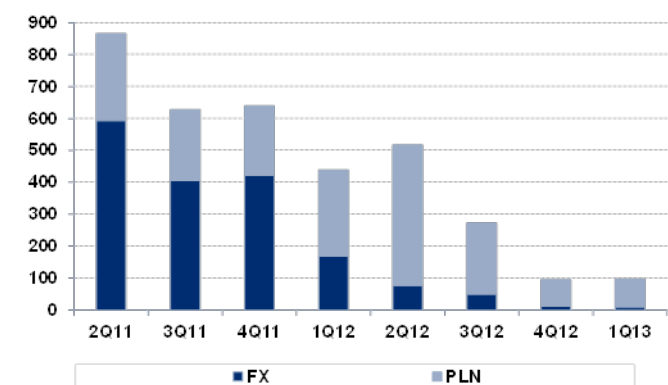
Source: Company Reports and Citi Research

Figure 23. mBank – Structure of Mortgage Production, 2Q11-2Q14 (Polish Zloty in million)



Source: Company Reports and Citi Research

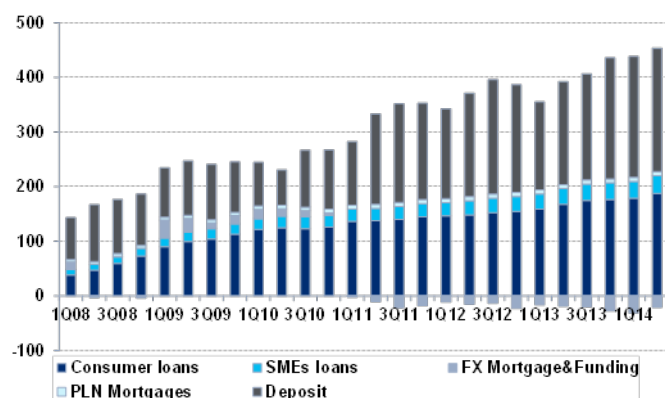
Figure 24. mBank – FX Structure of Mortgage Production (Private Individuals), 2Q11-1Q13 (Polish Zloty in million)



Source: Company Reports, Citi Research

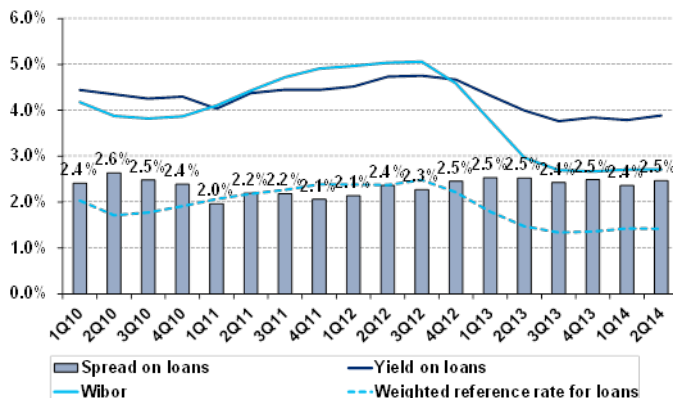
## Net Interest Income and Spreads

Figure 25. mBank – Structure of Retail NII, 1Q08-2Q14 (Polish Zloty in million)



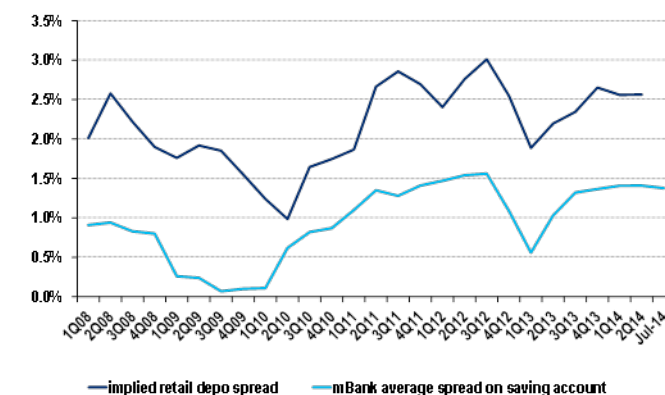
Source: Company Reports and Citi Research

Figure 26. mBank – Lending Spread, 1Q10-2Q14 (Percentage)



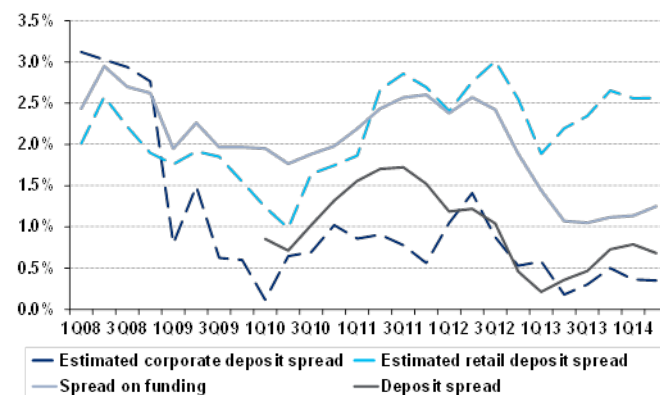
Source: Company Reports and Citi Research

Figure 27. mBank – Retail Deposit Spread vs. mBank's Spread on Saving Account, 1Q08-Jul-14 (Percentage)



Source: Company Reports and Citi Research

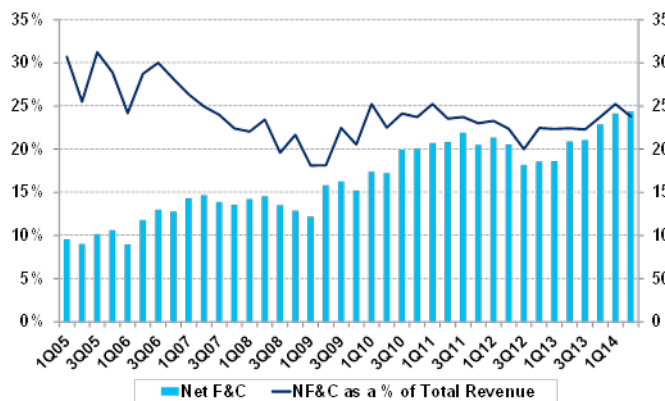
Figure 28. mBank – Funding Spread, 1Q08-2Q14 (Percentage)



Source: Company Reports and Citi Research

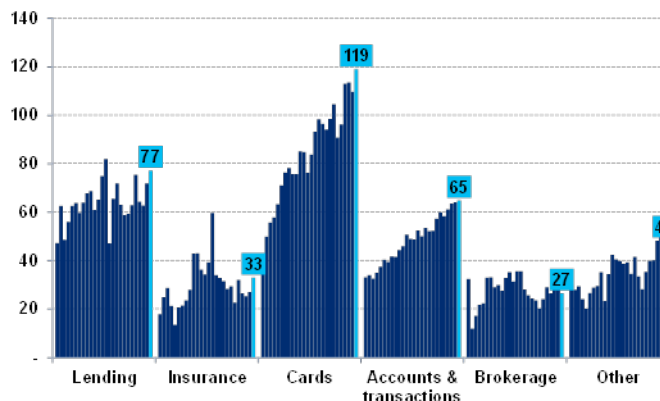
## Net Fees

Figure 29. mBank – Net Fees as Percentage of Total Revenues, 1Q08-2Q14 (Percentage/Polish Zloty in million)



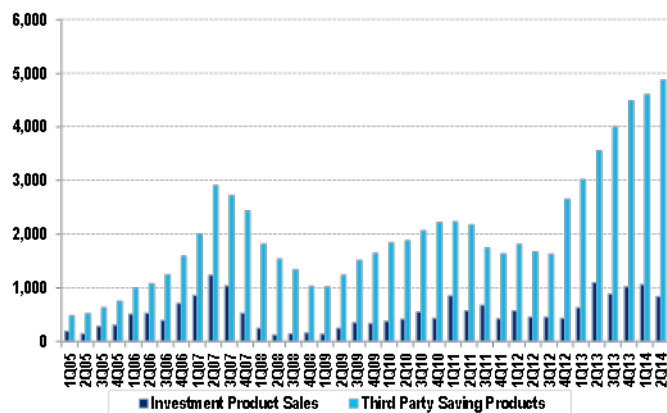
Source: Company Reports and Citi Research

Figure 30. mBank – Net Fees, 1Q08-2Q14 (Polish Zloty in million)



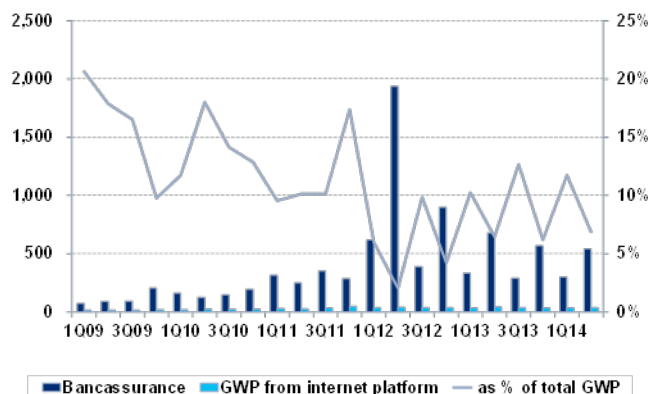
Source: Company Reports and Citi Research

Figure 31. mBank – Investment Products Sales and Third Party Saving Products Volume, 1Q05-2Q14 (Polish Zloty in million)



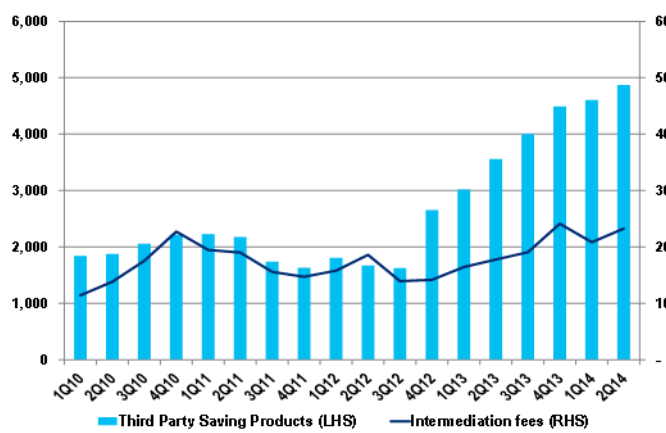
Source: Company reports

Figure 33. BRE Ubezpieczenia – Gross Written Premium, 1Q09-2Q14 (Polish Zloty in million/Percentage)



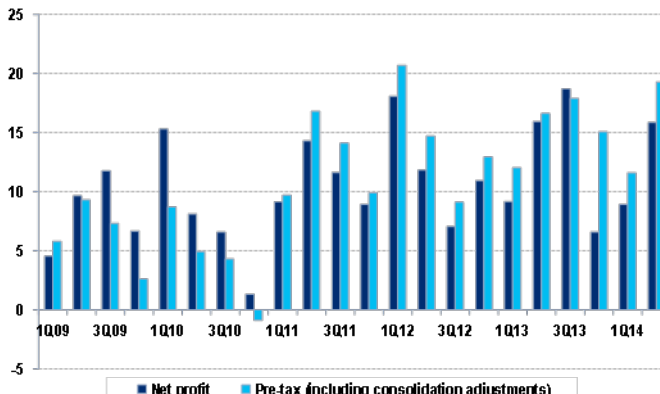
Source: Citi Research

Figure 32. mBank – Third Party Saving Products Volume and Intermediation Fees, 1Q10-2Q14 (Polish Zloty in million)



Source: Company reports

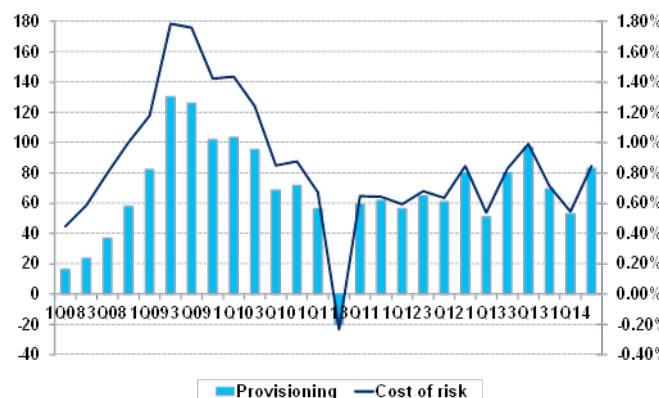
Figure 34. BRE Ubezpieczenia – Pre-tax and Net Profit, 1Q09-2Q14 (Polish Zloty in million/Percentage)



Source: Citi Research

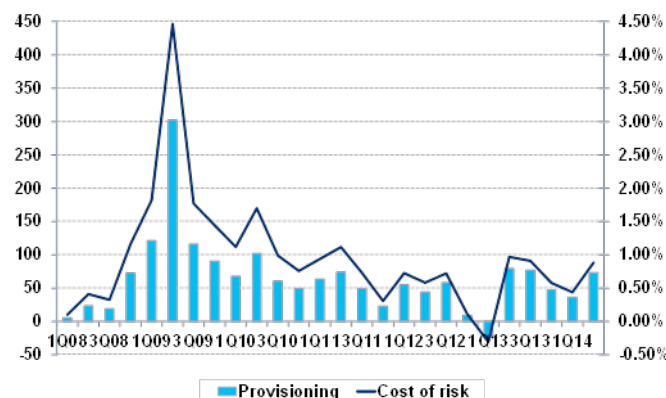
## Net Provisioning

Figure 35. mBank – Retail Provisioning, 1Q08-2Q14 (Polish Zloty in million/Percentage)



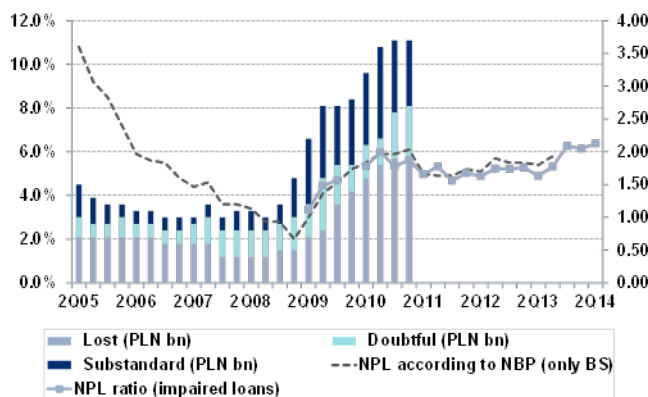
Source: Company Reports and Citi Research

Figure 36. mBank – Corporate Provisioning, 1Q08-2Q14 (Polish Zloty in million/Percentage)



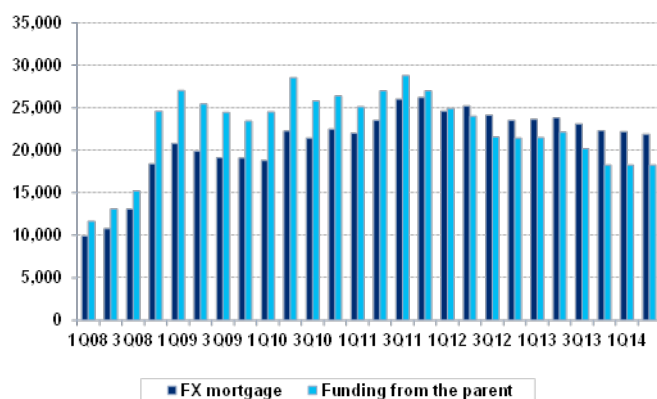
Source: Company Reports and Citi Research

Figure 37. mBank–NPLs Ratio and NPLs (according to NBP classification), 1Q09-2Q14 (Percentage/Polish Zloty in billion)



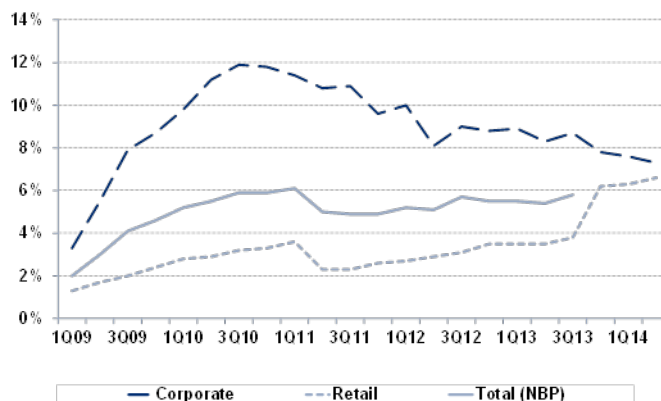
Source: Company Reports and Citi Research

Figure 39. mBank – FX Mortgages and Funding From the Parent, 1Q08-2Q14 (Polish Zloty in million)



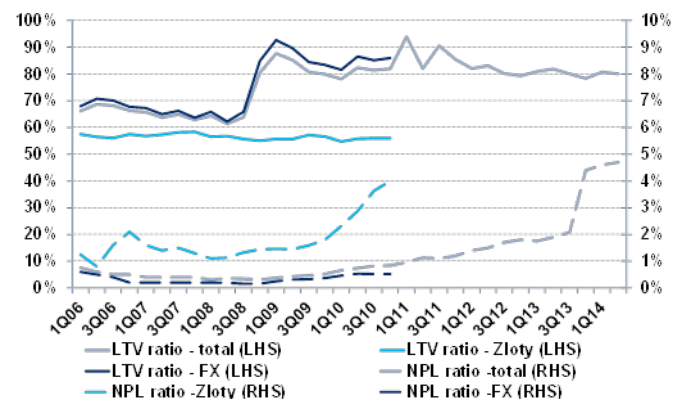
Source: Company Reports and Citi Research

Figure 38. mBank– Retail and Corporate NPL Ratios, 1Q09-2Q14 (Percentage)



Source: Company Reports and Citi Research

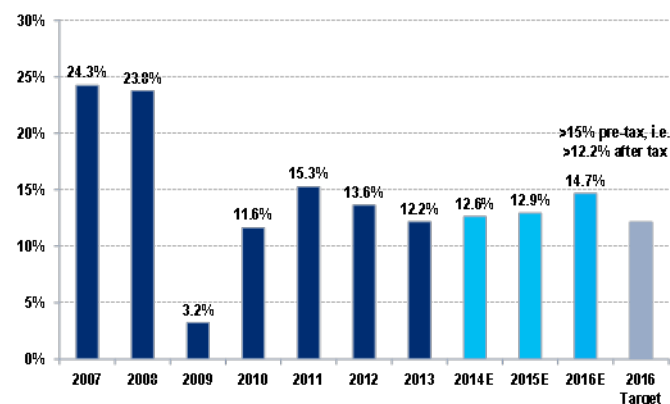
Figure 40. mBank – Mortgage Loan-to-Value (LTV) and NPL Ratios, 1Q06-2Q14 (Percentage)



Source: Company Reports and Citi Research

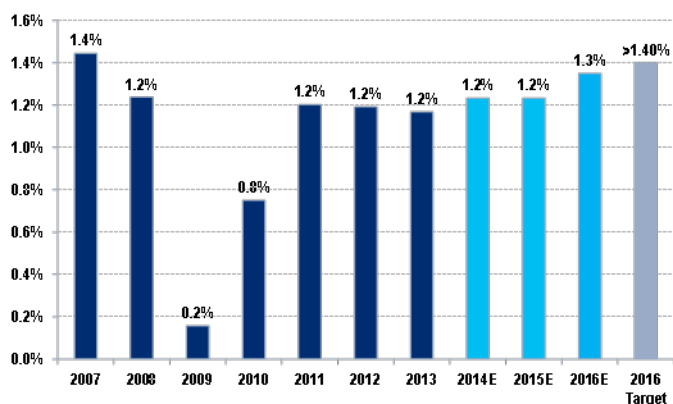
## Strategy Target vs. Citi Forecasts

Figure 41. mBank – ROE, 2007-2016E (Percentage)



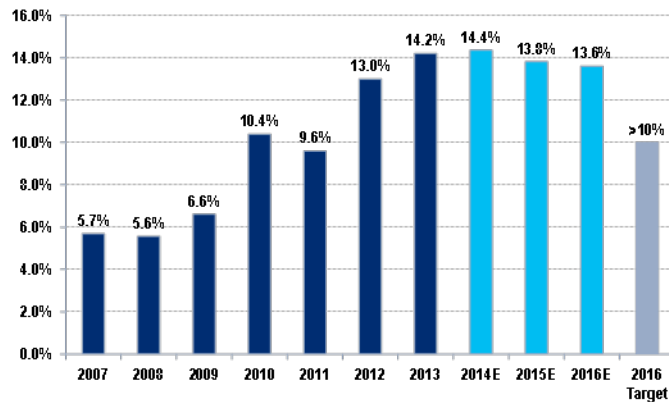
Source: Company reports and Citi Research

Figure 42. mBank – ROA 2007-2016E (Percentage)



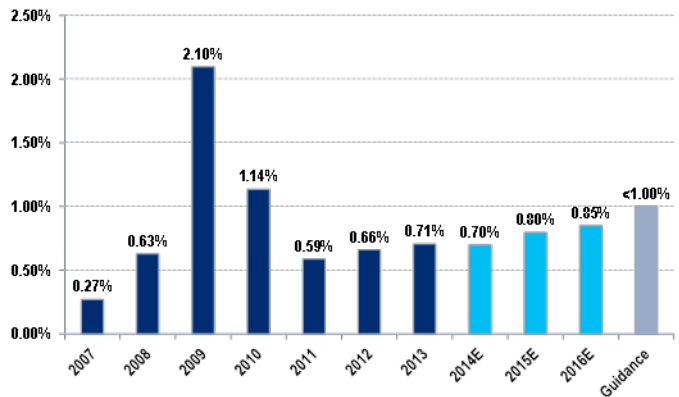
Source: Company reports and Citi Research

Figure 43. mBank – Tier 1, 2007-2016E (Percentage)



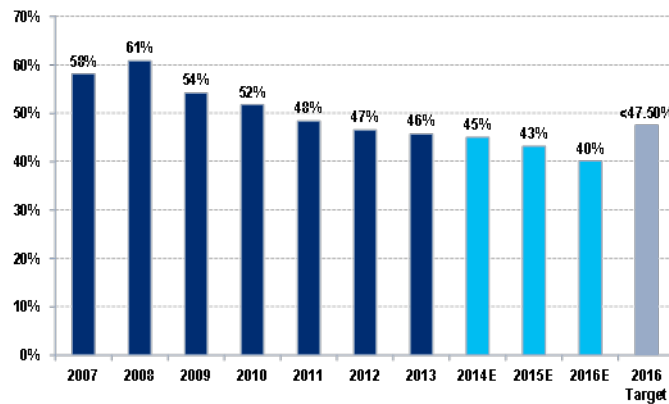
Source: Company reports and Citi Research

Figure 44. mBank – Cost of Risk, 2007-2016E (Percentage)



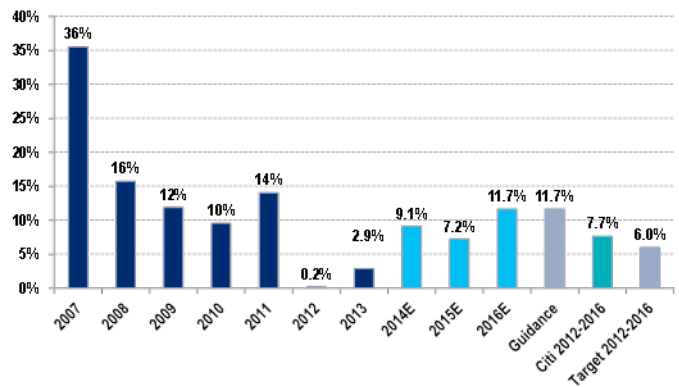
Source: Company reports and Citi Research

Figure 45. mBank – Costs-to-Income Ratio, 2007-2016E (Percentage)



Source: Company reports and Citi Research

Figure 46. mBank – Revenues Growth, 2007-2016E (Percentage)



Source: Company reports and Citi Research

## mBank SA

### Company description

mBank (70% owned by Commerzbank) is the fourth-largest Polish bank, with a market share of approximately 8% of banking assets. Historically, it has focused on commercial banking, although since 2001 it has been expanding its retail business, from 8% of its lending in 2000 to 54% in 2012. In November 2013, the bank was re-branded from BRE Bank to mBank.

### Investment strategy

What we like in the bank is the focus on tight cost management, its low exposure to the most troubled construction companies and mBank's business model of consumer finance (based on lending to current clients). However, these positives are offset by the high share of low-margin FX mortgage loans and funding from the parent banks in the balance sheet. We perceive the market price as fair and rate the stock Neutral.

### Valuation

Our Standard Warranted Equity Valuation (WEV) is based upon the formula:  $\text{Price} / \text{Book value} = (\text{Sustainable RoE} - \text{growth}) / (\text{Cost of equity} - \text{growth})$ . We assume a sustainable return on equity of 15.0%, sustainable ROTE 15.8%, a cost of equity of 10.25% and a sustainable growth rate of 4.5%. In WEV based on return on equity we arrive at ZI 484 fair value and in WEV based return on tangible equity at ZI 492. Our Economic Value Added Valuation of ZI 460 per share is equal to the sum of the net present value of the bank's future economic value-added (earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital, assuming no capital increase) and the proposed value of capital increase. In line with the approach we adopt for the rest of our coverage universe, our target price is based upon the shorter-term approach, the Warranted Tangible Equity valuation, and is set at ZI 492.

### Risks

The following risk factors might cause the share price to deviate from our target price. The macro economy may perform worse or better than anticipated and lead to higher/lower provisioning and slower/faster loan growth than anticipated. Specifically for mBank, we highlight that: 1) the bank's loan book is heavily weighted towards FX mortgage loans and a weaker zloty could negatively impact asset quality; and 2) the bank remains highly dependent on funding from parent Commerzbank, which could constrain the bank's growth outlook unless the operating environment improves dramatically. If the impact on the company from any of these factors proves to be more negative than we anticipate, the stock will likely have difficulty achieving our financial and price targets. Likewise, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

## Appendix A-1

### Analyst Certification

The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

### IMPORTANT DISCLOSURES

#### mBank SA (MBK.WA)

##### Ratings and Target Price History Fundamental Research

Analyst: Andrzej Powierza



|   | Date      | Rating                      | Target Price | Closing Price |
|---|-----------|-----------------------------|--------------|---------------|
| 1 | 19-Aug-11 | 2M                          | *318.00      | 248.60        |
| 2 | 30-Sep-11 | *1M                         | *298.00      | 242.00        |
| 3 | 7-Oct-11  | Stock rating system changed |              |               |
| 4 | 7-Oct-11  | *1                          | 298.00       | 239.30        |
| 5 | 9-Dec-11  | *3                          | *243.00      | 254.70        |

\* Indicates change

|    | Date      | Rating | Target Price | Closing Price |
|----|-----------|--------|--------------|---------------|
| 6  | 22-Feb-12 | 3      | *268.00      | 295.60        |
| 7  | 6-Jun-12  | *2     | *266.00      | 262.90        |
| 8  | 10-Aug-12 | *3     | *273.00      | 319.50        |
| 9  | 30-Nov-12 | 3      | *279.00      | 316.00        |
| 10 | 22-Mar-13 | 3      | *325.00      | 345.00        |

|    | Date      | Rating | Target Price | Closing Price |
|----|-----------|--------|--------------|---------------|
| 11 | 4-Jul-13  | 3      | *346.00      | 384.45        |
| 12 | 28-Aug-13 | 3      | *363.00      | 440.00        |
| 13 | 25-Nov-13 | 3      | *466.00      | 568.00        |
| 14 | 13-Feb-14 | 3      | *505.00      | 537.30        |
| 15 | 17-Jun-14 | *2     | *498.00      | 506.00        |

Rating/target price changes above reflect Eastern Standard Time

#### mBank SA (MBK.WA)

##### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Andrzej Powierza



\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30th June 2014 is as follows: Buy (1) representing 26% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 42% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 32% of the DMBH coverage 0% of which are IB clients

DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30th June 2014 is as follows: Buy (1) representing 26% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 42% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 32% of the DMBH coverage 0% of which are IB clients

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DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30th June 2014 is as follows: Buy (1) representing 26% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 42% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 32% of the DMBH coverage 0% of which are IB clients.

DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30th June 2014 is as follows: Buy (1) representing 26% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 42% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 32% of the DMBH coverage 0% of which are IB clients

DMBH is a market maker in the publicly traded equity securities of PKO BP. DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30th June 2014 is as follows: Buy (1) representing 26% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 42% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 32% of the DMBH coverage 0% of which are IB clients.

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DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 30th June 2014 is as follows: Buy (1) representing 26% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 42% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 32% of the DMBH coverage 0% of which are IB clients DMBH is a market maker in the publicly traded equity securities of BRE Bank SA.

A member of the household of Andrzej Powierza, Analyst, holds a long position in the securities of PKO BP.

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Citigroup Global Markets Inc. or its affiliates expects to receive or intends to seek, within the next three months, compensation for investment banking services from BNPP Polska, Alior Bank.

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| <i>Data current as of 30 Jun 2014</i>                                      | <b>12 Month Rating</b> |      |      | <b>Relative Rating</b> |      |      |
|--|------------------------|------|------|------------------------|------|------|
|  | Buy                    | Hold | Sell | Buy                    | Hold | Sell |
| Citi Research Global Fundamental Coverage                                  | 49%                    | 40%  | 12%  | 0%                     | 100% | 0%   |
| % of companies in each rating category that are investment banking clients | 55%                    | 53%  | 46%  | 0%                     | 54%  | 0%   |

#### Guide to Citi Research Fundamental Research Investment Ratings:

Citi Research stock recommendations include an investment rating and an optional risk rating to highlight high risk stocks.

**Risk rating** takes into account both price volatility and fundamental criteria. Stocks will either have no risk rating or a High risk rating assigned.

**Investment Ratings:** Citi Research investment ratings are Buy, Neutral and Sell. Our ratings are a function of analyst expectations of expected total return ("ETR") and risk. ETR is the sum of the forecast price appreciation (or depreciation) plus the dividend yield for a stock within the next 12 months. The Investment rating definitions are: Buy (1) ETR of 15% or more or 25% or more for High risk stocks; and Sell (3) for negative ETR. Any covered stock not assigned a Buy or a Sell is a Neutral (2). For stocks rated Neutral (2), if an analyst believes that there are insufficient valuation drivers and/or investment catalysts to derive a positive or negative investment view, they may elect with the approval of Citi Research management not to assign a target price and, thus, not derive an ETR. Analysts may place covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and / or trading in the company's securities (e.g. trading suspension). As soon as practically possible, the analyst will publish a note re-establishing a rating and investment thesis. To satisfy regulatory requirements, we correspond Under Review and Neutral to Hold in our ratings distribution table for our 12-month fundamental rating system. However, we reiterate that we do not consider Under Review to be a recommendation.

Prior to May 1, 2014 Citi Research may have also assigned a three-month relative call (or rating) to a stock to highlight expected out-performance (most preferred) or under-performance (least preferred) versus the geographic and industry sector over a 3 month period. The relative call may have highlighted a specific near-term catalyst or event impacting the company or the market that was anticipated to have a short-term price impact on the equity securities of the company. Absent any specific catalyst the analyst(s) may have indicated the most and least preferred stocks in the universe of stocks under consideration, explaining the basis for this short-term view. This three-month view may have been different from and did not affect a stock's fundamental equity rating, which reflected a longer-term total absolute return expectation. For purposes of NASD/NYSE ratings-distribution-disclosure rules, most

preferred calls corresponded to a buy recommendation and least preferred calls corresponded to a sell recommendation. Any stock not assigned to a most preferred or least preferred call was considered non-relative-rated (NRR). For purposes of NASD/NYSE ratings-distribution-disclosure rules we corresponded NRR to Hold in our ratings distribution table for our 3-month relative rating system. However, we reiterate that we did not consider NRR to be a recommendation.

Prior to October 8, 2011, the firm's stock recommendation system included a risk rating and an investment rating. **Risk ratings**, which took into account both price volatility and fundamental criteria, were: Low (L), Medium (M), High (H), and Speculative (S). **Investment Ratings** of Buy, Hold and Sell were a function of the Citi Research expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating. Additionally, analysts could have placed covered stocks "Under Review" in response to exceptional circumstances (e.g. lack of information critical to the analyst's thesis) affecting the company and/or trading in the company's securities (e.g. trading suspension). Stocks placed "Under Review" were monitored daily by management and as practically possible, the analyst published a note re-establishing a rating and investment thesis. For securities in developed markets (US, UK, Europe, Japan, and Australia/New Zealand), investment ratings were: Buy (1) (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); Hold (2) (0%-10% for Low-Risk stocks, 0%-15% for Medium-Risk stocks, 0%-20% for High-Risk stocks, and 0%-35% for Speculative stocks); and Sell (3) (negative total return). For securities in emerging markets (Asia Pacific, Emerging Europe/Middle East/Africa, and Latin America), investment ratings were: Buy (1) (expected total return of 15% or more for Low-Risk stocks, 20% or more for Medium-Risk stocks, 30% or more for High-Risk stocks, and 40% or more for Speculative stocks); Hold (2) (5%-15% for Low-Risk stocks, 10%-20% for Medium-Risk stocks, 15%-30% for High-Risk stocks, and 20%-40% for Speculative stocks); and Sell (3) (5% or less for Low-Risk stocks, 10% or less for Medium-Risk stocks, 15% or less for High-Risk stocks, and 20% or less for Speculative stocks).

Investment ratings are determined by the ranges described above at the time of initiation of coverage, a change in investment and/or risk rating, or a change in target price (subject to limited management discretion). At other times, the expected total returns may fall outside of these ranges because of market price movements and/or other short-term volatility or trading patterns. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. Your decision to buy or sell a security should be based upon your personal investment objectives and should be made only after evaluating the stock's expected performance and risk.

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Dom Maklerski Banku Handlowego SA

Andrzej Powierza

Citigroup Global Markets Ltd

Simon Nellis

#### OTHER DISCLOSURES

The subject company's share price set out on the front page of this Product is quoted as at 04 August 2014 12:49 PM on the issuer's primary market.

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