

# Bank Zachodni WBK (BZW.WA)

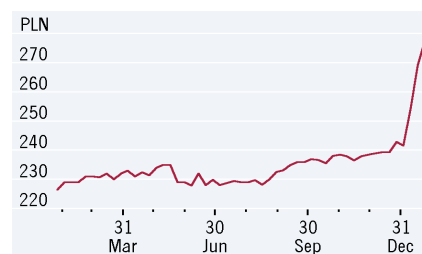
## Adding Scale to Excellence – Maintaining Buy

- **A Case Study in Excellence** — The marriage of BZ WBK's historical excellence in operational management (analysed in detail in this report) with scale following the merger with Kredyt Bank is compelling and leads us to be bullish on the stock, which remains our top pick among Polish financials.
- **Buy Maintained, TP to ZI 311** — We estimate that the merged entity will generate a sustainable ROE of 15.5%. Assuming a cost of equity 10% and a perpetual growth rate 4.5%, we value the shares at ZI 311, our new target price, up from ZI 266 previously. The upgrade is driven primarily by rolling-forward the basis of our valuation by one year.
- **Attractive Free-float** — The KNF (Polish FSA) required Santander to increase BZ WBK's free-float from 8.6% currently to at least 25% by April 1, 2013 and to at least 30% by December 31, 2014. KBC, currently holding a 16.2% stake, indicated it would like to completely divest its holding. As such the bank will have the third-largest free-float after PKO BP and Pekao and is likely to be one of Poland's more liquid shares.
- **Merger Costs and Synergies** — The bank targets ZI 340m in cost and ZI 125m in revenue synergies by 2015 and estimates integration costs at ZI 430m. We believe targeted cost synergies are credible, but remain skeptical regarding management's revenue synergy targets and assume just ZI 10m in revenue synergies.
- **Merger Included In Forecasts** — We replace our estimates for stand-alone BZ WBK with merged bank estimates. On a pro-forma basis, we increase our EPS estimates by 67% in 2013E due to lower provisioning assumptions because we expect the bank to increase provision coverage in Kredyt Bank through a fair-value adjustment through equity rather than through higher provisioning through the P&L.

- Company Update
- Target Price Change
- Estimate Change

<b>Buy</b>	<b>1</b>
Price (18 Feb 13)	ZL274.90
Target price	ZL311.00
	from ZL266.00
Expected share price return	13.1%
Expected dividend yield	5.2%
<b>Expected total return</b>	<b>18.4%</b>
Market Cap	ZL25,716M
	US\$8,202M

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



### Bank Zachodni WBK (PLN)

Year to 31 Dec	2011A	2012A	2013E	2014E	2015E
Net Income (ZLM)	1,184.3	1,433.8	1,907.1	1,900.0	2,407.9
Diluted EPS (ZL)	16.11	19.31	20.39	20.31	25.74
Diluted EPS (Old) (ZL)	16.11	18.18	15.75	18.87	20.17
PE (x)	17.1	14.2	13.5	13.5	10.7
P/BV (x)	2.7	2.3	1.8	1.7	1.6
DPS (ZL)	8.00	14.41	15.29	15.23	19.31
Net Div Yield (%)	2.9	5.2	5.6	5.5	7.0
ROE (%)	16.9	17.7	16.5	13.1	15.8

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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	2011	2012	2013E	2014E	2015E
<b>Valuation Ratios</b>					
P/E adjusted (x)	17.1	14.2	13.5	13.5	10.7
P/E reported (x)	17.1	14.2	13.5	13.5	10.7
P/BV (x)	2.7	2.3	1.8	1.7	1.6
P/Adjusted BV diluted (x)	2.7	2.3	1.8	1.7	1.6
Dividend yield (%)	2.9	5.2	5.6	5.5	7.0
<b>Per Share Data (ZL)</b>					
EPS adjusted	16.11	19.31	20.39	20.31	25.74
EPS reported	16.11	19.31	20.39	20.31	25.74
BVPS	100.66	119.03	152.76	157.78	168.29
Tangible BVPS	98.59	117.33	151.25	156.10	166.47
Adjusted BVPS diluted	100.11	118.40	152.76	157.78	168.29
DPS	8.00	14.41	15.29	15.23	19.31
<b>Profit &amp; Loss (ZLm)</b>					
Net interest income	2,069	2,301	3,176	3,383	3,665
Fees and commissions	1,358	1,385	1,765	1,955	2,150
Other operating Income	347	424	977	546	546
<b>Total operating income</b>	<b>3,773</b>	<b>4,110</b>	<b>5,918</b>	<b>5,884</b>	<b>6,362</b>
Total operating expenses	-1,875	-1,791	-2,912	-2,695	-2,544
<b>Oper. profit bef. provisions</b>	<b>1,898</b>	<b>2,319</b>	<b>3,006</b>	<b>3,189</b>	<b>3,818</b>
Bad debt provisions	-367	-502	-589	-761	-781
Non-operating/exceptionals	0	0	0	0	0
<b>Pre-tax profit</b>	<b>1,531</b>	<b>1,817</b>	<b>2,417</b>	<b>2,428</b>	<b>3,036</b>
Tax	-316	-374	-487	-489	-579
Extraord./Min. Int./Pref. Div.	-31	-9	-23	-39	-50
<b>Attributable profit</b>	<b>1,184</b>	<b>1,434</b>	<b>1,907</b>	<b>1,900</b>	<b>2,408</b>
Adjusted earnings	1,184	1,434	1,907	1,900	2,408
<b>Growth Rates (%)</b>					
EPS adjusted	21.6	19.8	5.6	-0.4	26.7
Oper. profit bef. prov.	7.0	22.2	29.6	6.1	19.7
<b>Balance Sheet (ZLm)</b>					
<b>Total assets</b>	<b>59,797</b>	<b>60,019</b>	<b>106,298</b>	<b>111,218</b>	<b>120,115</b>
Avg interest earning assets	54,881	58,083	100,579	105,187	111,063
Customer loans	39,432	41,412	75,025	78,636	84,749
Gross NPLs	2,179	2,236	5,177	5,111	5,085
<b>Liab. &amp; shar. funds</b>	<b>59,797</b>	<b>60,019</b>	<b>106,298</b>	<b>111,218</b>	<b>120,115</b>
Total customer deposits	46,829	47,077	82,211	88,988	96,552
Reserve for loan losses	1,415	1,544	3,367	3,499	3,601
Shareholders' equity	7,356	8,884	14,290	14,759	15,742
<b>Profitability/Solvency Ratios (%)</b>					
ROE adjusted	16.9	17.7	16.5	13.1	15.8
Net interest margin	3.77	3.96	3.16	3.22	3.30
Cost/income ratio	49.7	43.6	49.2	45.8	40.0
Cash cost/average assets	3.3	3.0	3.5	2.5	2.2
NPLs/customer loans	5.5	5.4	6.9	6.5	6.0
Reserve for loan losses/NPLs	65.0	69.1	65.0	68.5	70.8
Bad debt prov./avg. cust. loans	1.0	1.2	1.0	1.0	1.0
Loans/deposit ratio	84.2	88.0	91.3	88.4	87.8
Tier 1 capital ratio	13.2	14.3	12.7	12.4	12.1
Total capital ratio	15.1	16.6	15.3	14.9	14.3

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# Contents

<b>Adding Scale to Excellence</b>	<b>4</b>
<b>New BZ WBK Is Emerging</b>	<b>4</b>
Well-Managed BZ WBK...	4
...Will Become the Third Biggest Bank in Poland...	7
...and the Third Most Liquid Polish Bank on WSE	10
<b>Future Changes in the Group</b>	<b>12</b>
<b>Valuation</b>	<b>13</b>
Standard Warranted Equity Valuation	13
Economic Value Added (EVA) Valuation	14
Comparison to Peers	15
<b>A Case Study in Excellence</b>	<b>17</b>
<b>BZ WBK - Successful Growth Story</b>	<b>17</b>
<b>Ideally Mean</b>	<b>18</b>
<b>ROE Deconstructed</b>	<b>19</b>
ROE Driven Primarily by ROA	20
<b>Net Interest Income Insight</b>	<b>23</b>
High Yield on Assets Due to Low Share of FX Mortgages	24
Moderate Cost of Funding Due to Low Funding Needs	28
<b>Cost of Risk Insight</b>	<b>31</b>
Cost of Risk Reflects Loan Structure	31
Corporate Provisioning Between PKO BP and Pekao	32
<b>Fee Leader</b>	<b>33</b>
<b>The Scale — Merger Overview</b>	<b>36</b>
<b>Legal Merger Completed</b>	<b>36</b>
<b>Market Position</b>	<b>36</b>
<b>Kredyt Bank Characteristics</b>	<b>39</b>
Unsuccessful Investment	39
Kredyt Bank ROE Deconstructed	40
<b>Financial Forecasts</b>	<b>42</b>
Pro-Forma Results and Merger Accounting	42
Synergies	45
Summary of Financial Forecasts	48
<b>Santander's Obligations</b>	<b>49</b>
KNF' Requirements	51
Acquisition of Santander Consumer Bank Polska	52
Acquisition of Santander Consumer Finance	54
<b>Bank Zachodni WBK</b>	<b>55</b>
Company description	55
Investment strategy	55
Valuation	55
Risks	55
<b>Appendix A-1</b>	<b>58</b>

## Adding Scale to Excellence

Due to high margins adjusted for cost of risk and diversified fee revenues, BZ WBK has been one of Poland's most profitable banks. As a result of the merger with Kredyt Bank the bank will achieve the scale needed to further improve cost efficiency and should continue to be one of the best managed Polish banks, in our view. In this note we analyse the sources of the bank's success in the past ("The Excellence" section) and the impact of the merger on the bank's future profitability ("The Scale" section).

## New BZ WBK Is Emerging

### Well-Managed BZ WBK...

**BZ WBK was one of Poland's most profitable banks...**

Due to good management BZ WBK (similarly to its predecessor, WBK) has been one of Poland's most profitable banks. On a continuous basis BZ WBK delivered a ROE comparable to ROEs of PKO BP and Pekao despite lacking their advantage of scale. Since 2010 the bank's ROE diverged upward from the sector and closest peers' profitability. In our opinion, this was due mainly to:

- low share of unprofitable mortgage loans,
- successful re-pricing of corporate loans and
- diversified fee income, e.g. material income from in-sourcing services for other banks in terms of card and ATM management (see the next chapter for a detailed analysis of BZ WBK's historical results).

**...and its 2004-2011 net profit CAGR (15%) outpaced the sector's (12%)**

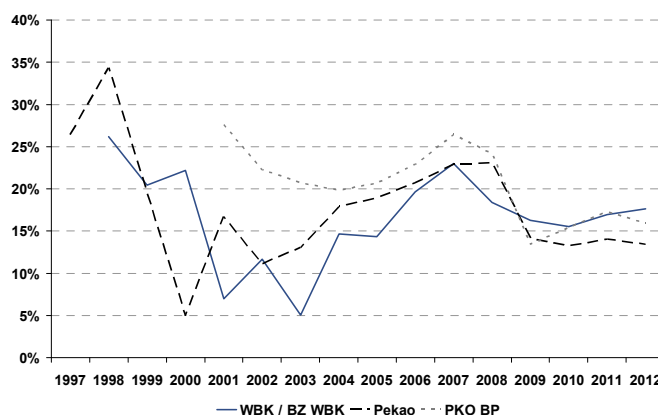
Since the creation of BZ WBK through the merger of WBK with Bank Zachodni in 2001 the bank's net profit increased from Zł 149m to Zł 1,184m in 2011 and Zł 1,463m in 2012 (2001-2011 CAGR 23% vs. 16% for PKO BP, 14% for the sector and 9% for Pekao). However, 2001 net profit may be seen as a low base for comparison as it was negatively affected by the cost of the merger and post-merger restructuring. Thus we have also compared the growth of net profit vs. a base of 2004: From 2004 to 2011 BZ WBK's earnings grew on average 15% annually, in line with PKO BP's net profit and above Pekao's (2004-2011 CAGR 12%) and the sector's earnings as well (CAGR 12%). We note that since 2001 BZ WBK hasn't done any material capital increase while Pekao's issued shares to BPH shareholders in 2007 and PKO BP raised capital through a rights issue in 2009.

Figure 1. BZ WBK – ROE, 1997-2012 (Percentage)



Source: NBP, KNF, company reports and Citi Research

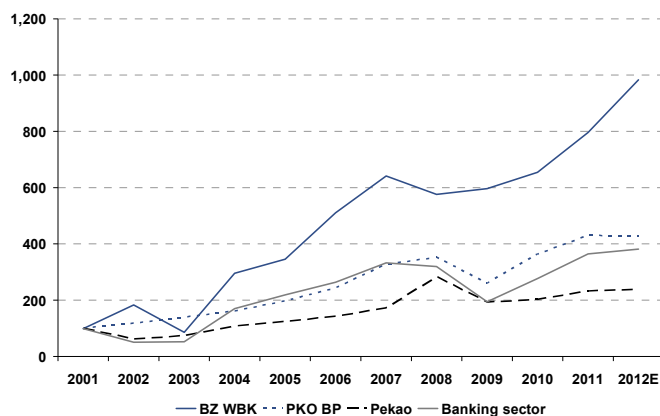
Figure 2. BZ WBK – ROE, 1997-2012\* (Percentage)



Note: \*Citi Research estimates for PKO BP and Pekao for 2012, actual for BZ WBK

Source: Company reports and Citi Research

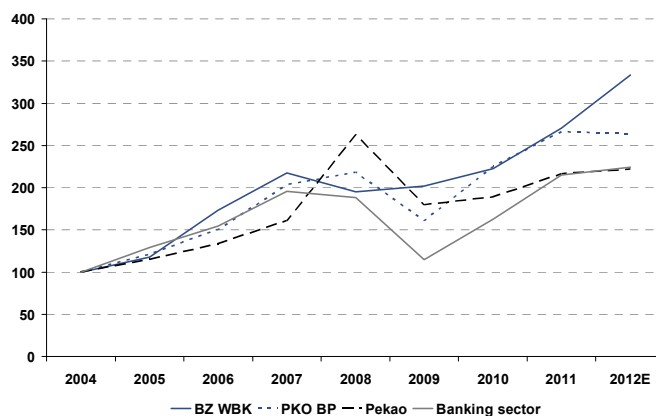
Figure 3. Polish Banks – Net Profit Growth Rebalanced (2001=100), 2001-2012E\*



Note: \*Citi Research estimates for PKO BP and Pekao for 2012, actual for BZ WBK and the sector

Source: NBP, KNF, company reports and Citi Research

Figure 4. Polish Banks – Net Profit Growth Rebalanced (2004=100), 2004-2012E\*



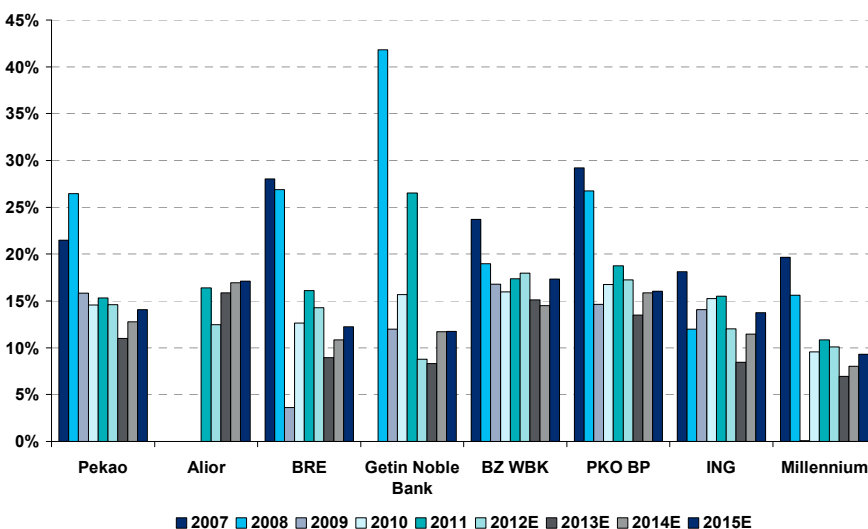
Note: \*Citi Research estimates for PKO BP and Pekao for 2012, actual for BZ WBK and the sector

Source: NBP, KNF, company reports and Citi Research

#### We expect 17.8% ROTE in 2015

Post the merger with Kredyt Bank, BZ WBK's equity will be inflated by the goodwill recognized as part of the merger process (we estimate it at ZI 1.5bn) and thus we expect ROE will decline from 17.7% in 2012 and 16.9% in 2011 to 13.7% in 2013E, 13.1% in 2014 and 15.8% in 2015. However, return on tangible equity (i.e. excluding intangible assets and goodwill) is expected to remain at c17%-18% (we expect 17.8% in 2015 vs. 17.3% in 2011 and 18.0% in 2012.)

Figure 5. Polish Banks – Return on Tangible Equity, 2007-2015E (Percentage)

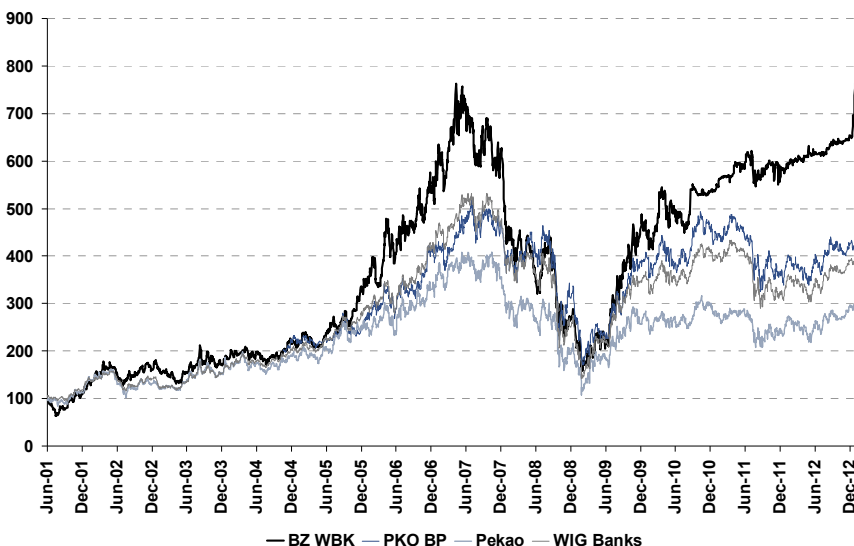


Source: Company reports, Citi Research estimates

#### The superior profitability was reflected in the stock price performance

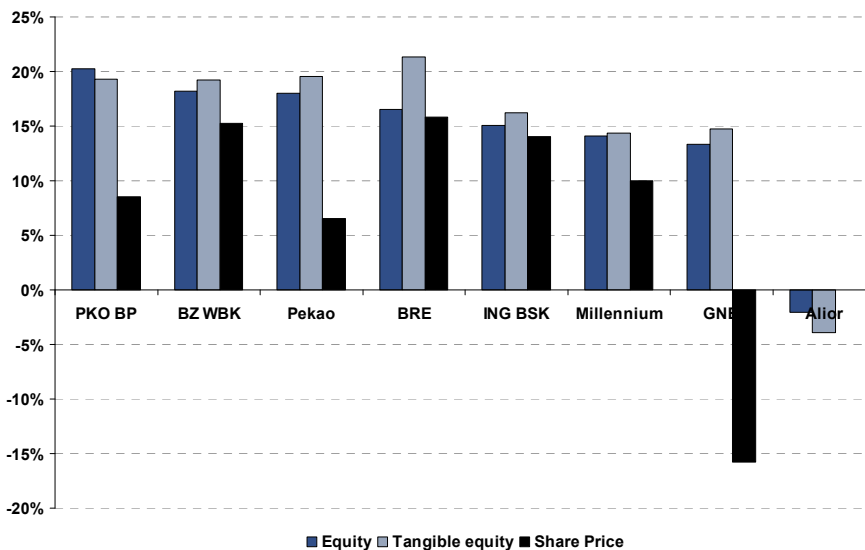
The superior profitability and high pace of growth in net profit were reflected in BZ WBK's stock price. Indeed, the shares outperformed PKO BP, Pekao and the WIG Banks index (although we note that stock performance was supported by Santander's tender at ZI 226.89 in 2011 and low liquidity in the bank's share since then).

Figure 6. Polish Banks – Total Shareholders Return Rebalanced (2001=100), Jun 01 – Feb 13



Source: Stooq.pl, Citi Research

Figure 7. Polish Banks – Fundamental and Market Internal Rate of Return (IRR), 2004-3Q12 (Percentage)

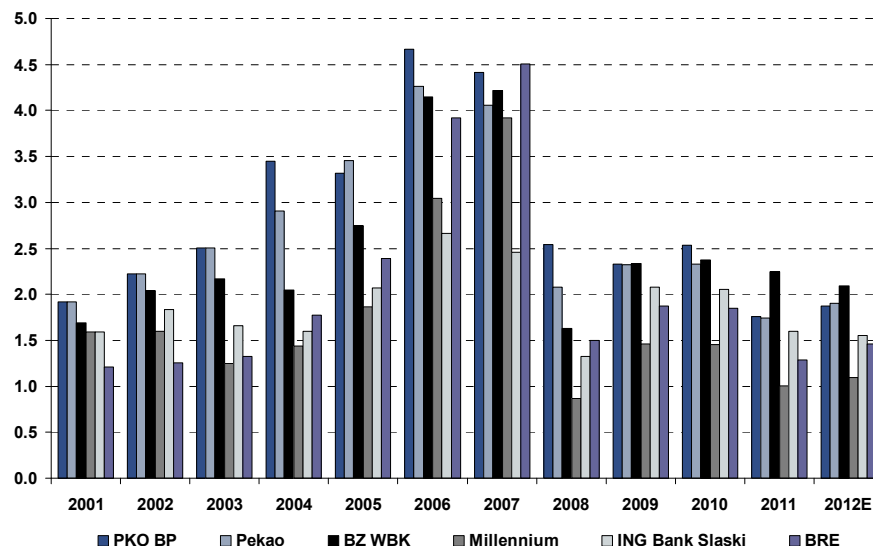


Note: Fundamental IRR calculated as the annual rate of the growth of equity and tangible equity, adjusted for transfers to and from shareholders (dividends and capital increase). Market IRR calculated as the annual growth rate in share price, adjusted for dividends.

Source: Company reports, Citi Research

Owing to its high profitability BZ WBK traded at multiples closer to Poland's two largest banks (Pekao and PKO BP), with a material premium to medium-sized banks.

Figure 8. Polish Banks – P/BV Historical Multiples, 2001-2012E



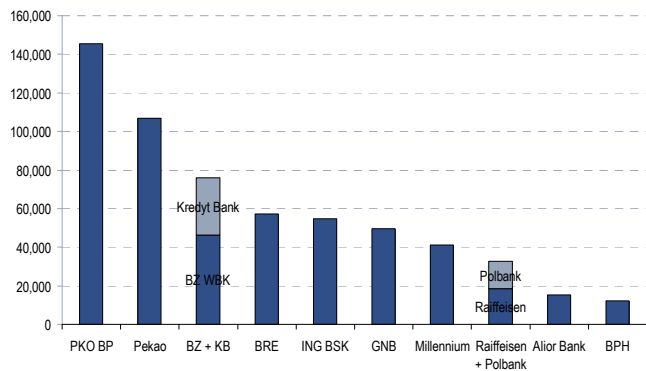
Source: Powered by dataCentral

### ...Will Become the Third-Largest Bank in Poland...

Post the merger, BZ WBK is the third-largest bank in Poland in terms of deposits and equity

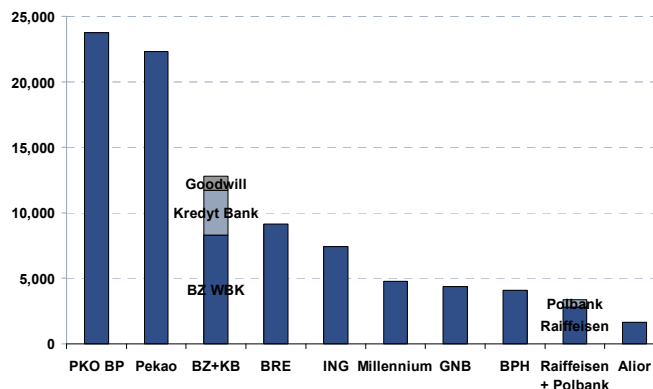
Due to the merger, BZ WBK will emerge as Poland's third-largest bank. We think it will continue to benefit from strong management as BZ WBK's management team will continue to manage the merged entity and given Santander's know-how in retail banking (including best practices in cost management). The merger will add significant scale to the operation and should enable the bank to strengthen its position as one of the most profitable banks in Poland.

Figure 9. Polish Banks – Client Deposits, 3Q12 (Polish Zloty in million)



Source: Banks, Citi Research, Rzeczpospolita

Figure 10. Polish Banks – Polish Banks – Shareholders Equity, 3Q12 (Polish Zloty in million)



Source: Banks, Citi Research, Rzeczpospolita

BZ WBK looks for ZI 125m revenues synergies and ZI 340m cost synergies

At its Investor Day on Feb 4, 2012, BZ WBK slightly revised upward Santander's projection of merger synergies to pre-tax ZI 465m (vs. ZI 436m communicated by Santander in February 2012). As we explained in our note [BZ WBK and Kredyt Bank - A Good Marriage: Upgrading BZ WBK and Kredyt Bank to Buy](#), published in April 2012, we fully believe in Santander's cost savings targets but we are sceptical

on targeted revenues synergies because we think that the potential gains from lower cost of funding and higher cross-sell in Kredyt Bank will be broadly offset by lower interest revenues on lower lending (negatively affected by improved pricing as some clients may decide to choose a cheaper offer from competitors and the bank may cut off the most risky clients). On the other hand, we expect that improved lending practices may lead to a lower cost of risk in the merged bank.

**Given distorted base, it is tricky to present detailed synergy forecasts**

Due to the pre-merger cost restructuring started in 2012 (that probably wouldn't have taken place if the merger didn't happen) and an abnormal increase in Kredyt Bank's cost of funding in 2012, caused by funding from KBC being replaced with local deposits (even in the scenario of a lack of merger we had assumed a gradual decline in Kredyt Bank's cost of funding), it is tough to set the base for synergies hence we treat the projections of merger synergies as an illustration of expected trends rather than as a precise calculation. Since April 2012 we have slightly revised our synergy estimates, taking into account the lower cost base at both banks (due to headcount reduction in 2012) and a higher cost of funding for Kredyt Bank.

**Figure 11. BZ WBK – Synergy Estimates, 2015E (Polish Zloty in million)**

	Santander (Feb 2012)	BZ WBK (Feb 2013)	Citi Research (Apr 2012)	Citi Research Feb 2013)
Revenues synergies	114	125	0	10
Cost synergies	322	340	322	308
Cost of risk synergies			69	55
<b>Total Pre-tax synergies</b>	<b>436</b>	<b>465</b>	<b>391</b>	<b>373</b>
After tax synergies	349	377	317	302

Source: Company reports, Citi Research

**We expect BZ WBK's net profit to rise, pro-forma, +7% yoy in 2013**

We expect BZ WBK's net profit to rise to ZI 1,907m in 2013 (+33% yoy, pro-forma +7% yoy, EPS +6% yoy), driven by:

- higher net interest income (pro-forma +3% yoy), positively affected by decreased cost of funding in the former Kredyt Bank, due partly to the high base (in 2011-2012 the bank was replacing part of funding from KBC with local deposits and had to offer high rates to attract new deposits) and due partly to post-merger re-pricing of deposits;
- lower provisioning (pro-forma -11% yoy) because we expect that, in the process of assessment of the fair-value of Kredyt Bank's assets (to include them into BZ WBK's books and calculate goodwill on the transaction), the value of Kredyt Bank's loans will be set conservatively below the current book value and owing to that provisioning in the coming quarters will be relatively muted (in other words, we expect a significant part of 2013 provisioning in Kredyt Bank not to go through P&L but to enlarge goodwill).

**In our forecasts we include...**

We note that in our forecasts for BZ WBK (and for other Polish banks) we include:

**... a reduction in interchange fee...**

- a reduction in interchange fee from c1.6% in 2012 to c1.1% (so far the card organisations have voluntary reduced the interchange fee to c1.1%-1.3% but parliament is working on a law to set the upper limit at 1.0%);

**... and a bank levy**

- implementation of bank levy tax at 0.1% of RWAs (parliament is working on the draft of a bill that states that in the year, when the bank levy is implemented, banks will be required to pay the full annual levy – for details on implementation of the interchange cap and banking tax, see [Polish Banks Big Picture – November 2012 - Two Things You Can't Avoid](#)).



Figure 12. BZ WBK – Profit and Loss, 2012-2015E (Polish Zloty in million)

	2012 PF	2013E	Chg.	2014E	Chg.	2015E	Chg.
Net Interest Income	3,089.4	3,176.0	2.8%	3,382.9	6.5%	3,665.1	8.3%
Net Fee & Commission Income	1,950.8	1,764.7	-9.5%	1,955.0	10.8%	2,150.4	10.0%
Financial Income	556.7	855.0	53.6%	424.3	-50.4%	426.3	0.5%
Other Income	48.8	122.0	150.2%	122.0	0.0%	120.0	-1.6%
<b>Total Revenue</b>	<b>5,645.6</b>	<b>5,917.7</b>	<b>4.8%</b>	<b>5,884.2</b>	<b>-0.6%</b>	<b>6,361.8</b>	<b>8.1%</b>
including merger synergies	0.0	35.6	na	50.5	41.7%	10.1	na
Labour Costs		-1,332.8	na	-1,289.3	-3.3%	-1,301.5	0.9%
General Costs		-1,389.4	na	-1,211.7	-12.8%	-1,041.0	-14.1%
Depreciation		-189.8	na	-194.0	2.2%	-201.7	4.0%
<b>Operating Expenses</b>	<b>-2,727.4</b>	<b>-2,912.1</b>	<b>6.8%</b>	<b>-2,695.0</b>	<b>-7.5%</b>	<b>-2,544.2</b>	<b>-5.6%</b>
including merger synergies	0.0	82.3	na	232.9	183.1%	308.0	32.3%
integration costs	-37.8	-250.0	1229.8%	-120.0	-52.0%	0.0	na
<b>Operating Profit</b>	<b>2,918.1</b>	<b>3,005.7</b>	<b>3.0%</b>	<b>3,189.2</b>	<b>6.1%</b>	<b>3,817.7</b>	<b>19.7%</b>
Provision Charge	-659.0	-588.7	-10.7%	-761.0	29.3%	-781.4	2.7%
Associate Income	20.8	8.0	-61.5%	8.0	0.0%	10.0	25.0%
Profit Before Tax	2,297.1	2,425.0	5.6%	2,436.1	0.5%	3,046.2	25.0%
Minorities	-28.8	-31.0	7.5%	-47.0	51.7%	-59.5	26.7%
Tax	-482.4	-486.9	0.9%	-489.2	0.5%	-578.8	18.3%
<b>Net Profit</b>	<b>1,785.9</b>	<b>1,907.1</b>	<b>6.8%</b>	<b>1,900.0</b>	<b>-0.4%</b>	<b>2,407.9</b>	<b>26.7%</b>
EPS (Zl)		20.4	na	20.3	-0.4%	25.7	26.7%
DPS (Zl)		15.3	na	15.2	-0.4%	19.3	26.7%

Source: Company reports, Citi Research estimates

Figure 13. BZ WBK – Balance Sheet, 2012-2015E (Polish Zloty in million)

	2012 PF	2013E	Chg.	2014E	Chg.	2015E	Chg.
Cash and NBP Balances	5,121	5,197	1.5%	5,773	11.1%	6,234	8.0%
Interbank placements	2,638	2,041	-22.6%	2,268	11.1%	2,449	8.0%
Financial Assets & Securities	22,564	23,919	6.0%	24,382	1.9%	26,332	8.0%
Net client lending	67,897	71,658	5.5%	75,137	4.9%	81,148	8.0%
Fixed assets	734	533	-27.4%	592	11.1%	639	8.0%
Other assets	3,126	2,950	-5.6%	3,067	3.9%	3,312	8.0%
<b>Total Assets</b>	<b>102,078</b>	<b>106,298</b>	<b>4.1%</b>	<b>111,218</b>	<b>4.6%</b>	<b>120,115</b>	<b>8.0%</b>
Interbank borrowing	5,634	4,729	-16.1%	2,837	-40.0%	3,064	8.0%
Client deposits	77,470	82,211	6.1%	88,988	8.2%	96,552	8.5%
Other liabilities	5,423	4,945	-8.8%	4,462	-9.8%	4,526	1.4%
Minorities	93	124	33.2%	171	37.8%	231	34.7%
Equity (ex Minorities)	13,458	14,290	6.2%	14,759	3.3%	15,742	6.7%
<b>Total liabilities &amp; Equity</b>	<b>102,078</b>	<b>106,298</b>	<b>4.1%</b>	<b>111,218</b>	<b>4.6%</b>	<b>120,115</b>	<b>8.0%</b>
BVPS (Zl)	144	153	6.2%	158	3.3%	168	6.7%

Source: Company reports, Citi Research estimates

Figure 14. BZ WBK – Key Ratios, 20012-2015E (Percentage)

GROUP	2012 PF	2013E	2014E	2015E
<b>NIM on AIEA</b>	<b>3.13%</b>	<b>3.16%</b>	<b>3.22%</b>	<b>3.30%</b>
NIM on Total Ave. Assets	3.11%	3.06%	3.11%	3.17%
Net Fee & Commission Income/Total Income	34.6%	29.8%	33.2%	33.8%
Net Fee & Commission Income/Deposits	2.5%	2.1%	2.2%	2.2%
<b>Cost/Income</b>	<b>48.3%</b>	<b>49.2%</b>	<b>45.8%</b>	<b>40.0%</b>
Cost/Avg. Assets	2.7%	2.8%	2.5%	2.2%
Effective tax rate	27.0%	20.1%	20.1%	19.0%
Dividend Payout Ratio	na	75.0%	75.0%	75.0%
<b>Provisions/Avg Net Loans</b>	<b>0.98%</b>	<b>0.84%</b>	<b>1.04%</b>	<b>1.00%</b>
Equity/Assets	13.2%	13.6%	13.4%	13.3%
<b>Loans/Deposits</b>	<b>87.6%</b>	<b>87.2%</b>	<b>84.4%</b>	<b>84.0%</b>
Loans/Total Assets	66.5%	67.4%	67.6%	67.6%
<b>ROE</b>	<b>15.0%</b>	<b>13.7%</b>	<b>13.1%</b>	<b>15.8%</b>
ROA	1.80%	1.84%	1.75%	2.08%
NPLs/Total Loans	7.0%	6.9%	6.5%	6.0%
Provision Coverage of NPLs	57.8%	65.0%	68.5%	70.8%
RWA/Total Assets	76.0%	74.0%	75.0%	76.0%
<b>CAR</b>	<b>14.2%</b>	<b>15.3%</b>	<b>14.9%</b>	<b>14.3%</b>

Source: Company reports, Citi Research estimates

### ...and the Third Most Liquid Polish Bank on WSE

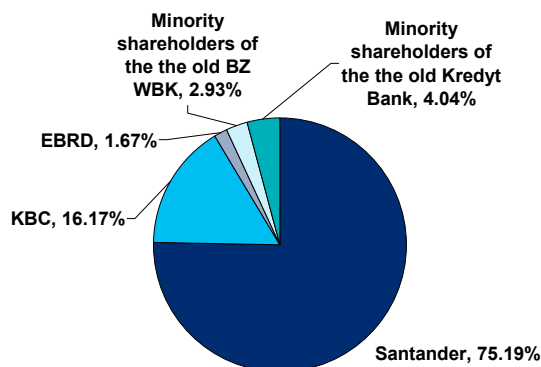
**Free float will be increased from 8.6% currently ...**

Post the merger, Santander has 75.19% of the bank's shares while KBC has a 16.17% stake and the EBRD (which purchased new shares of BZ WBK issued in 2012) has a stake of 1.67%. Other shareholders have just 6.97% of the bank's shares (of which 4.04% are shares issued to Kredyt Bank's minority shareholders).

**... to at least 25% till April 1, 2013 and to at least 30% till end of 2014**

One of the conditions upon which the merger with Kredyt Bank was approved by the KNF (Polish FSA) is a requirement to increase the free-float to at least 25% by April 1, 2012 and to at least 30% by December 31, 2014. In the future Santander will have to maintain at least a 30% free-float or consider a further increase to 40%. Assuming that, in line with GPW's (the Warsaw Stock Exchange) definition of free-float the EBRD's stake is classified as free-float, at least 15.3m shares (16.36% of total) have to be sold to minority investors to reach the 25% threshold and 20.0m (21.36%) to reach the 30% threshold. At the current market price, the value of the stakes to be sold are, respectively, ZI 4.2bn (USD 1.3m) and ZI 5.5bn (USD 1.7m).

Figure 15. BZ WBK – Shareholders Structure (Percentage)



Source: Company reports, Citi Research

At the current market price, the value of BZ WBK's free-float would give the bank the third rank among Polish banks

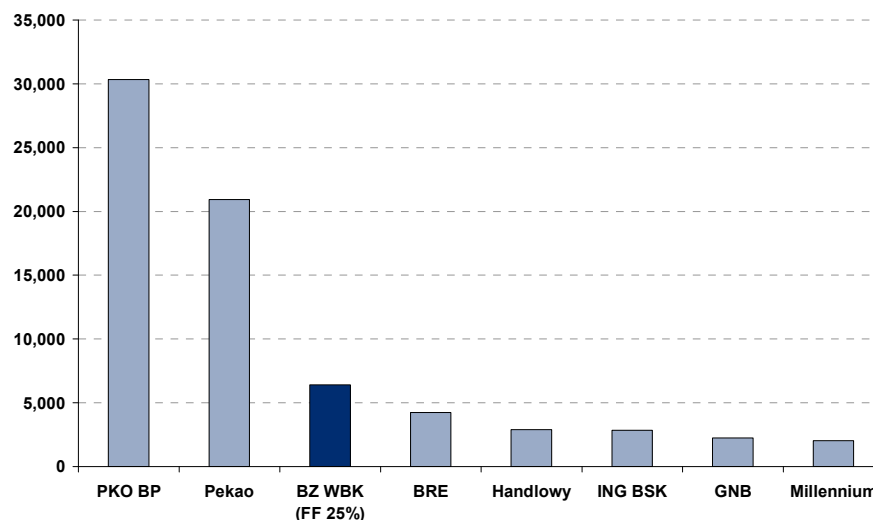
Currently, PKO BP, Pekao and BRE are the three Polish banks with the highest value of free-float (Zl 30bn, Zl 21bn and Zl 4.2bn, respectively). At the current market price, the value of BZ WBK's free-float would be Zl 6.3bn (25% free-float) or Zl 7.6bn (30%), which would give the bank the third position in terms of market value of free-float and potentially in terms of turnover.

Figure 16. BZ WBK – Free-float Estimates (Polish Zloty in million)

	Share price							
	190	210	230	250	270	290	310	330
free-float 25%	4,443	4,911	5,379	5,847	6,314	6,782	7,250	7,717
30%	5,332	5,893	6,455	7,016	7,577	8,138	8,700	9,261
35%	6,221	6,876	7,530	8,185	8,840	9,495	10,150	10,804
40%	7,109	7,858	8,606	9,355	10,103	10,851	11,600	12,348

Source: Citi Research

Figure 17. Polish Banks – Value of Free-float, Feb 2013 (Polish Zloty in million)



Source: Company reports and Citi Research

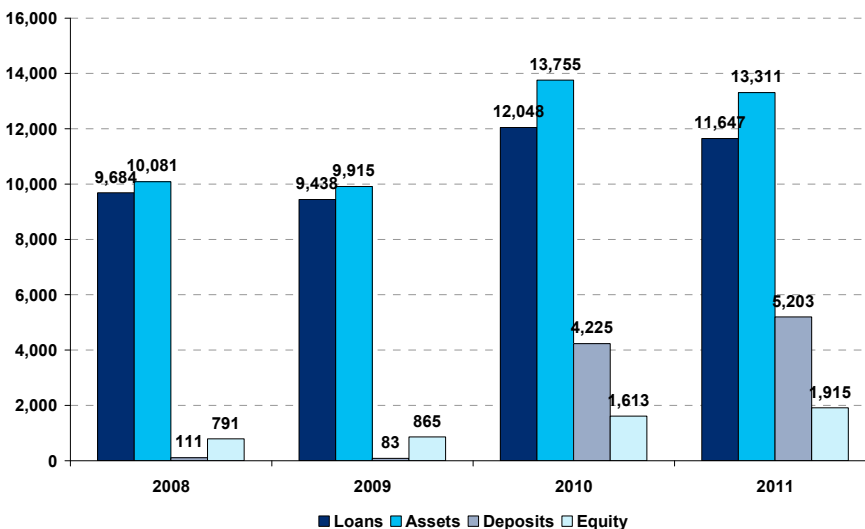
## Future Changes in the Group

The other conditions of the merger were the following commitments of Santander:

- to make Santander Consumer Bank, currently directly held by Santander, a direct subsidiary of BZ WBK (by March 31, 2014) and
- to make Santander Consumer Finance a direct subsidiary of Santander Consumer Bank (in 9 months from the implementation of the amended recommendation T).

Santander Consumer Bank is a medium-sized bank specialised in consumer finance, while Santander Consumer Finance is a non-banking company specialised in instalment loans (see the section **Santander's Obligations** for details).

Figure 18. Santander Consumer Bank – Key Balance Sheet Data, 2008-2011 (Polish Zloty in million)



Source: Company reports, Citi Research

At BZ WBK's Investor Day the bank's representatives said they will keep Santander Consumer Bank an independent legal and business entity but haven't disclosed the details of the planned acquisition. We do not know:

- if the transaction is to be paid in cash or in BZ WBK's shares;
- if BZ WBK will acquire a 100% stake in Santander Consumer or only the 70% stake held by Spanish Santander Consumer Finance (the remaining 30% stake is controlled by AIG).

We note, however, that if BZ WBK acquires 100% of Santander Consumer Bank and pays for it with shares, Santander's stake in the bank would remain broadly unchanged while AIG would get a c5% stake in the new BZ WBK. On the other hand, if BZ WBK acquires only a 70% stake with shares, then Santander's stake in BZ WBK would increase by c3-4pp.

## Valuation

**We value BZ WBK using a Standard Warranted Equity Valuation and an Economic Value Added valuation**

We value BZ WBK using a Standard Warranted Equity Valuation (WEV) and an Economic Value Added (EVA) valuation. These are standard methods that we use when valuing our coverage universe of listed Polish banks. Both methods are based on estimated return on capital. In our opinion, such an approach is the appropriate method to value banks because, given the capital requirements set by regulators, a bank's ability to generate a return on capital determines the level of future growth and dividend payout. Conservatively, we set our target price based on the lower of our two methods (WEV).

### Standard Warranted Equity Valuation

**Our WEV approach suggests a valuation at ZI 311 per share**

Our Standard Warranted Equity Valuation of ZI 311 per share is based on the formula:  $\text{Price} / \text{Book value} = (\text{Sustainable ROE} - \text{growth}) / (\text{Cost of equity} - \text{growth})$ . We assume sustainable return on equity of 15.5%, a sustainable growth rate of 4.5% and a cost of equity of 10.0 %.

Figure 19. BZ WBK – Warranted Equity Valuation (Polish Zloty, except where stated)

Sustainable ROE	15.50%
COE	10.00%
Growth	4.50%
Target P/BV multiple	2.00
2015E BVPS	168.3
2015E Target Value Per Share	336.6
Months to Discount to Feb 2014	22
<b>Discounted</b>	<b>282.6</b>
2013E DPS	15.3
Months to Discount to Feb 2014	4
<b>Discounted</b>	<b>14.8</b>
2014E DPS	15.2
Months to Discount to Feb 2014	16
<b>Discounted</b>	<b>13.4</b>
<b>Value per share</b>	<b>311</b>
<b>Implied Upside / (Downside)</b>	<b>13.1%</b>

Source: Citi Research estimates

## Economic Value Added (EVA) Valuation

Our Economic Value Added Valuation of ZI 371 per share is equal to the sum of the net present value of the bank's future economic value-added (forecast earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital).

Figure 20. BZ WBK – Economic Value Added Model

	2005	2006	2007	2008	2009	2010	2011	2012	2013E	2014E	2015E	Terminal
Average Risk Free Rate	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	
Required Equity/Required Tier I Capital	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	
Required Tier I Ratio	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	
Required Equity	1,538	1,993	2,564	3,975	3,749	3,566	4,159	4,226	7,077	7,507	8,216	
Forecast Equity	3,755	3,960	4,342	4,973	5,947	6,623	7,356	8,884	14,290	14,759	15,742	
Excess Equity	2,216	1,967	1,778	998	2,198	3,058	3,197	4,659	7,213	7,252	7,527	
Earnings on Excess Equity	129	114	103	58	127	177	185	270	418	421	437	
Forecasted Net Profit	516	758	955	855	886	974	1,184	1,434	1,907	1,900	2,408	
Deduct Earnings on Excess Equity	-129	-114	-103	-58	-127	-177	-185	-270	-418	-421	-437	
Add Back Tax on Earnings on Excess Equity	27	24	21	12	24	41	38	55	84	84	83	
<b>Adjusted Earnings</b>	<b>414</b>	<b>668</b>	<b>872</b>	<b>810</b>	<b>783</b>	<b>838</b>	<b>1,037</b>	<b>1,219</b>	<b>1,573</b>	<b>1,564</b>	<b>2,054</b>	
Adjusted ROE (ex excess equity)	26.9%	37.8%	38.3%	24.8%	20.3%	22.9%	26.8%	29.1%	27.8%	21.4%	26.1%	
Capital charge	154	177	228	327	386	366	386	419	565	729	786	
EVA	260	491	645	483	397	473	651	799	1,008	835	1,268	24,096
NPV								799	1,008	759	1,048	19,914
Years out								0	0	1	2	2
Discount factor (discount to end-07)								1.00	1.00	0.91	0.83	0.83
<b>Discount rate</b>	<b>10.00%</b>											
<b>Long-term growth rate (capital and profits)</b>	<b>4.50%</b>											
Current book value (2012 pro-forma excluding goodwill)	11,975											
EVA flows 2013-2015	2,814											
Terminal value	19,914											
<b>Total</b>	<b>34,703</b>											
Number of shares	93.5											
<b>Value per share</b>	<b>371.0</b>											
<b>Implied Upside</b>	<b>35.0%</b>											

Source: Company data, Citi Research estimates

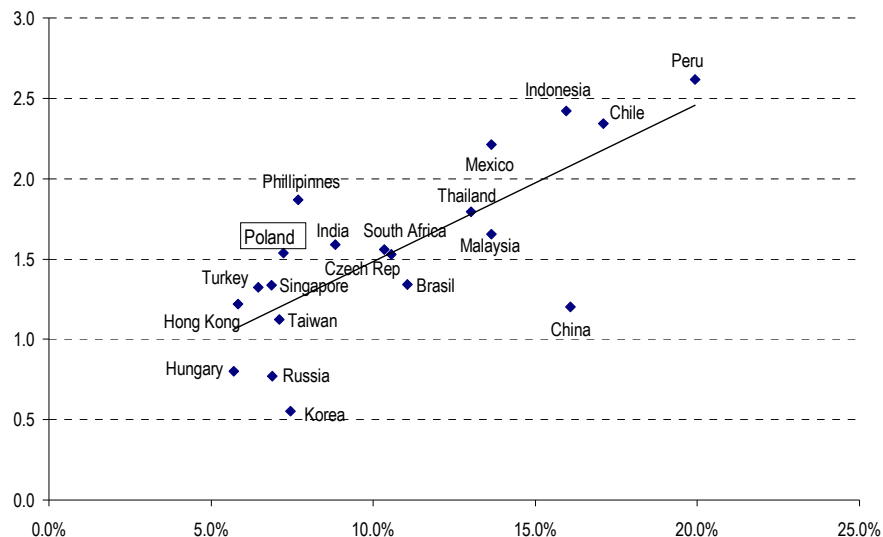
## Comparison to Peers

Figure 21. CEEMEA Banks – Trading Multiples, 2012E – 2014E

	Share Price	Rating/Risk	Mkt Cap USD (M)	Target price	P/E (x)		P/Adjusted BV (x)				Adjusted RoAE		
CEE Banks					2012e	2013e	2014e	2012e	2013e	2014e	2012e	2013e	2014e
Alior Bank	PLN 70.80	1H	1,436	94.00	21.5	13.2	10.6	2.0	1.7	1.5	11.4%	14.8%	15.7%
Komerčni Banka	CZK 4,084.00	1	8,168	4,400.00	11.1	12.4	12.6	1.6	1.5	1.5	15.8%	12.6%	11.9%
BRE	PLN 331.00	3	4,449	279.00	12.1	16.7	13.0	1.5	1.4	1.3	13.2%	8.5%	10.3%
Bank Zachodni	PLN 274.90	1	8,202	311.00	14.2	13.5	13.5	2.3	1.8	1.7	17.7%	13.7%	13.1%
Getin Noble	PLN 1.90	2H	1,606	1.81	13.7	13.6	8.7	1.1	1.1	0.9	8.5%	8.1%	11.4%
ING Bank Śląski	PLN 87.00	2	3,610	92.00	13.5	18.2	12.9	1.5	1.4	1.4	12.0%	8.0%	10.9%
Bank Millennium	PLN 4.88	3	1,888	3.70	13.2	17.0	13.6	1.2	1.1	1.0	9.5%	6.9%	8.0%
OTP Bank	HUF 4,877.00	3	6,301	3,950.00	9.9	9.0	7.6	0.9	0.8	0.7	9.0%	9.2%	10.1%
Bank Pekao	PLN 159.10	3	13,319	148.00	14.0	17.8	15.1	1.8	1.8	1.8	13.4%	10.1%	11.7%
PKO BP	PLN 35.36	2	14,098	38.10	11.7	14.1	11.3	1.8	1.7	1.6	15.9%	12.4%	14.5%
Austria Banks													
Erste Bank	EUR 23.07	2	12,153	26.00	29.4	19.5	9.7	0.8	0.8	0.8	2.9%	4.2%	8.2%
Raiffeisen Bank Intl	EUR 30.28	3	7,904	27.50	7.9	8.2	6.7	0.8	0.7	0.7	10.0%	8.9%	10.2%
CIS Banks													
Bank Georgia	GBP 13.80	2	713	15.00	7.2	6.1	5.5	1.3	1.1	0.9	21.7%	21.7%	20.4%
Bank St Petersburg	RUB 49.84	1	498	68.00	24.9	6.6	3.6	0.4	0.4	0.4	1.8%	6.6%	11.1%
Halyk Bank	USD 8.25	1	2,250	10.00	6.3	5.7	5.3	1.2	1.0	0.9	20.7%	19.3%	17.8%
Kazkommertsbank	USD 2.55	2H	993	3.00	6.4	5.4	3.5	0.4	0.3	0.3	6.0%	6.7%	9.6%
Sberbank	RUB 106.23	1	78,713	130.00	6.7	6.1	5.7	1.5	1.2	1.0	23.9%	21.4%	19.2%
Bank VTB	USD 3.70	2	19,140	4.29	7.1	6.1	5.3	0.9	0.8	0.7	13.0%	13.5%	13.6%
Bank Vozrozhdenie	RUB 640.10	1	505	825.00	7.0	5.7	4.4	0.7	0.7	0.6	11.1%	12.1%	13.7%
Israel Banks													
Israel Discount	ILS 6.35	2	1,815	5.40	8.4	9.1	7.3	0.6	0.5	0.5	7.0%	6.1%	7.1%
Bank Leumi	ILS 13.20	3	5,276	10.10	12.0	11.6	10.7	0.8	0.7	0.7	6.7%	6.5%	6.6%
Bank Hapoalim	ILS 16.32	2	5,843	16.20	9.0	9.7	8.8	0.8	0.8	0.7	9.7%	8.3%	8.5%
Turkey Banks													
Bank Asya	TRY 2.22	1	1,131	2.20	9.6	7.4	5.9	0.8	0.8	0.7	9.3%	10.8%	11.9%
Garanti	TRY 8.62	2	20,486	8.65	9.8	9.3	8.1	1.7	1.5	1.3	18.9%	17.1%	17.1%
Halkbank	TRY 16.75	1	11,848	22.90	8.6	8.6	7.7	1.9	1.6	1.4	25.0%	20.5%	19.3%
Isbank	TRY 6.60	2	16,806	7.13	9.8	10.4	9.8	1.5	1.3	1.2	16.0%	13.6%	13.1%
Vakıfbank	TRY 5.44	2	7,696	6.00	8.9	8.8	7.3	1.3	1.1	1.0	15.2%	13.3%	14.0%
Yapi Kredi	TRY 5.14	2	12,643	4.10	9.8	8.8	7.8	1.5	1.3	1.1	16.5%	15.7%	15.2%
South Africa Banks													
African Bank	ZAR 30.23	1	2,755	38.00	8.5	7.3	6.3	1.7	1.5	1.3	20.3%	21.7%	22.7%
ABSA Grp	ZAR 165.50	2	13,370	162.90	13.5	10.3	9.0	1.8	1.6	1.5	13.6%	16.7%	17.5%
FirstRand	ZAR 31.03	2	19,679	34.10	12.6	10.7	9.1	2.5	2.2	1.9	21.3%	22.1%	22.5%
Investec	GBP 4.94	1	6,757	4.80	13.7	11.3	9.6	1.3	1.2	1.1	9.7%	11.5%	12.8%
Nedbank Ltd	ZAR 189.70	2	10,829	205.90	11.8	9.8	8.4	1.6	1.5	1.3	14.6%	15.9%	17.0%
Standard Bank	ZAR 118.45	2	21,402	120.10	12.6	10.6	9.0	1.7	1.6	1.4	14.1%	15.5%	16.5%
MENA Banks													
Riyad Bank	SAR 23.30	2	9,319	23.00	10.4	10.4	9.6	1.1	1.1	1.0	10.9%	10.4%	10.9%
BSF SA	SAR 30.70	2	7,400	35.00	9.9	9.1	8.3	1.3	1.2	1.1	13.5%	13.5%	13.6%
Samba	SAR 44.90	1	10,775	62.00	9.4	8.5	7.4	1.3	1.2	1.1	14.5%	14.7%	15.5%
AlRajhi Bank	SAR 67.75	2	27,097	80.00	12.9	11.8	10.6	2.8	2.6	2.5	22.6%	23.1%	24.1%
Alinma Bank	SAR 13.55	3	5,419	10.00	27.0	19.1	14.3	1.2	1.2	1.1	4.6%	6.3%	8.0%
ADCB	AED 3.82	3	5,819	2.31	8.7	9.0	8.0	1.1	1.0	0.9	13.1%	11.7%	12.2%
Attijariwafa Bnk	MAD 303.90	2	7,314	376.00	12.5	10.9	9.5	2.0	1.8	1.6	17.0%	17.4%	17.8%
Bank Muscat	OMR 0.64	1	3,362	0.80	8.5	8.3	7.2	1.2	1.1	1.0	15.6%	14.7%	15.2%
Comm Bank of Qatar	QAR 76.70	1	5,213	101.00	9.4	8.6	8.2	1.4	1.4	1.3	15.3%	16.2%	16.4%
CIB	EGP 34.92	2	3,113	40.00	9.1	6.5	5.4	2.1	1.7	1.4	24.6%	29.4%	29.3%
First Gulf Bank	AED 13.00	1	10,618	12.74	10.2	8.6	7.6	1.8	1.6	1.4	19.3%	19.9%	19.5%
NBAD	AED 11.25	2	11,867	9.32	10.8	9.9	8.7	1.7	1.6	1.4	16.3%	16.7%	16.9%
Ntnt Soc Gen Bk	EGP 37.66	3	2,481	24.00	11.1	10.9	8.7	2.0	1.8	1.6	18.4%	17.3%	19.3%
Rest of Africa Banks													
Equity Bank	KES 27.50	3	1,162	15.00	9.6	11.4	9.9	2.5	2.2	1.9	28.3%	20.5%	20.8%
First Bk Nigeria	NGN 19.73	1	4,089	24.00	7.7	7.0	5.3	1.5	1.3	1.2	20.8%	20.1%	23.7%
Guar Trust Bnk	NGN 24.93	1	4,660	31.00	8.9	8.3	6.9	2.6	2.4	2.1	32.4%	30.1%	32.4%
KCB	KES 37.25	3	1,263	20.00	9.0	11.7	10.4	2.2	2.0	1.8	25.6%	17.5%	17.9%
Skye Bank	NGN 6.24	1	524	10.00	4.9	4.2	3.3	0.7	0.6	0.6	14.9%	15.7%	18.4%
UBA	NGN 7.80	1	1,634	8.50	6.1	6.2	5.6	1.2	1.1	1.0	22.0%	18.4%	19.0%
Zenith Bank	NGN 21.08	1	4,203	26.00	8.4	8.0	6.6	1.4	1.3	1.2	18.7%	17.1%	19.1%

Source: Powered by dataCentral, Prices as of February 18

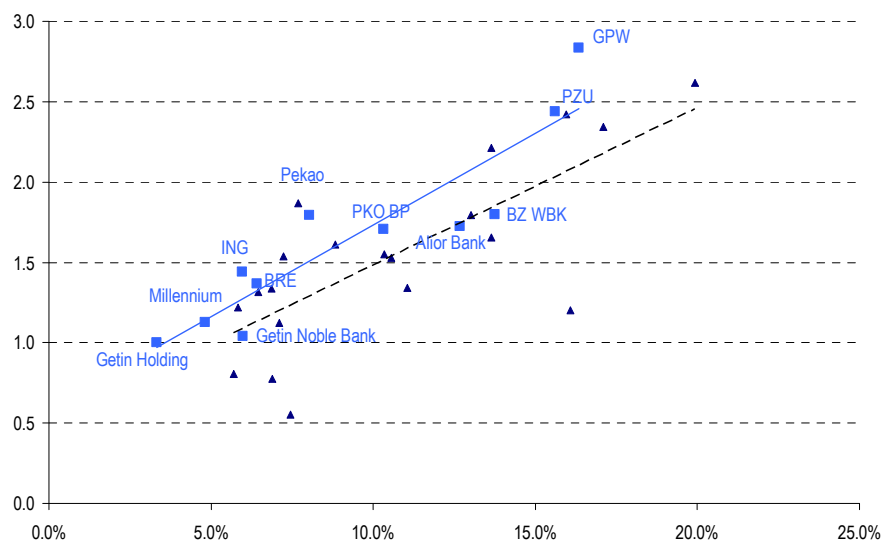
Figure 22. GEM Banks – P/BV and Real ROE\*, 2013E



\* At median, inflation adjusted

Source: Citi Research

Figure 23. Polish Financials – P/BV and ROE\*, 2013E



\*For comparative purposes triangles indicate relation of P/BV and ROE for GEM Banks (see figure above)

GPW (GPW.WA; ZL40.40; 2H); Getin Holding (GTN.WA; ZL2.72; 2H); PZU (PZU.WA; ZL410.50; 2)

Source: Citi Research



## A Case Study in Excellence

### BZ WBK – Successful Growth Story

**BZ WBK emerged as the result of the merger of Bank Zachodni with Wielkopolski Bank Kredytowy (WBK)**

As the name indicates, BZ WBK emerged as the result of the merger of Bank Zachodni with Wielkopolski Bank Kredytowy (WBK), both then controlled by Irish AIB. Both banks were established in 1989 on the basis of regional branches of the National Bank of Poland (NBP) located in Western Poland (Wrocław in Lower Silesia region and Poznań in Wielkopolska). The bank also opened many branches in key cities in other regions. BZ WBK focused on servicing medium-sized companies (also through its leasing and factoring subsidiaries) and Commercial Real-Estate (CRE) lending. In 2006-07 the bank took advantage of the strong equity market and materially increased revenues from asset management while later it diversified retail revenues by developing cash and mortgage lending (for a short period of time in 2008 it provided FX mortgages), current accounts and transactional services.

**Due to good management BZ WBK was one of the most profitable banks in Poland**

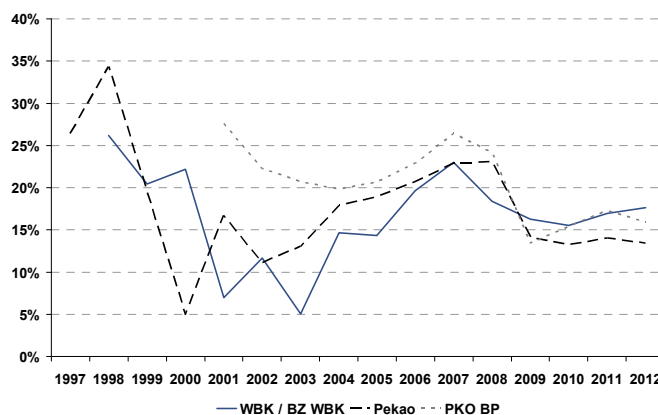
Due to good management BZ WBK (similarly to its predecessor WBK) was one of the most profitable banks in Poland and on a continuous basis delivered an ROE comparable to that of PKO BP and Pekao despite lacking their advantage of scale. Since 2010 the bank's ROE has diverged upward from the sector and closest peers, which, in our opinion, has been due mainly to its low share of unprofitable mortgage loans, successful re-pricing of corporate loans and diversified fee income.

Figure 24. BZ WBK – ROE, 1997-2012 (Percentage)



Source: NBP, KNF, Company reports and Citi Research

Figure 25. BZ WBK – ROE, 1997-2012\* (Percentage)

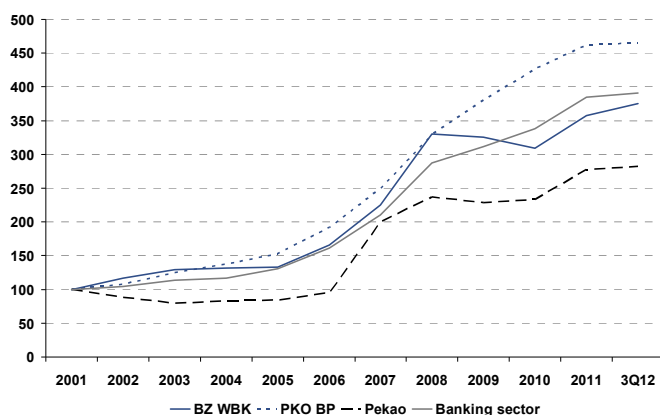


Note: \* Citi Research estimates of 2012 ROE for PKO BP and Pekao, actual ROE for BZ WBK

Source: Company reports and Citi Research

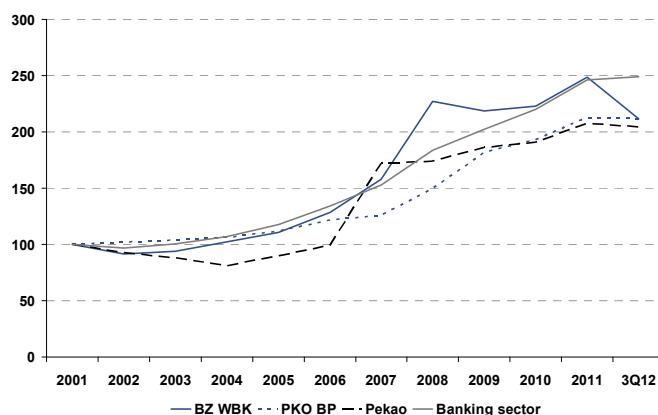
## Ideally Prudent

Figure 26. Polish Banks – Loan Growth Rebalanced (2001=100), 2001-3Q12



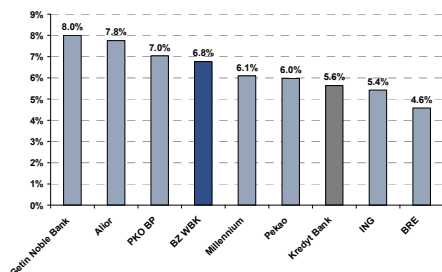
Source: NBP, KNF, Company reports and Citi Research

Figure 27. Polish Banks – Deposit Growth Rebalanced (2001=100), 2001-3Q12



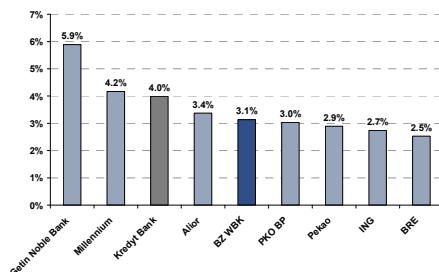
Source: NBP, KNF, Company reports and Citi Research

Figure 28. Polish Banks – Yield on Assets, 9M12 (Percentage)



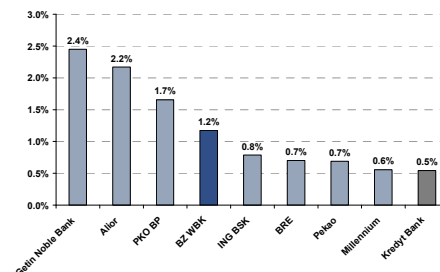
Source: Company reports and Citi Research

Figure 29. Polish Banks – Cost of Funding, 9M12 (Percentage)



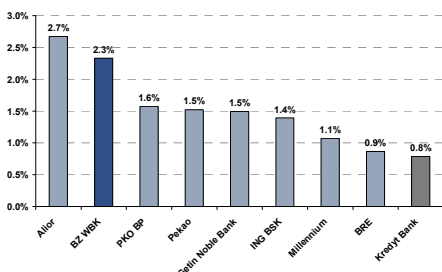
Source: Company reports and Citi Research

Figure 30. Polish Banks – Cost of Risk, 9M12 (Percentage)



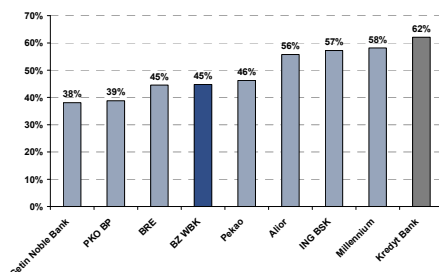
Source: Company reports and Citi Research

Figure 31. Polish Banks – Net Fee to Assets, 9M12 (Percentage)



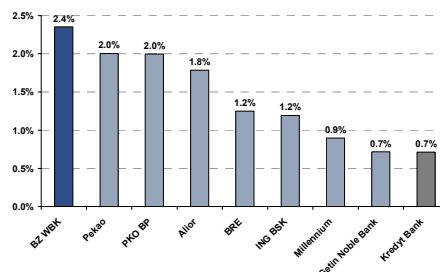
Source: Company reports and Citi Research

Figure 32. Polish Banks – Cost to Income, 9M12 (Percentage)



Source: Company reports and Citi Research

Figure 33. Polish Banks – ROA, 9M12 (Percentage)



Source: Company reports and Citi Research

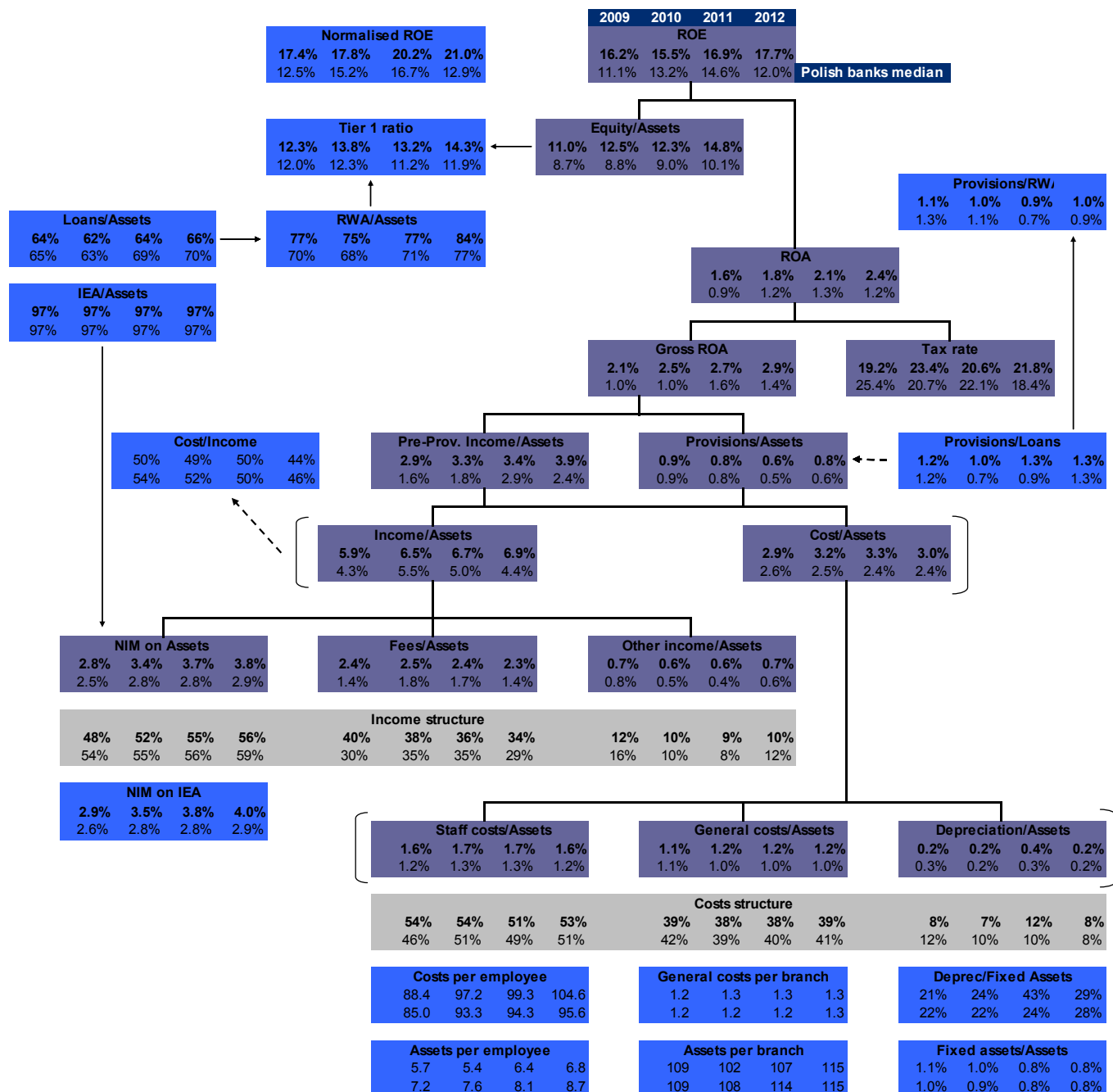
**Lending growth in line with the market and lack of business mistakes has led to superior profitability**

Since the merger of Wielkopolski Bank Kredytowy (WBK) with Bank Zachodni (BZ) in 2001, BZ WBK has increased its loans and deposits broadly in line with the sector. Its yield on assets has been higher than the sector average (in our opinion, due mainly to successful re-pricing of corporate loans after 2009), while its cost of funding and cost of risk have been in line with the market and enough to make the bank's net interest margin adjusted for cost of risk the highest in our universe of

Polish banks. Add to that relatively high and diversified fee income and decent costs, and BZ WBK has been able to deliver the highest return on assets (ROA) and the second-highest return on equity (ROE) in our Polish banks universe. In our opinion, BZ WBK's case proves that you don't need to be outstanding in many areas to outperform, it is enough to avoid material mistakes.

## ROE Deconstructed

Figure 34. BZ WBK – DuPont Analysis, 2009-2012



Source: Company reports, Citi Research

## ROE Driven Primarily by ROA

**Banks' ROE depends on capital leverage and on return on assets**

Broadly speaking, a banks' ROE depends on capital leverage and on return on assets (ROA). The ability to 'play' with leverage is limited by regulation. The regulator usually acts pro-cyclically and it increases capital requirements in reaction to financial crisis (as demonstrated currently by the implementation of Basel 3). Banks can lower capital requirements through optimising balance sheet structures (sometimes similar products have a different risk weight in standard models) and through implementation of more sophisticated models to calculate capital requirements: Internal Rating Based (IRB) and Advanced Internal Rating Based (Advanced IRB) approaches. However, room for self-help is limited because:

- Firstly, the leverage ratio (capital-to-assets) implemented by Basel 3 as the supplementary measure of bank's capitalization materially limits the bank's ability to lower its capital requirements;
- Secondly, the regulators' additional restrictions on capital return (e.g. KNF's (Polish FSA's) recommendations limiting dividend payout at 50% for 2011 earnings and 75% for 2012 earnings) significantly decrease the banks' freedom in shaping their capital structure (as demonstrated by the inability of overcapitalized Pekao (Core Tier 1 at 18%) to return surplus capital to shareholders).

**In our opinion, banks should focus on maximising their ROA**

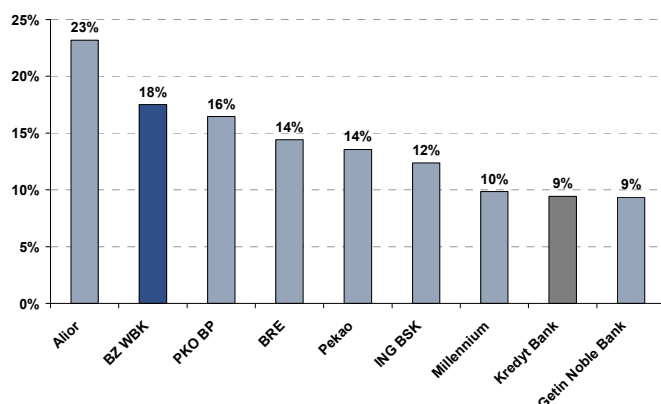
We think that longer term banks should assume that they will have limited ability to shape their capital structures. Hence, in our opinion, the banks should focus rather on maximising ROA.

## The second-highest ROE in our universe of Polish banks

**In 9M12, due to its high ROA, BZ WBK has delivered the second-highest ROE**

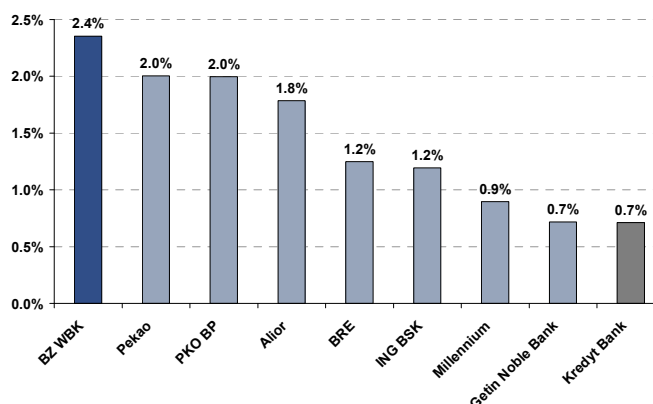
In 9M12, due to its "best in class" return-on-assets (ROA), BZ WBK has delivered the second-highest ROE in our universe of Polish banks despite having the second-lowest capital leverage (e.g. the second-highest Tier 1 ratio).

Figure 35. Polish Banks – ROE, 9M12 (Percentage)



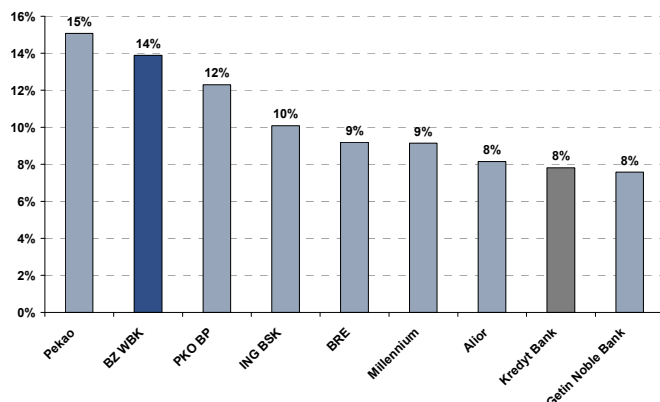
Source: Company reports and Citi Research Citi Research

Figure 36. Polish Banks – ROA, 9M12 (Percentage)



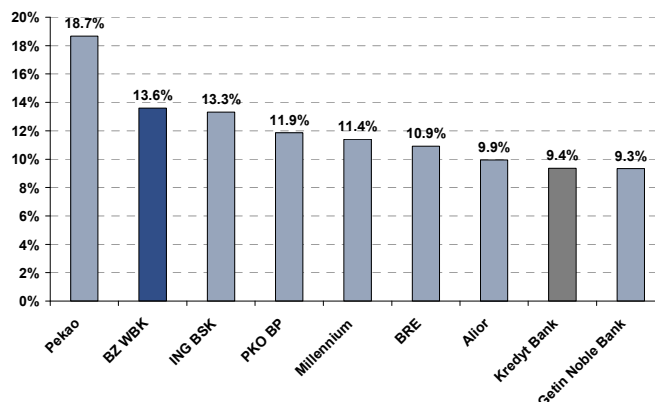
Source: Company reports and Citi Research

Figure 37. Polish Banks – Equity-to-Assets, 9M12 (Percentage)



Source: Company reports and Citi Research

Figure 38. Polish Banks – Tier 1, 9M12 (Percentage)



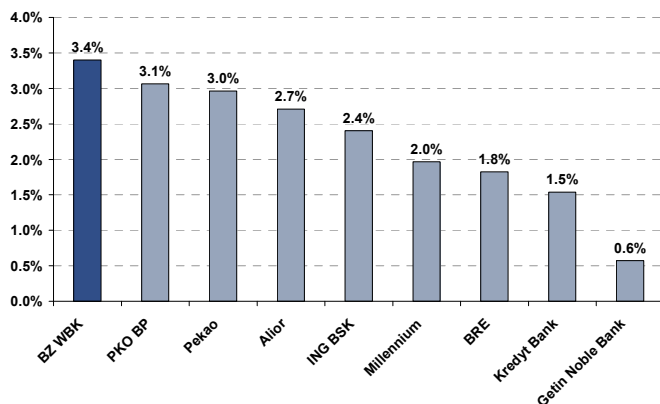
Source: Company reports and Citi Research

**The bank's profitability benefited from high revenues**

The bank's profitability benefited from high revenues (adjusted for costs of risk) driven by BZ-WBK having:

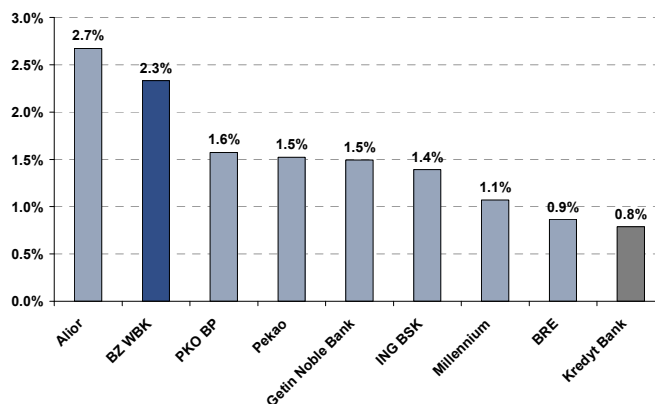
- the highest net interest margin (NIM) adjusted for cost of risk (proving proper risk pricing);
- the second-highest net fees to assets.

Figure 39. Polish Banks – NIM Adjusted for Cost of Risk, 9M12 (Percentage)



Source: Company reports and Citi Research

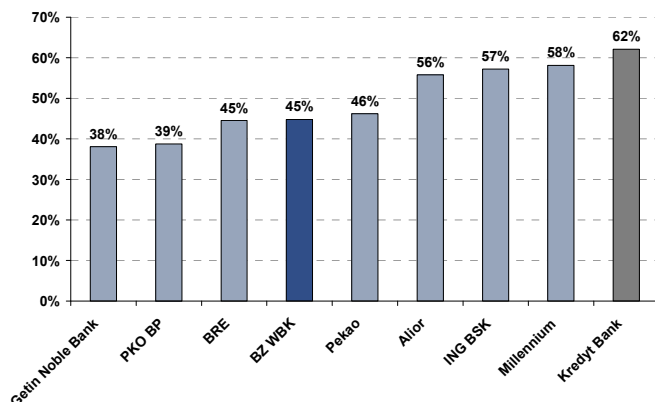
Figure 40. Polish Banks – Net Fees to Assets, 9M12 (Percentage)



Source: Company reports and Citi Research

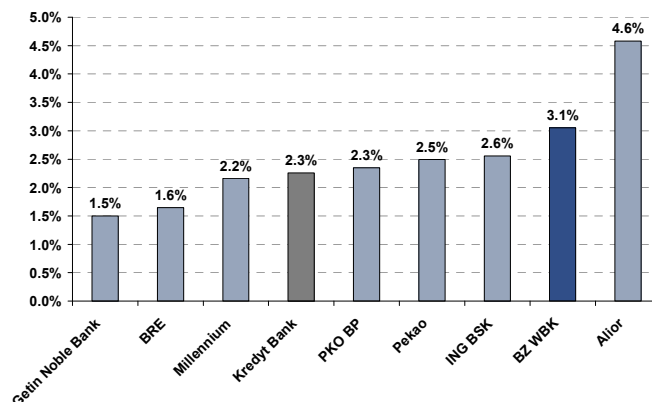
Owing to high revenues per assets, even despite the second-highest cost per assets, the bank's cost-to-income ratio was at a decent level.

Figure 41. Polish Banks – Cost-to-Income, 9M12 (Percentage)



Source: Company reports and Citi Research

Figure 42. Polish Banks – Cost-to-Assets, 9M12 (Percentage)

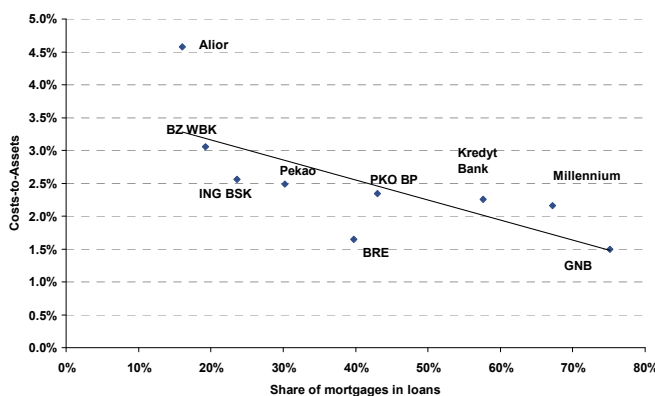


Source: Company reports and Citi Research

**Revenue-to-assets and cost-to-assets ratios depend on the balance sheet structure**

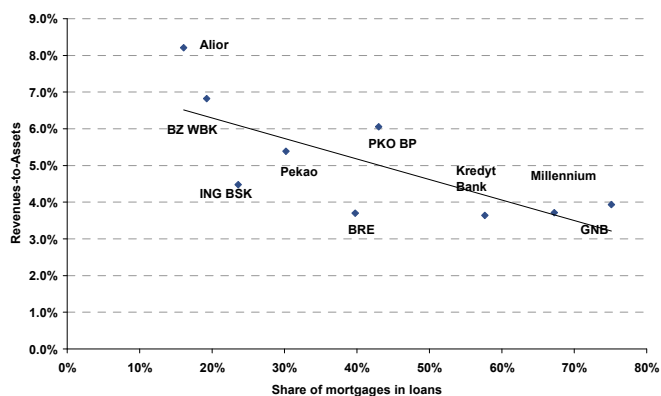
We note that both revenue-to-assets and cost-to-assets ratios depend to a large extent on the balance sheet structure, namely on the share of (low-margin but also low-laborious) mortgage loans (a lower share of mortgages leads to higher revenues per assets and simultaneously to higher cost-to-assets) and thus the two banks with the lowest share of mortgages (Alior and BZ WBK) have the highest revenue-to-assets and the highest cost-to-assets ratios.

Figure 43. Polish Banks – Costs-to-Assets vs. Share of Mortgages in Loans, 9M12 (Percentage)



Source: Company reports and Citi Research

Figure 44. Polish Banks – Revenues-to-Assets vs. Share of Mortgages in Loans, 9M12 (Percentage)



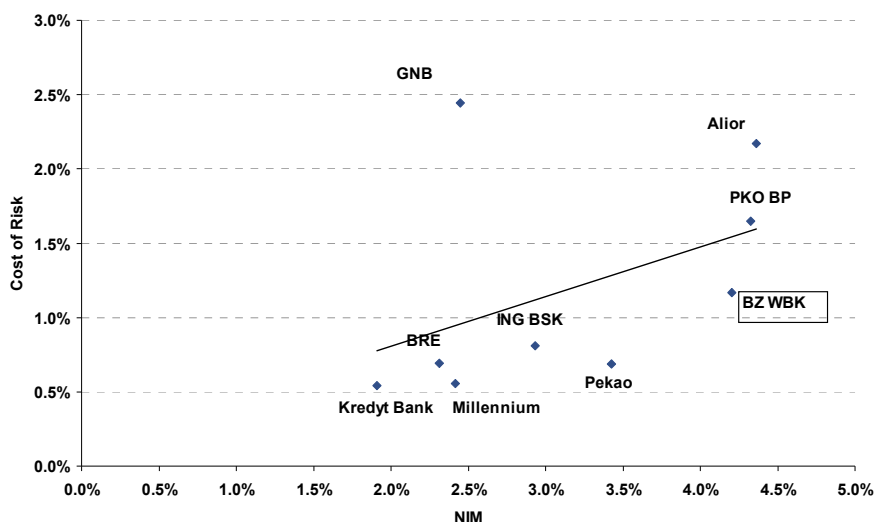
Source: Company reports and Citi Research

## Net Interest Income Insight

High NIM and moderate cost of risk...

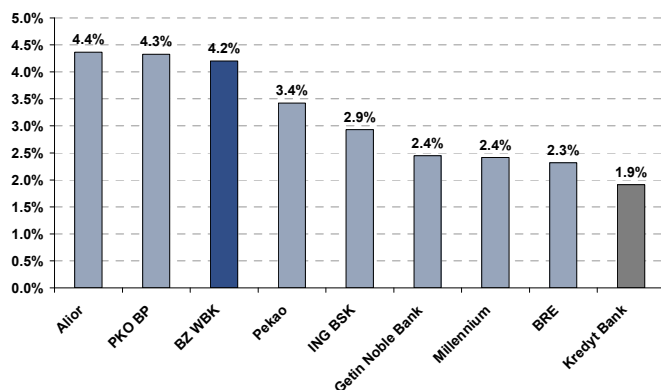
BZ WBK enjoys a high NIM (only slightly lower than Alior's and PKO BP's NIMs) and moderate cost of risk.

Figure 45. Polish Banks – Costs of Risk vs. NIM, 9M12 (Percentage)



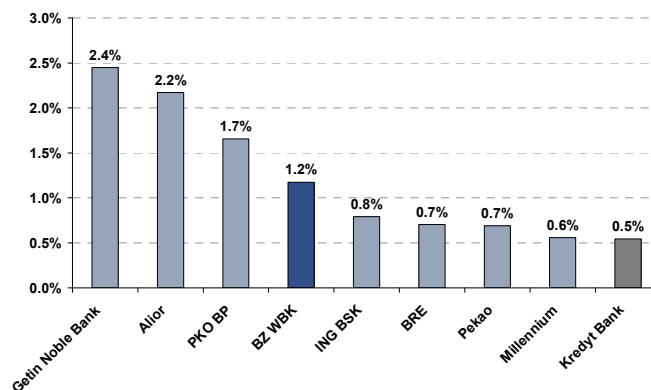
Source: Company reports and Citi Research

Figure 46. Polish Banks – NIM, 9M12 (Percentage)



Source: Company reports and Citi Research

Figure 47. Polish Banks – Cost of Risk, 9M12 (Percentage)

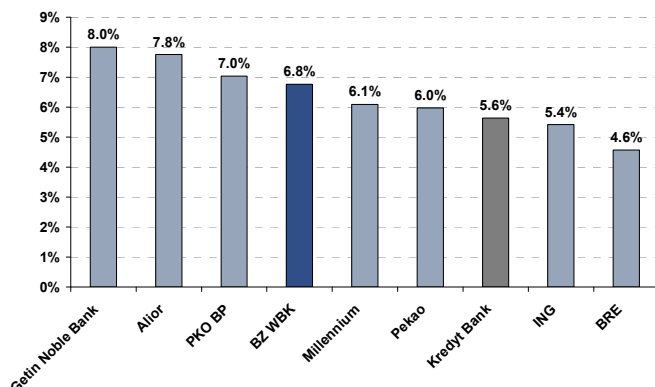


Source: Company reports and Citi Research

...due to high yield on interest earning assets

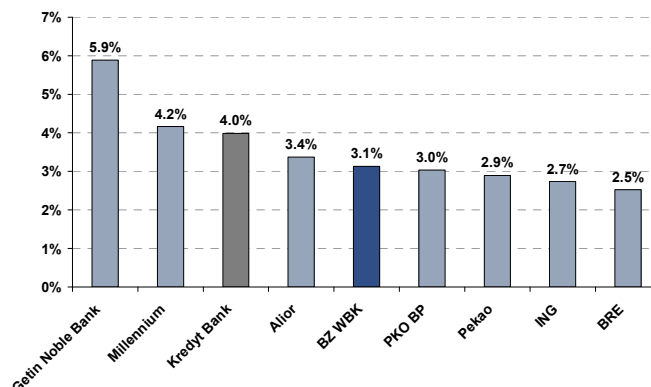
What was behind the bank's superior NIM? The answer is: a relatively high yield on interest earning assets and a moderate cost of funding.

Figure 48. Polish Banks – Yield on Assets, 9M12 (Percentage)



Source: Company reports and Citi Research

Figure 49. Polish Banks – Cost of Funding, 9M12 (Percentage)



Source: Company reports and Citi Research

## High Yield on Assets Due to Low Share of FX Mortgages

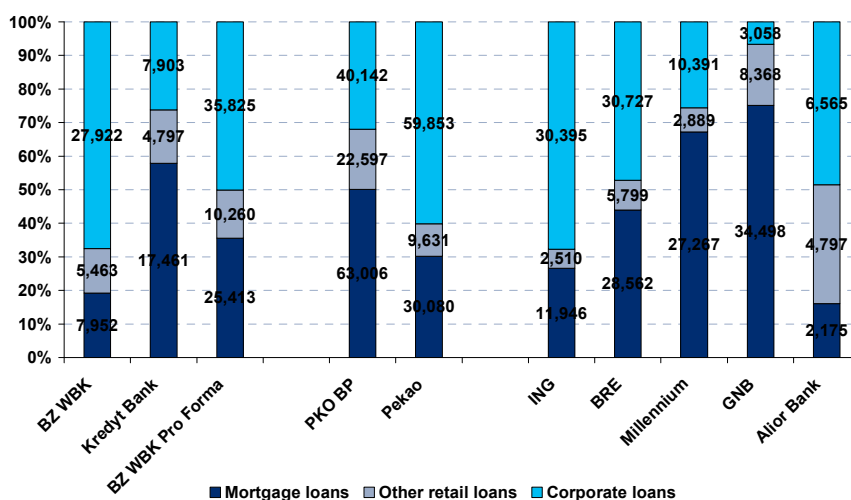
Yield on interest earning assets is affected by asset structure

The yield on interest-earning assets is affected by asset structure. Given the similar share of non-lending interest earning assets at the main banks (the outliers are Getin Noble Bank and Millennium, which have a relatively high share of loans, and ING BSK with the lowest share), the main factor impacting interest income should be the structure of loans. Another factor impacting nominal interest income is the currency structure of assets but we note that FX-denominated loans, despite their lower nominal rate, have a similar or even higher lending spread.

BZ WBK's yield on assets was positively affected by its low share of low-margin mortgages

BZ WBK's yield on assets was positively affected by the low share of low-margin mortgages and, in particular, low share of pre-crisis FX mortgages, which, given increased costs of funding, are unprofitable at the moment.

Figure 50. Polish Banks – Structure of Loans, 3Q12 (Percentage/Polish Zloty in million)



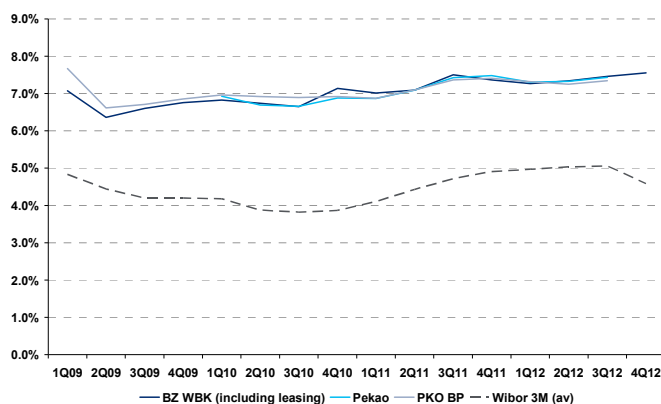
Source: Company reports and Citi Research



### High yield on loans and on non-lending interest earning assets

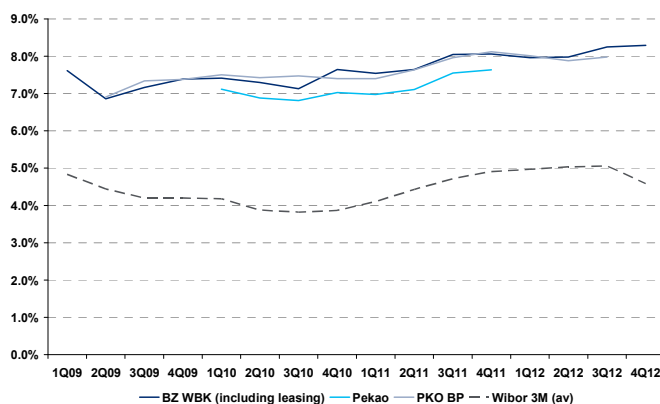
Comparing BZ WBK to Pekao and PKO BP, we have found that the three banks have surprisingly similar interest rates on total loans but including income from FX swaps and CIRS, Pekao's yield on loans is lower than those of PKO BP and BZ WBK. Relative to PKO BP, BZ WBK and Pekao have a slightly lower share of loans in interest earning assets. On the other hand, BZ WBK's yield on non-lending interest earning assets (i.e. at fixed-income securities and receivables from banks) is visibly higher than Pekao's.

Figure 51. BZ WBK, PKO BP and Pekao – Yield on Loans, 1Q09-4Q12 (Percentage)



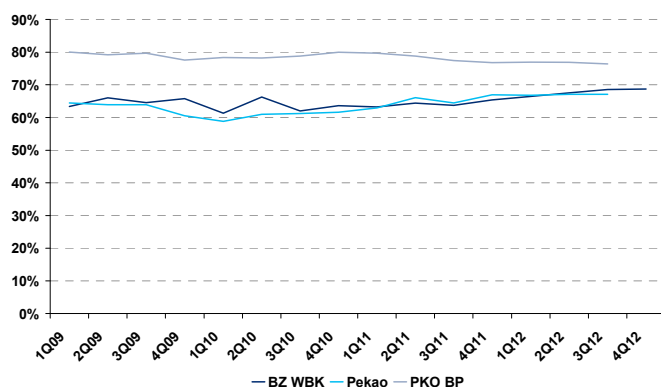
Source: Company reports, www.stock.pl and Citi Research

Figure 52. BZ WBK, PKO BP and Pekao – Yield on Loans (Including FX Swaps/CIRS Income), 1Q09-4Q12 (Percentage)



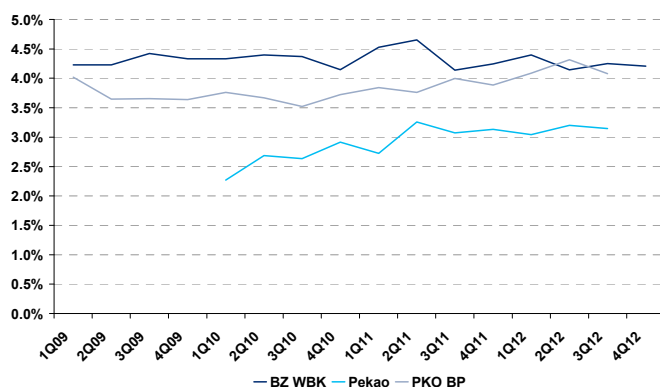
Source: Company reports, www.stock.pl and Citi Research

Figure 53. BZ WBK, PKO BP and Pekao – Share of Loans in Interest Earning Assets, 1Q09-4Q12 (Percentage)



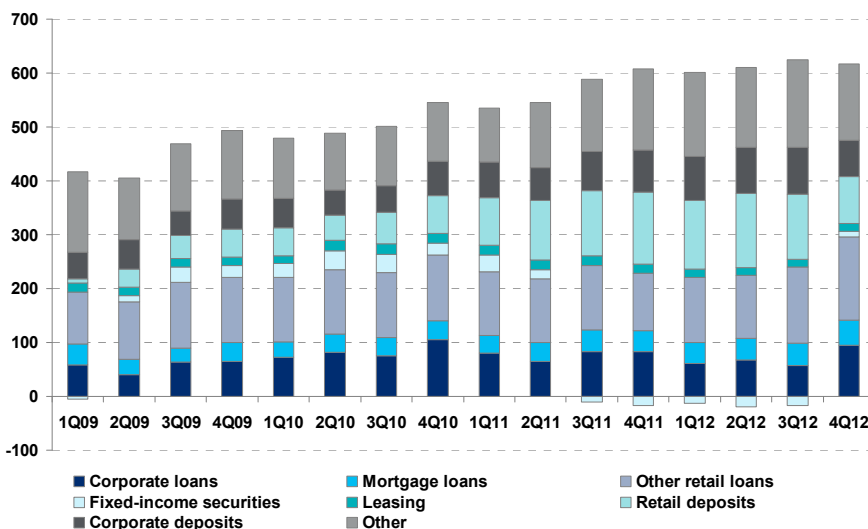
Source: Company reports and Citi Research

Figure 54. BZ WBK, PKO BP and Pekao – Yield on non-lending Interest Earning Assets, 1Q09-4Q12 (Percentage)



Source: Company reports and Citi Research

Figure 55. BZ WBK – Breakdown of Net Interest Income\*, 1Q09-4Q12 (Polish Zloty in million)



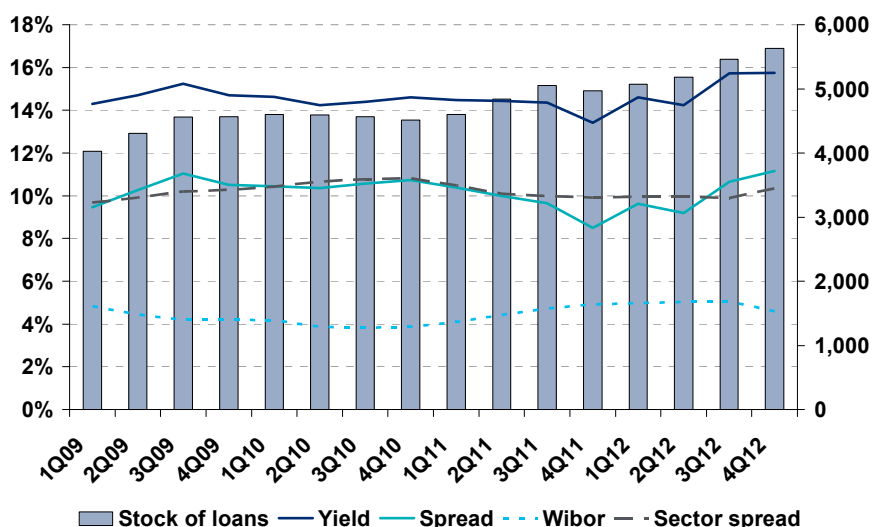
Note: \* Interest income and interest cost compared to cost of funding (calculated at WIBOR 3M)

Source: Company reports and Citi Research

Net interest income generated on interest earning assets (calculated as interest income less cost of funds at WIBOR 3M) rose from Zł c.200m quarterly at the beginning of 2009 to Zł c350m in 4Q12, driven by:

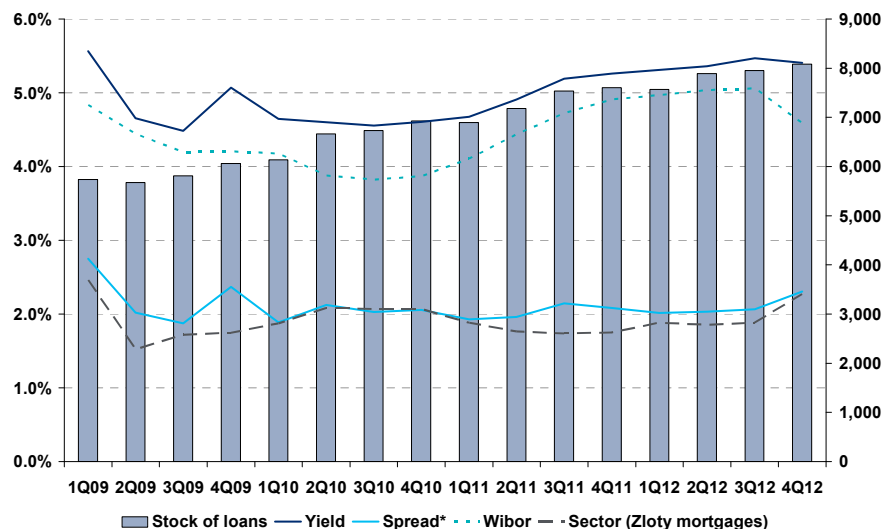
- higher net income on non-mortgage loans due to increased volume (especially in 2009 when the stock of non-mortgage retail loans grew from Zł 4.0bn in 1Q09 to Zł 4.6bn in 4Q09) and higher lending spread, driven partly by increased pricing (3Q12) and partly (4Q12) by lower WIBOR;
- higher net income on mortgage loans due to increased volume and broadly flat spreads (on a quarterly basis spreads fluctuated driven by changes in WIBOR due to an average 3-6 months delay in loan re-pricing).

Figure 56. BZ WBK – Spread on Non-mortgage Loans, 1Q09-4Q12 (Percentage/Polish Zloty in million)



Source: Company reports, www.stock.pl and Citi Research

Figure 57. BZ WBK – Spread\* on Mortgage Loans, 1Q09-4Q12 (Percentage/Polish Zloty in million)



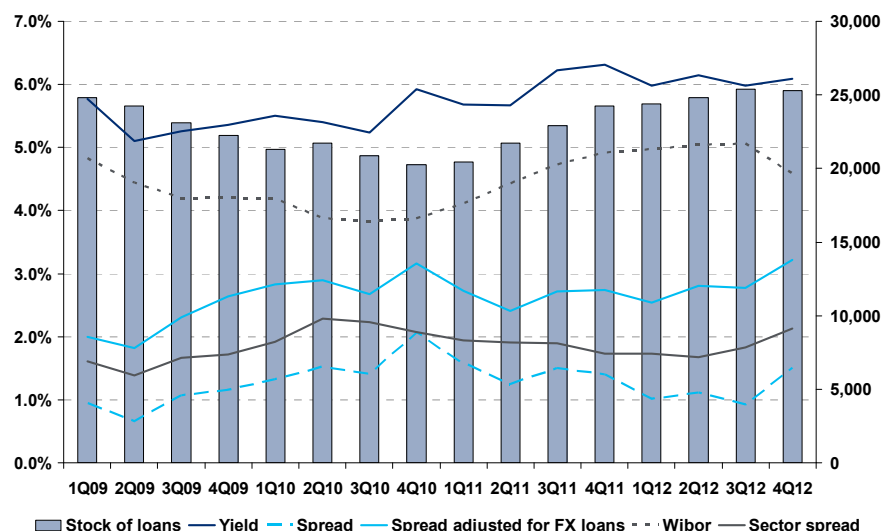
Note: \*Spread calculated to weighted average of CHF Libor 3M and WIBOR 3M

Source: Company reports, www.stock.pl and Citi Research

In our opinion, a higher than average spread on corporate lending is one of the main reasons for BZ WBK's superior profitability.

Net interest income on corporate loans fluctuated driven by changes in WIBOR (lower WIBOR led to higher spread and higher NII). We note that the bank's spread on corporate loans (c2.8%), calculated as the difference between the yield on corporate loans and the reference rate being the weighted average of WIBOR and EUR LIBOR, is much higher than the average spread in the industry (c2.0%). In our opinion, successful re-pricing of corporate loans in 2009-2010, which led to higher than average spreads, is one of the main reasons for BZ WBK's superior profitability.

Figure 58. BZ WBK – Spread\* on Corporate Loans, 1Q09-4Q12 (Percentage/Polish Zloty in million)



Note: \*Spread calculated to weighted average of EUR Libor 3M and WIBOR 3M

Source: Company reports, www.stock.pl and Citi Research

## Moderate Cost of Funding Due to Low Funding Needs

Figure 59. Polish Banks – Cost of Funding Adjusted for FX Structure of Interest Bearing Liabilities, 2011 (Percentage)

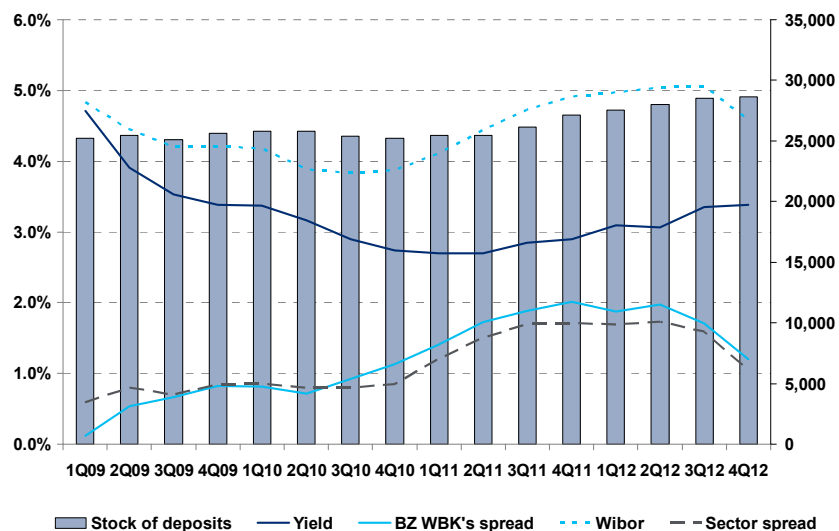
	Weighted average reference rate	Cost of funding	Spread
ING	4.0%	2.5%	1.5%
Pekao	3.9%	2.4%	1.5%
<b>BZ WBK</b>	<b>4.1%</b>	<b>2.6%</b>	<b>1.4%</b>
PKO BP	4.0%	2.9%	1.2%
BRE	2.8%	2.0%	0.8%
Millennium	4.0%	3.4%	0.6%
Kredyt Bank	3.1%	3.2%	-0.1%
Getin Noble Bank	4.4%	4.7%	-0.4%

Source: Company reports, NBP and Citi Research

**BZ WBK's retail deposit spread is slightly higher than the sector spread due to the bank's low funding needs**

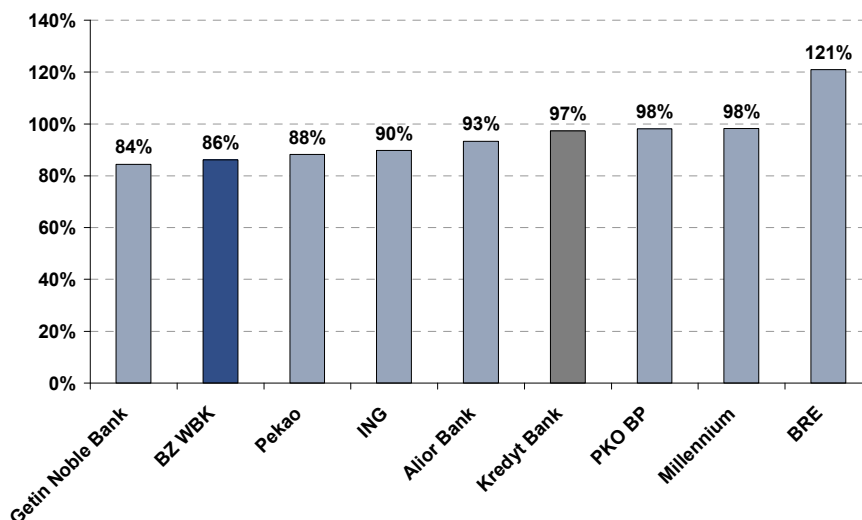
The bank's net interest income on retail deposits was driven by fluctuations in the sector's deposit spread, affected by changes in WIBOR (higher WIBOR led to an increased deposit spread in 2011 while a subsequent decrease in WIBOR caused a decline in deposit spread). In our opinion, BZ WBK's retail deposit spread is slightly higher than the sector spread due to the bank's low funding needs. The bank enjoys a low loan-to-deposit ratio, due partly to its low share of FX-denominated mortgages. The rapid zloty depreciation at the end of 2008 led FX-denominated assets to grow rapidly in zloty terms. Banks that funded their FX lending with zloty deposits and FX swaps had to gather new deposits quickly to match the growth in assets and overpaid for them as a result.

Figure 60. BZ WBK – Spread on Retail Deposits, 1Q09-4Q12 (Percentage/Polish Zloty in million)



Source: Company reports, www.stock.pl and Citi Research

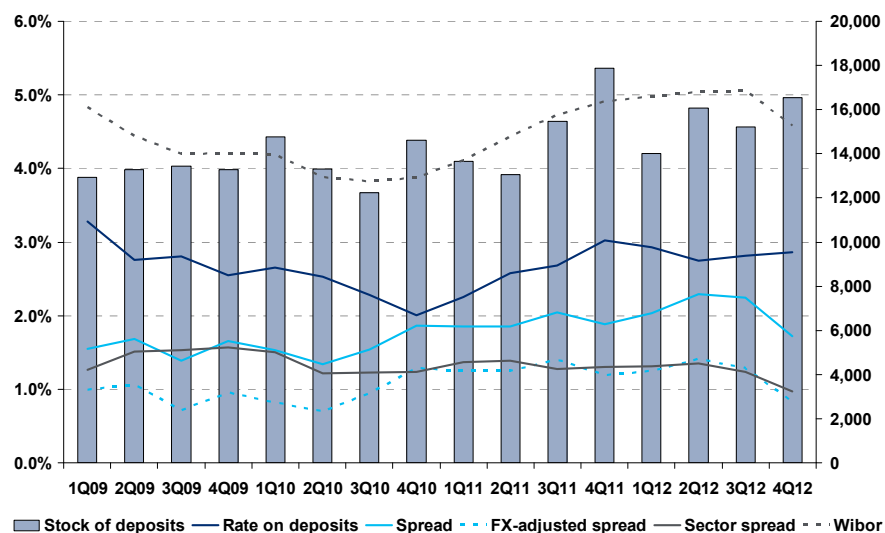
Figure 61. BZ WBK – Loan-to-Deposit Ratio, 3Q12 (Percentage)



Source: Company reports, www.stock.pl and Citi Research

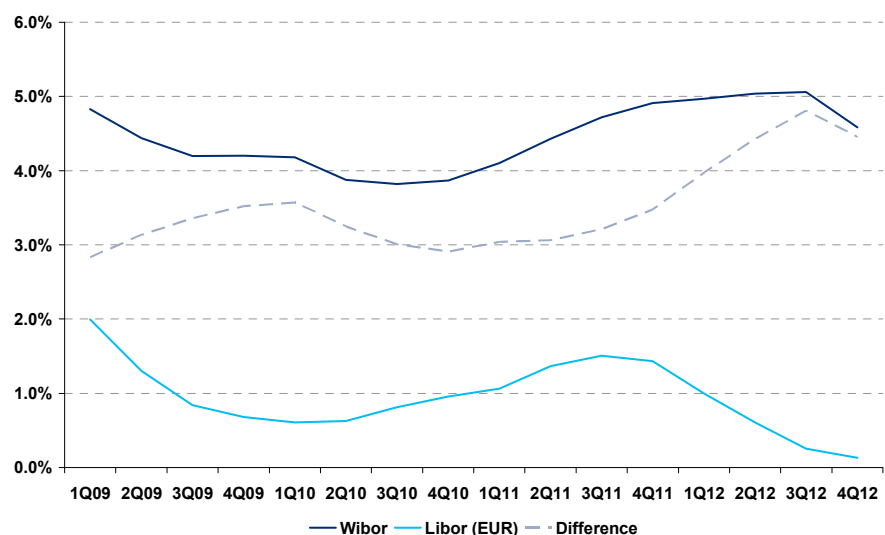
BZ WBK doesn't disclose the FX structure of retail and corporate deposits so in our calculation we do not take into account that part of corporate deposits is denominated in FX and thus the real spread on corporate deposits is lower than our estimate. The question is how big is the difference? FX-denominated loans amounted to 11% total deposits in 2011 and 10% in 2008, so were not significant, but we think that the majority of FX-denominated loans come from corporate rather than from retail clients. Assuming that c80% of FX deposits are corporate, we estimate that c20% of corporate deposits are denominated in FX and we find that since end-2010 BZ WBK's spread on corporate deposits has been in line with the sector trend. Widening of the spread between WIBOR and EUR LIBOR partly explains the growth in the raw (unadjusted for FX) deposit spread in 1H12. The material improvement in the deposit corporate spread in 2010 was one of the drivers of the growth in the bank's total net interest margin.

Figure 62. BZ WBK – Spread on Corporate Deposits, 1Q09-4Q12 (Percentage/Polish Zloty in million)



Source: Company reports, www.stock.pl and Citi Research

Figure 63. Polish Banks – WIBOR 3M vs. EUR Libor 3M, 1Q09-4Q12 (Percentage)

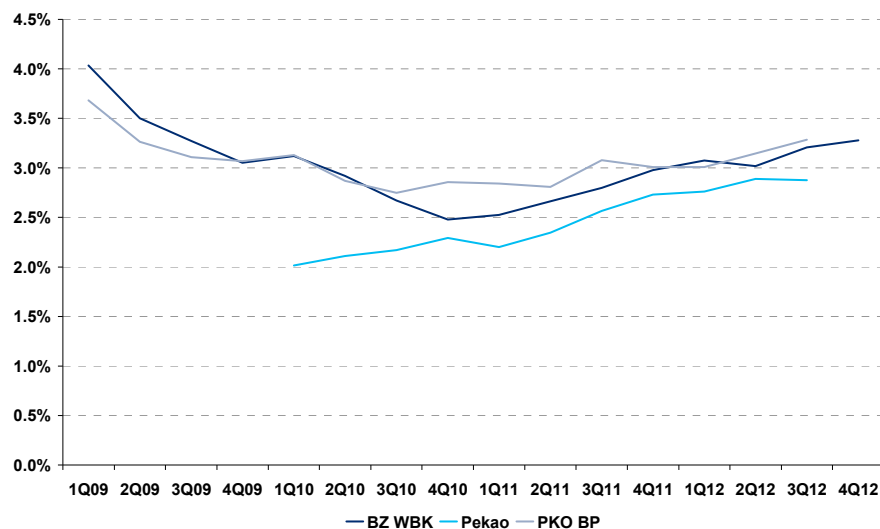


Source: www.stock.pl and Citi Research

**BZ WBK's cost of deposit was very similar to PKO BP's cost and slightly higher than Pekao's**

In comparison to its closest peers, BZ WBK's cost of deposits was very similar to PKO BP's and slightly higher than Pekao's.

Figure 64. BZ WBK, PKO BP and Pekao – Cost of Deposits, 1Q09-4Q12 (Percentage)

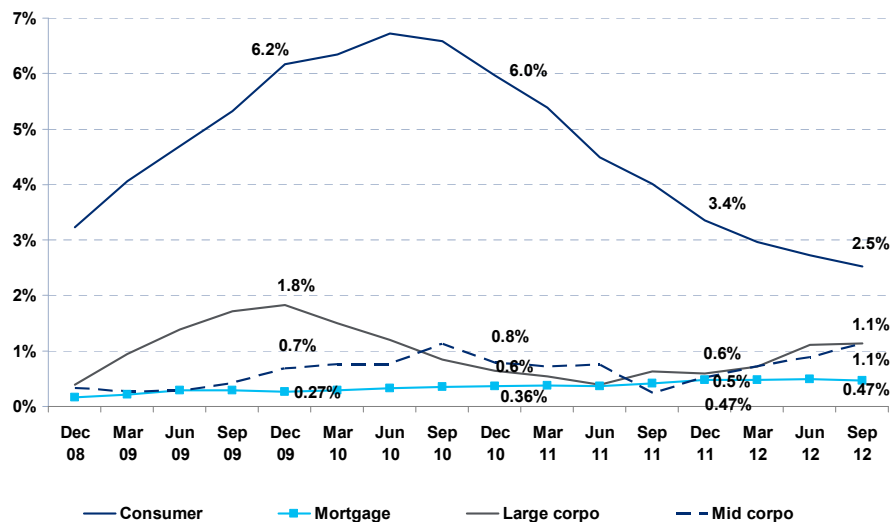


Source: Company reports and Citi Research

## Cost of Risk Insight

### Cost of Risk Reflects Loan Structure

Figure 65. Polish Banks – Cost of Risk, 4Q08-3Q12 (Percentage)



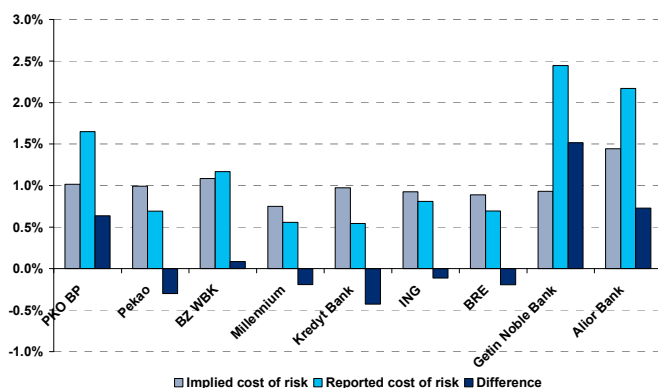
Source: NBP

In the long term the discrepancies between cost of risk reported by banks and that implied by the sector data are small

Taking advantage of data on cost of risk per product (consumer and mortgage loan, lending to large and mid corporations) disclosed by the NBP (see chart below) we have calculated the theoretical cost of risk for our universe of Polish banks. Short term there are some divergences between the cost of risk implied by sector data and reported costs of risk (see calculations for 9M12), but in longer term the discrepancies are much lower (see a chart with calculation for 2010-9M12) and can be explained by stock-specific issues:

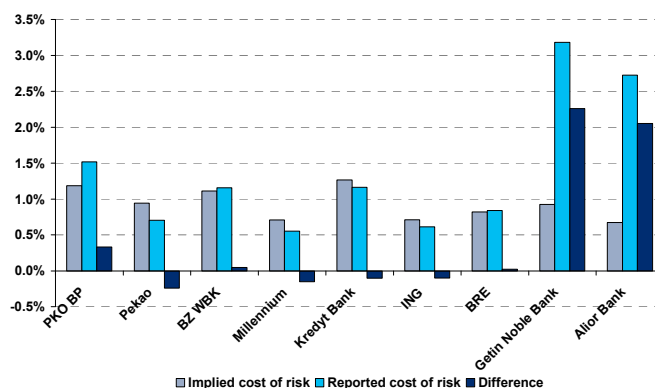
- Getin Noble has paid for high growth in 2007-2010 and its NPL ratio and cost of risk in consumer and mortgage lending have been much above the sector average in the recent years;
- Similarly, Alior's high cost of risk reflects the bank's above sector growth but it is also driven by its high share (vs. sector average) of more risky loans to SMEs (classified as a corporate loans);
- PKO BP's higher than implied cost of risk may be an effect of its higher appetite for growth (e.g. reflected in high growth in lending to SMEs in 2010).
- Pekao's lower than implied cost of risk may be due to its more prudent lending practices or its more loose provisioning practices.

Figure 66. Polish Banks – Reported vs. Implied by the Loan Structure Cost of Risk, 9M12 (Percentage)



Source: Company reports, NBP and Citi Research

Figure 67. Polish Banks – Reported vs. Implied by the Loan Structure Cost of Risk, 2010-9M12 (Percentage)



Source: Company reports, NBP and Citi Research

BZ WBK's cost of risk (117bp in 9M12 and 116bp in 2010-9M12) nearly ideally matches the theoretical cost of risk implied by the sector's cost of risk by product and the bank's structure of loans (108bp and 111bp, respectively).

## Corporate Provisioning Between PKO BP and Pekao

**BZ WBK's cost of risk in the corporate segment was higher than Pekao's but lower than PKO BP's**

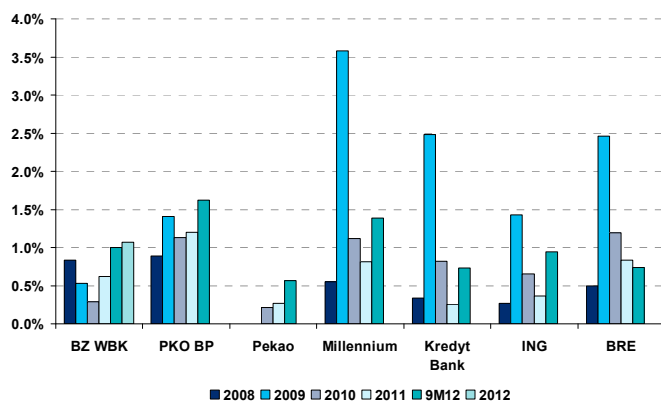
BZ WBK's cost of risk in the corporate segment (100bp in 9M 12 and 62bp in 2011) was higher than Pekao's one (56bp and 27bp, respectively) but lower than PKO BP's cost (162bp and 120bp, respectively). In 2011 and 2012 BZ WBK's corporate provisioning were broadly in line with sector trends. We note that the deviations from sector trends in 2009-2010 were caused mainly by BZ WBK's decision to significantly increase provisioning in 4Q08 – owing to this early reaction to the ongoing crisis BZ WBK was able to report lower provisioning in 2009 and 2010.

**BZ WBK's cost of risk in the retail division was higher than peers', due mainly to its higher share of non-mortgage loans**

In the retail division BZ WBK's cost of risk is higher than peers', due mainly to its higher share of non-mortgage loans in the retail loan mix (41% in 3Q12 vs. 24% in Pekao and 37% in PKO BP), but we note that before 3Q10 the bank's retail cost of risk was also higher than the sector benchmark (sector benchmark calculated as a weighted average of mortgage and consumer cost of risk, weights based on BZ WBK's structure of retail loans).

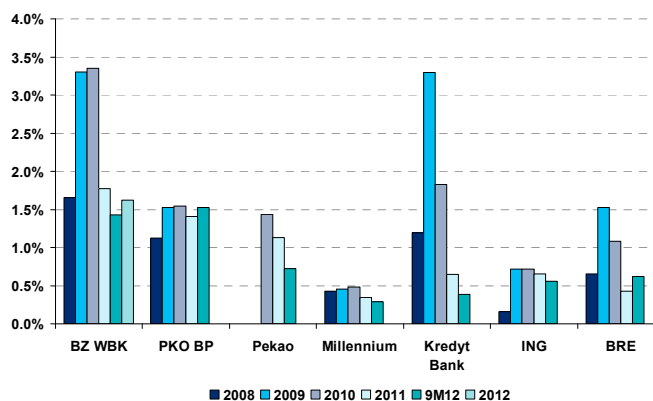


Figure 68. Polish Banks – Corporate Cost of Risk, 2008-2012  
(Percentage)



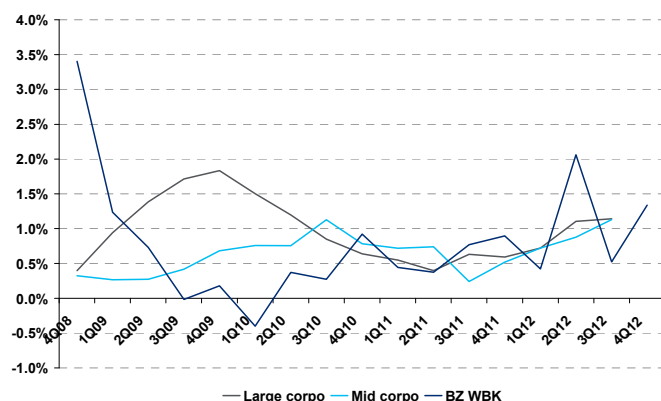
Source: Company reports and Citi Research

Figure 69. Polish Banks – Retail Cost of Risk, 1Q07-4Q12



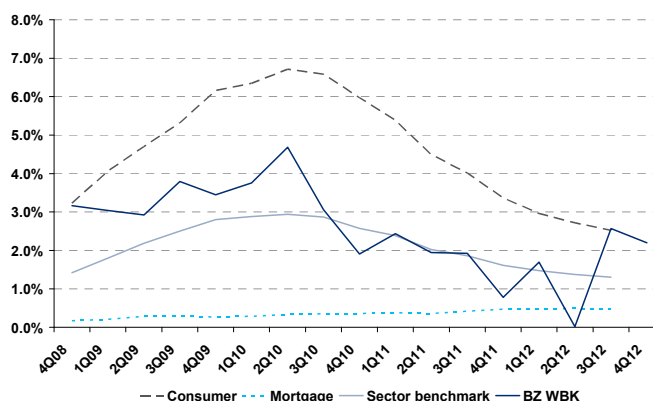
Source: Company reports and Citi Research

Figure 70. BZ WBK – Corporate Cost of Risk vs. Sector, 4Q08-4Q12  
(Percentage)



Source: Company reports, NBP and Citi Research

Figure 71. BZ WBK – Retail Cost of Risk vs. Sector\*, 4Q08-4Q12  
(Percentage)



Note: Sector benchmark calculated as an weighted average of mortgage and consumer cost of risk (weights based on BZ WBK's structure of retail loans)

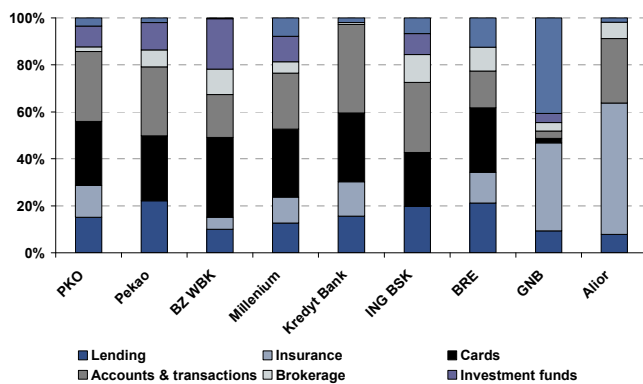
Source: Company reports, NBP and Citi Research

## Fee Leader

**The bank has enjoyed a high share of fee income in total revenues**

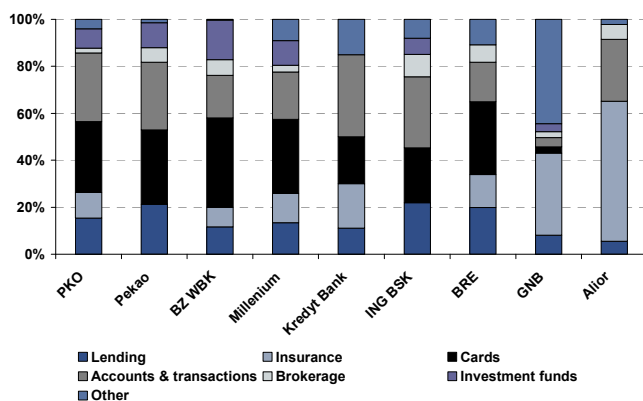
The key area of BZ WBK's superiority vs. other banks is in fee generation. Since inception, the bank has enjoyed a high share of fee income in total revenues and high net fees vs. average assets. In 9M12 and FY2012 BZ WBK's (annualised) fee revenues were equal to 4.4% and 4.0%, respectively, of average assets but this figure is not fully comparable because other banks (excluding ING BSK) do not include FX commission in fee revenues. Excluding FX commission, the bank's fee revenues to average assets stood at 3.8% and 3.4% and were the second-highest, just after Alior Bank. But BZ WBK's mastery lies not only in the ability to generate high fee income but predominantly in its differentiation of fee income.

Figure 72. Polish Banks – Structure of Fee Income (excluding FX Commission), 2011 (Percentage)



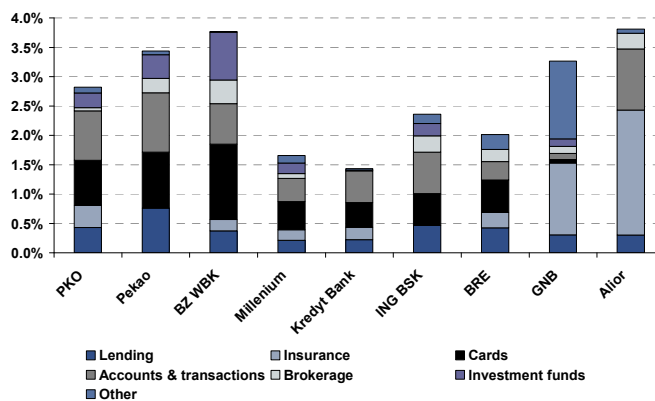
Source: Company reports and Citi Research

Figure 74. Polish Banks – Structure of Fee Income (excluding FX Commission), 9M11 (Percentage)



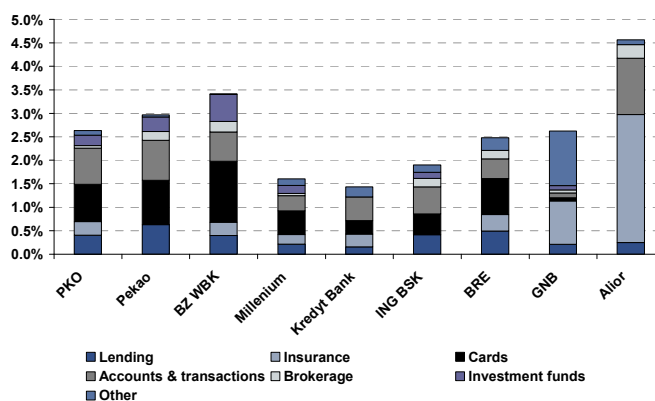
Source: Company reports and Citi Research

Figure 73. Polish Banks – Fee Income (excluding FX Commission) As Percentage of Assets, 2011 (Percentage)



Source: Company reports and Citi Research

Figure 75. Polish Banks – Fee Income (excluding FX Commission) As Percentage of Assets, 9M11 (Percentage)



Source: Company reports and Citi Research

### High income from “eBusiness & Payments”...

The bank generated a high share of fee revenues (25% in 2011 and 28% in 2012) from the business lines dubbed “eBusiness & Payments” and “direct banking”. These items include revenues from international transfers, mass payments, Western Union transfers, trade finance, debit cards, in-sourcing services for banks and other institutions and from other electronic and telecommunication services. In the charts below we present these revenues as card revenues, together with separately reported credit card fees. Such card fees amounted to 1.3% of average assets in 2011 and 9M12 vs. 0.8%-1.0% in PKO BP and Pekao and 0.3%-0.8% in Kredyt Bank, Millennium, ING BSK and BRE.

### ...due to in-sourcing services for banks and other financial institutions...

What distinguishes BZ WBK from other banks, in our view, is its strength in in-sourcing services for banks and other financial institutions. The bank is one of the leading providers of services in the areas of:

- domestic and international payment transactions,
- card personalization, issuance and servicing;
- management of ATM networks.

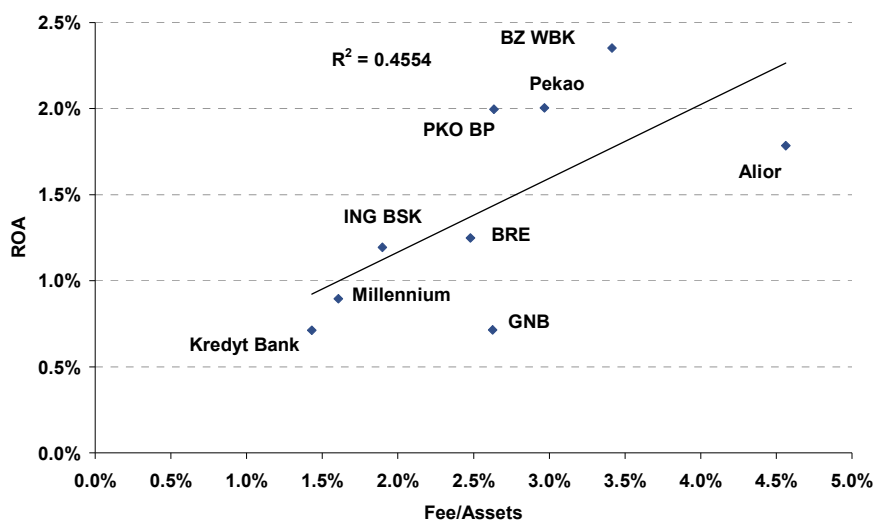
...e.g. managing the network of 753 third-party ATMs and servicing c3m cards

High fee generation is the only way to achieve high return on assets

In 2011 BZ WBK provided services to more than 20 banks, managed a network of 753 third-party ATMs and serviced c3m Visa and Mastercard cards issued by other institutions.

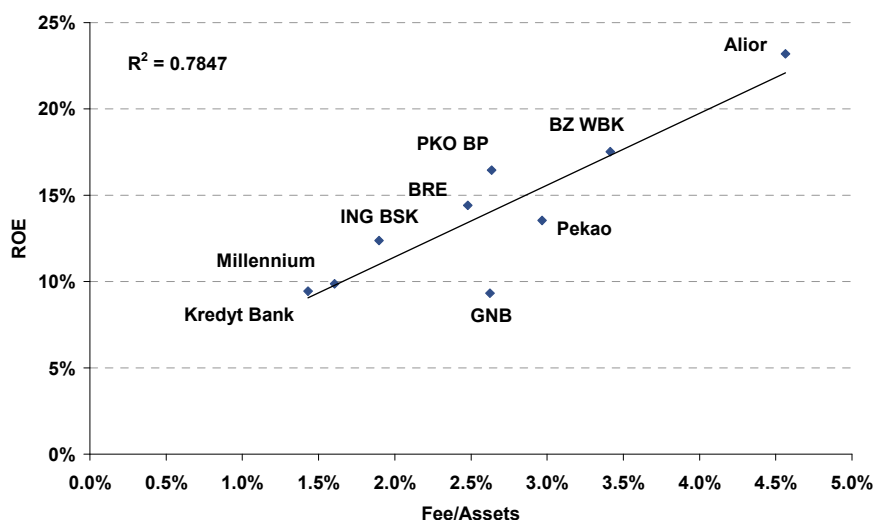
In general, we think that high fee generation is the only good way to achieve high return on assets and, ultimately, a high return on equity. The relation between fee-to-assets and ROA presented at the chart below is not particularly strong but this is due to two outliers, Alior Bank and Getin Noble Bank, which, due to high cost of risk (both) and a high cost-to-income ratio (the former), deliver low ROA despite high fee income (excluding them we get an  $R^2$  of 0.915).

Figure 76. Polish Banks – Fee-to-Assets vs. ROA, 9M12 (Percentage)



Source: Company reports and Citi Research

Figure 77. Polish Banks – Fee-to-Assets vs. ROE, 9M12 (Percentage)



Source: Company reports and Citi Research

## The Scale – Merger Overview

### Legal Merger Completed

The legal merger took place on January 4, 2013

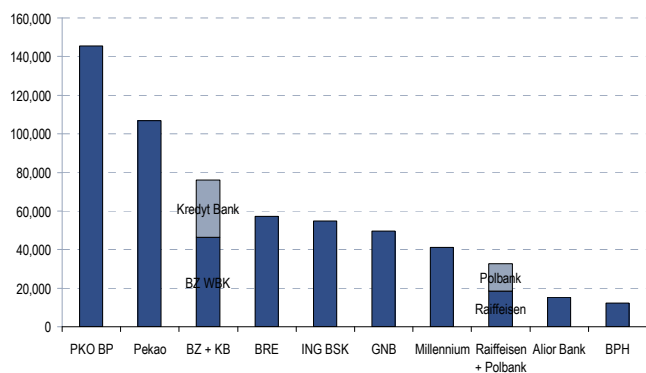
The merger of BZ WBK with Kredyt Bank was announced by their strategic shareholders, Santander and KBC, on February 28, 2012. The merger plan was announced in May 2012 while the KNF (Polish FSA) approved the transaction in December 2012. The legal merger took place on January 4, 2013 and on this day the main functions (risk, ALM, Treasury, Finance, Legal, Compliance and Internal Audit) were integrated. The bank started the process of brand migration that is planned to be completed in September 2013. Simultaneously BZ WBK is working on client and product migration, which is scheduled for mid 2014.

### Market Position

A strong third position in main categories

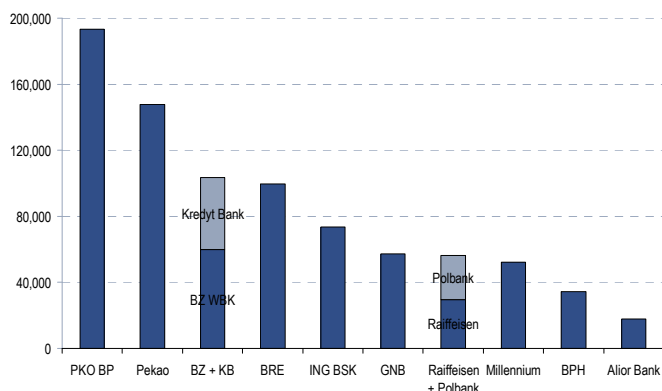
The merger of BZ WBK with Kredyt Bank will create Poland's third-largest bank in terms of deposits, assets and equity and the fourth-largest in term of loans (just behind BRE). With the merger, BZ WBK will strengthen its position as the third-largest bank in terms of own branches (excluding franchise outlets).

Figure 78. Polish Banks – Client Deposits, 3Q12 (Polish Zloty in million)



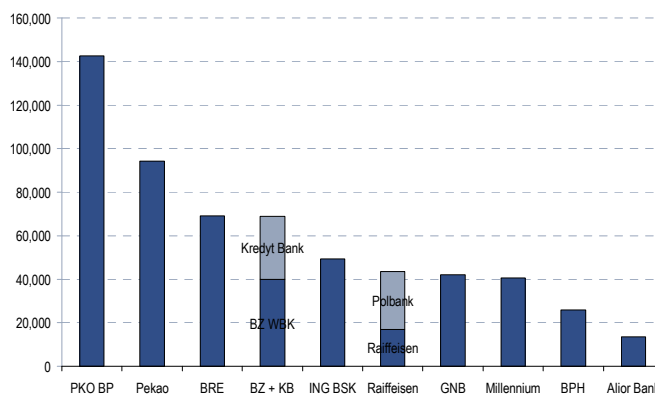
Source: Company reports, Citi Research, Rzeczpospolita

Figure 80. Polish Banks – Total Assets, 3Q12 (Polish Zloty in million)



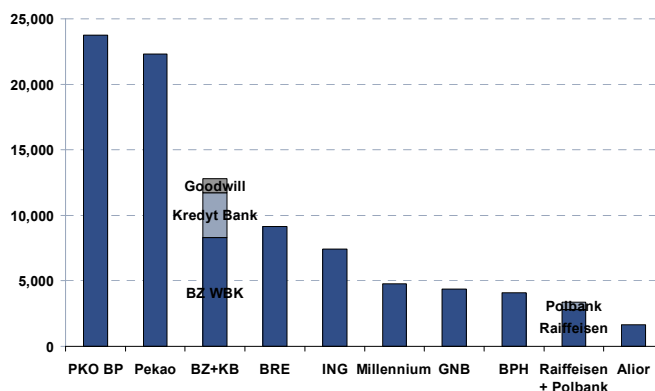
Source: Company reports, Citi Research, Rzeczpospolita

Figure 79. Polish Banks – Net Loans, 3Q12 (Polish Zloty in million)



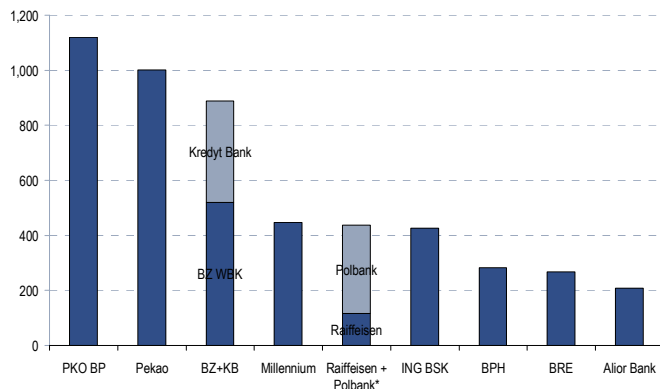
Source: Company reports, Citi Research, Rzeczpospolita

Figure 81. Polish Banks – Shareholders' Equity, 3Q12 (Polish Zloty in million)



Source: Company reports, Citi Research, Rzeczpospolita

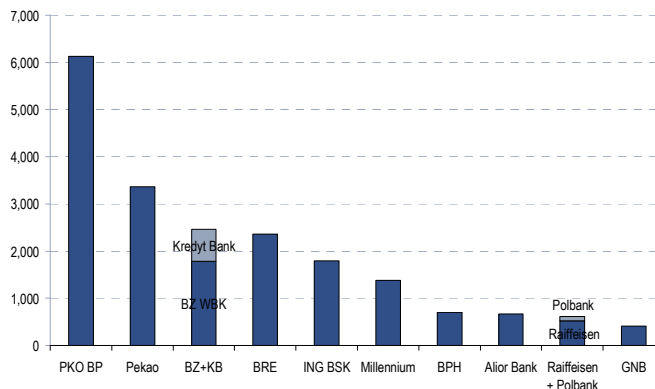
Figure 82. Polish Banks – Branches, 2012



\* data as of 2011

Source: Company reports, Citi Research, bankier.pl

Figure 83. Polish Banks – Current Accounts (thousands), 3Q12

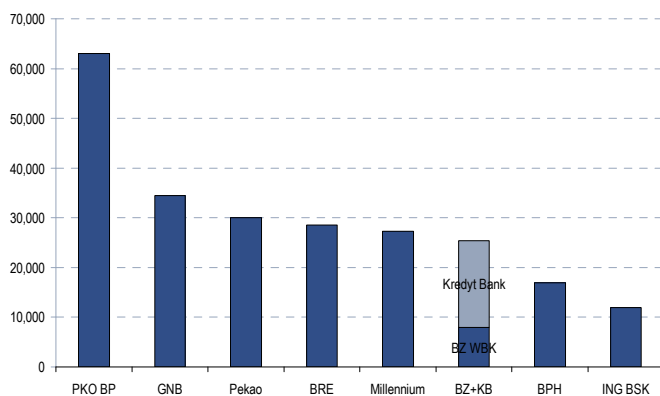


Source: Company reports, Citi Research, prnews

#### The fifth-largest retail lender in Poland among listed banks

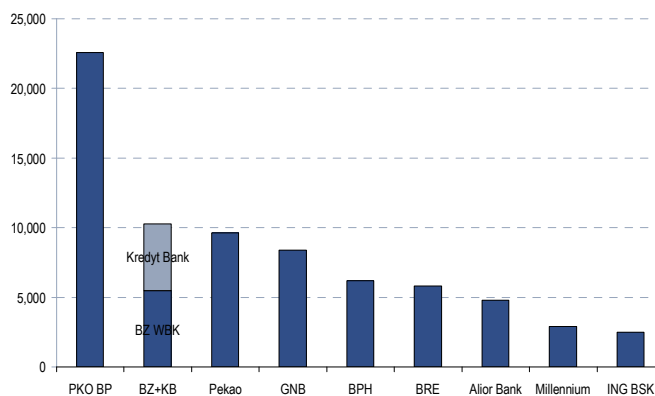
To be more precise, the new bank will be the fifth-largest retail lender in Poland among listed banks (the sixth-largest in mortgage loans and the second-largest in other retail loans) and the second most important lender to corporate clients (third if we include PKO BP's SME lending in corporate loans). BZ WBK will also be third in retail deposits and fourth in corporate deposits.

Figure 84. Polish Banks – Mortgage Loans, 3Q12 (Polish Zloty in million)



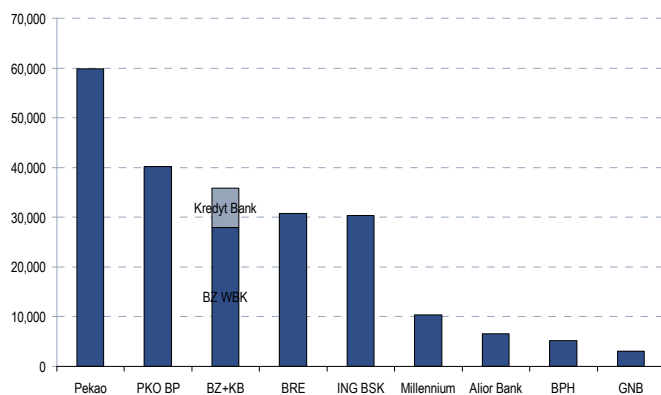
Source: Company reports, Citi Research

Figure 85. Polish Banks – Non-mortgage Retail Loans, 3Q12 (Polish Zloty in million)



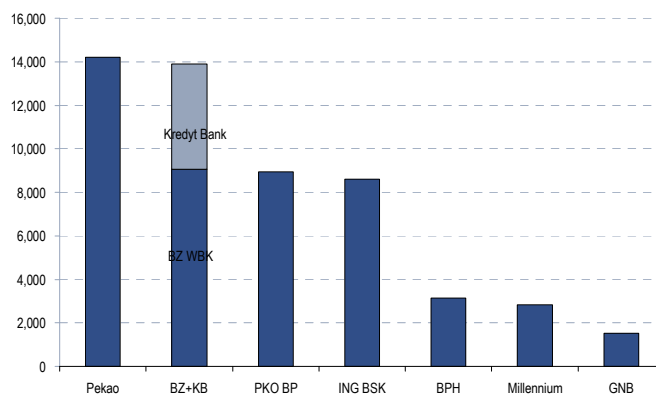
Source: Company reports, Citi Research

Figure 86. Polish Banks – Corporate Loans, 3Q12 (Polish Zloty in million)



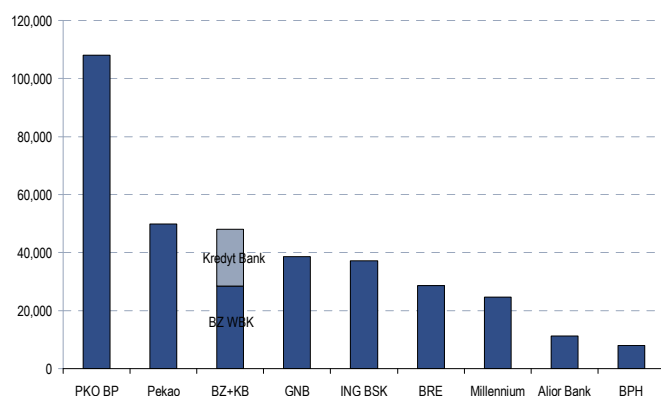
Source: Company reports, Citi Research

Figure 87. Polish Banks – Investment Funds AUM, 3Q12 (Polish Zloty in million)



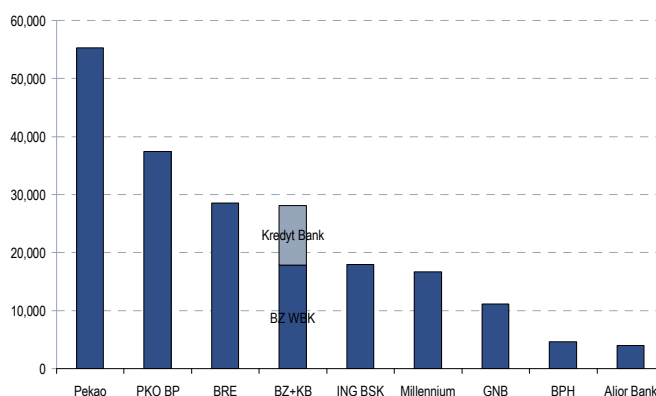
Source: Company reports, Citi Research

Figure 88. Polish Banks – Retail Deposits, 3Q12 (Polish Zloty in million)



Source: Company reports, Citi Research

Figure 89. Polish Banks – Corporate Deposits, 3Q12 (Polish Zloty in million)

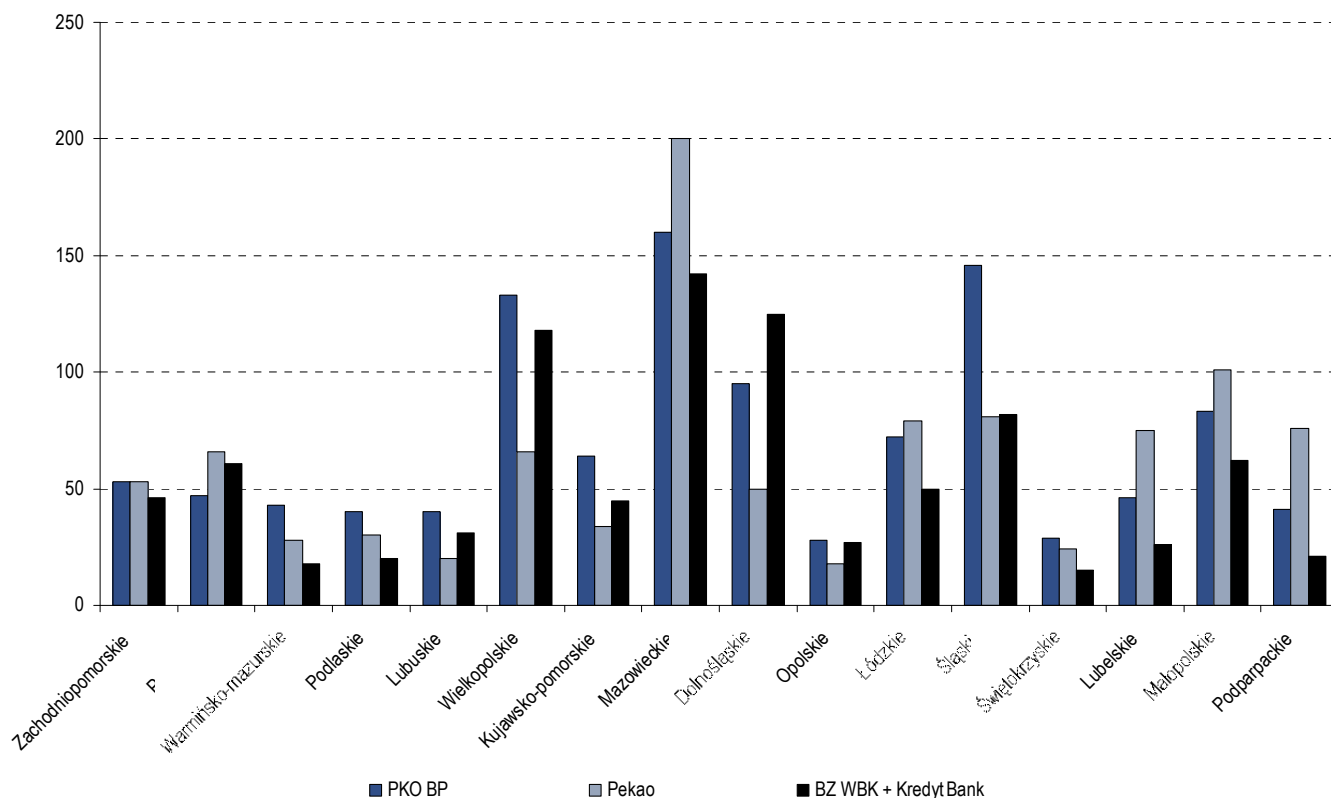


Source: Company reports, Citi Research

**The new bank will be first in terms of number of branches in the Lower Silesia region (dolnośląskie)**

The new bank will be first in terms of number of branches in the Lower Silesia region (dolnośląskie), the second in regions like Wielkopolskie, Pomorskie and Upper Silesia (śląskie), and the third, but close to the top two, in other most developed regions such as the Mazowieckie and Małopolskie regions.

Figure 90. Polish Top Banks – Branches Per Region (Województwo), 2012



Source: Company data, Citi Research

## Kredyt Bank Characteristics

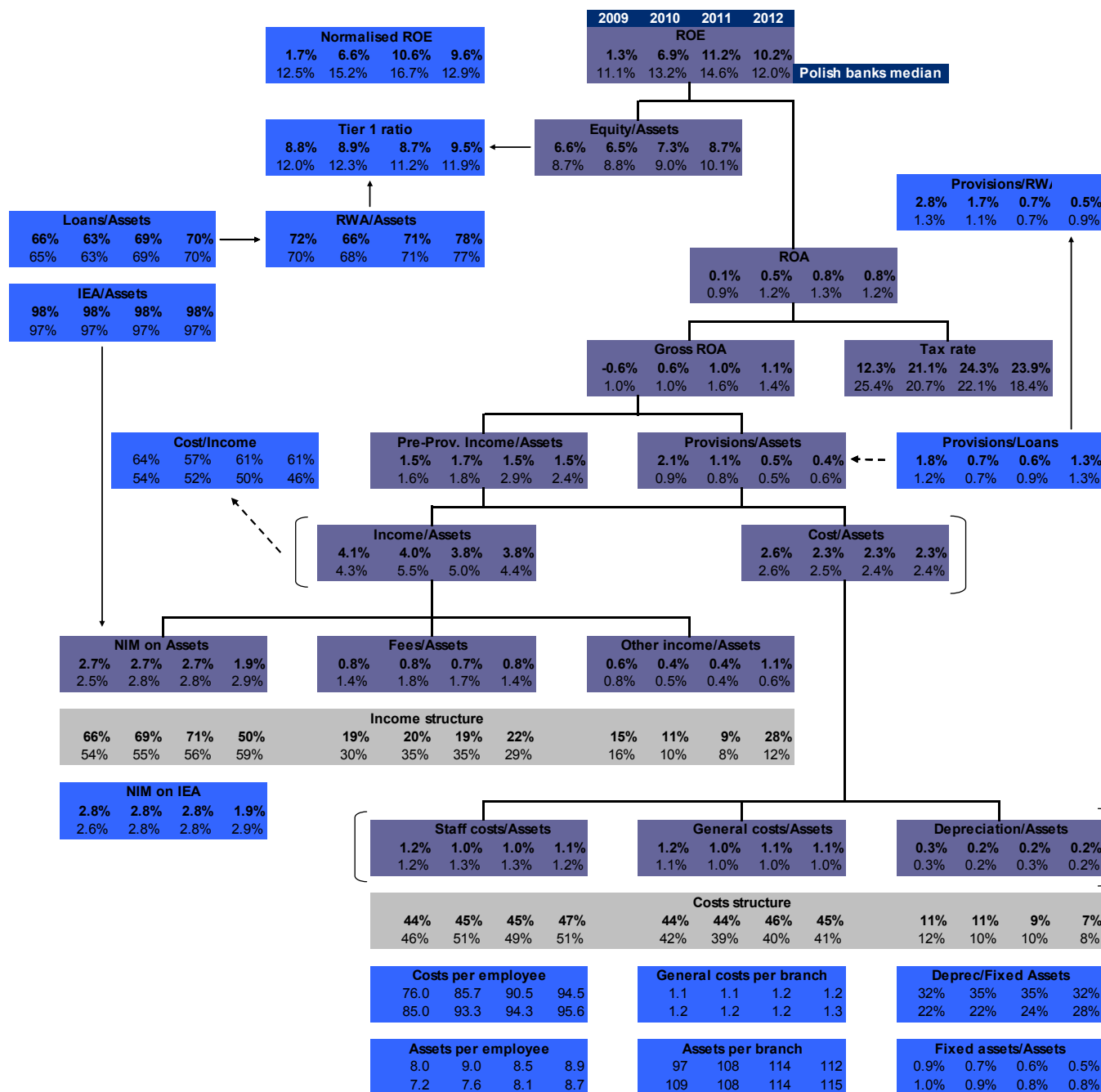
### Unsuccessful Investment

**Kredyt Bank has required KBC's support several times**

Kredyt Bank, created as a green-field project in 1990 and growing in the 1990s through acquisitions of small private banks and the purchase of PBI from the NBP in 1997, is a medium-sized bank focused on mortgage, consumer and corporate lending. Since 1996 its strategic shareholder has been KBC. Given Kredyt Bank's average 1997-2011 ROE of 1.8% (vs. the median for our universe ex. BGZ and GNB at 12%), we would not describe the investment as a success. In fact, KBC has had to support Kredyt Bank a number of times, e.g. injecting capital in 2003 and 2004 and buying its Zagiel consumer finance subsidiary in 4Q09 (which allowed Kredyt Bank to book a ZI 230m net profit on the sale and offset the negative impact of ZI 374 in provisioning).

## Kredyt Bank ROE Deconstructed

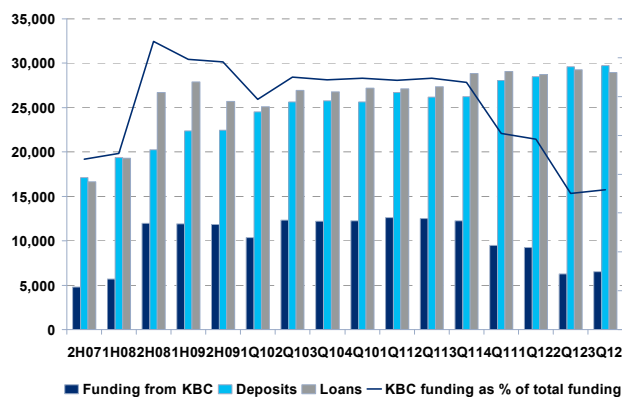
Figure 91. Kredyt Bank – DuPont Analysis, 2009-2012



Source: Company reports, Citi Research

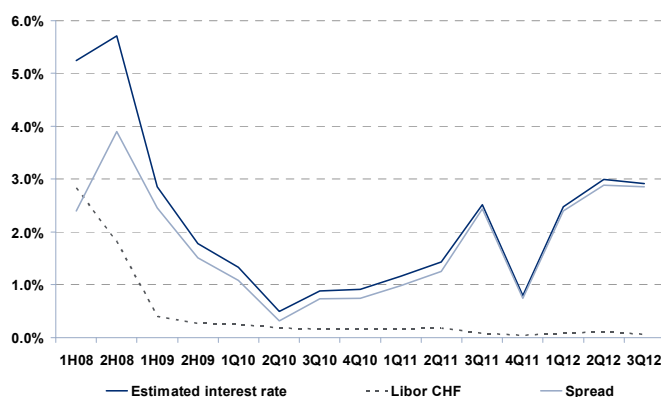


Figure 92. Kredyt Bank – Funding from KBC vs. Deposits, 2H07-3Q12 (Polish Zloty in million)



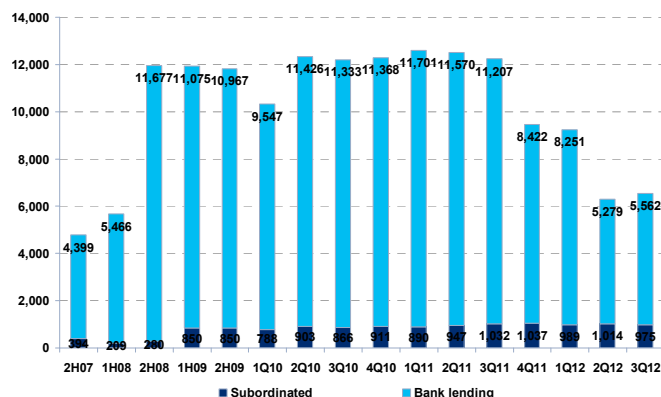
Source: Company reports and Citi Research

Figure 94. Kredyt Bank – Estimate of Cost of Funding From KBC, 1H08-3Q12 (Percentage)



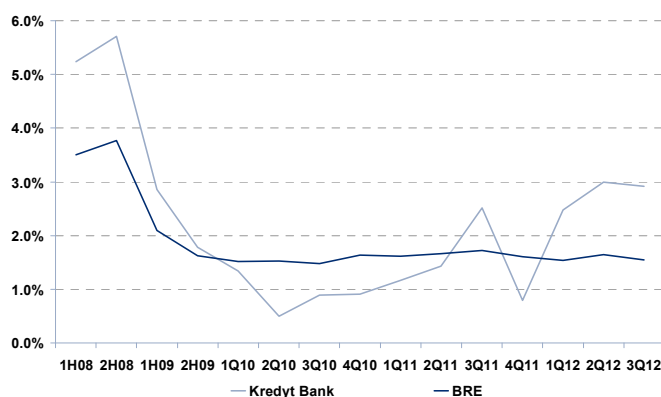
Source: Citi Research estimates

Figure 93. Kredyt Bank – Funding from KBC, 2H07-3Q12 (Polish Zloty in million)



Source: Company reports and Citi Research

Figure 95. Kredyt Bank and BRE – Estimate of Cost of Funding From Parents, 1H08-4Q11 (Percentage)



Source: Citi Research estimates

## Financial Forecasts

### Pro-Forma Results and Merger Accounting

Figure 96. BZ WBK and Kredyt Bank – Pro-Forma Balance Sheet, 3Q12 (Polish Zloty in million)

	BZ WBK	Kredyt Bank	Aggregate	Internal transactions	One-off adjustments related to the transaction	Accounting unification	Pro-forma	Share of KB in aggregated
Cash and NBP Balances	2,607	770	3,376				3,376	23%
Interbank placements	1,622	1,412	3,034	-4			3,030	47%
Financial Assets & Securities	14,265	11,693	25,958	-2		100	26,056	45%
Net client lending	39,929	29,153	69,081				69,081	42%
Fixed assets	467	227	693			31	725	33%
Intangible assets	115	84	199			-14	185	42%
Goodwill			0		1,025		1,025	
Other assets	867	297	1,164		-15	-23	1,126	25%
<b>Total Assets</b>	<b>59,872</b>	<b>43,634</b>	<b>103,506</b>	<b>-6</b>	<b>1,009</b>	<b>94</b>	<b>104,604</b>	<b>42%</b>
Interbank borrowing	2,519	8,008	10,527	-4			10,523	76%
Client deposits	46,398	29,791	76,189				76,189	39%
Other liabilities	2,140	1,455	3,594	-2	1	28	3,621	40%
Subordinated debt	411	975	1,386				1,386	70%
Minorities	88	0	88				88	0%
Equity (ex Minorities)	8,316	3,405	11,722		1,075		12,797	29%
<b>Total liabilities &amp; Equity</b>	<b>59,872</b>	<b>43,634</b>	<b>103,506</b>	<b>-6</b>	<b>1,076</b>	<b>28</b>	<b>104,604</b>	<b>42%</b>

Source: Company reports

Figure 97. BZ WBK and Kredyt Bank – Pro-Forma Profit and Loss Statement, 3Q12 (Polish Zloty in million)

	BZ WBK	Kredyt Bank	Aggregate	Internal transactions	One-off adjustments related to the transaction	Accounting unification	Pro-forma	Share of KB in aggregated
Net Interest Income	1,709	602	2,311				2,311	26%
Net Fee & Commission Income	1,020	253	1,273			168.3	1,442	20%
Financial Income	174	260	434			-168.3	265	60%
Other Income	82	53	135		-17.2	-12.7	105	39%
<b>Total Revenue</b>	<b>2,985</b>	<b>1,168</b>	<b>4,153</b>	<b>0.0</b>	<b>-17.2</b>	<b>-12.7</b>	<b>4,123</b>	<b>28%</b>
Operating Expenses	-1,336	-726	-2,062		21.0	2.0	-2,039	35%
<b>Operating Profit</b>	<b>1,649</b>	<b>442</b>	<b>2,091</b>	<b>0.0</b>	<b>3.8</b>	<b>-10.7</b>	<b>2,084</b>	<b>21%</b>
Provision Charge	-341	-118	-460			8.8	-451	26%
Associate Income	12	1	13				13	8%
One-off items					17.2		17	
<b>Profit Before Tax</b>	<b>1,320</b>	<b>325</b>	<b>1,645</b>	<b>0.0</b>	<b>21.0</b>	<b>-1.9</b>	<b>1,664</b>	<b>20%</b>
Minorities	-24	0.0	-24				-24	0%
Tax	-267	-96	-363		11.6	0.4	-351	26%
<b>Net Profit</b>	<b>1,029</b>	<b>229</b>	<b>1,258</b>	<b>0.0</b>	<b>32.61</b>	<b>-1.6</b>	<b>1,289</b>	<b>18%</b>

Source: Company reports

**We have estimated a fair value adjustment of Kredyt Bank's loans at ZI 504m**

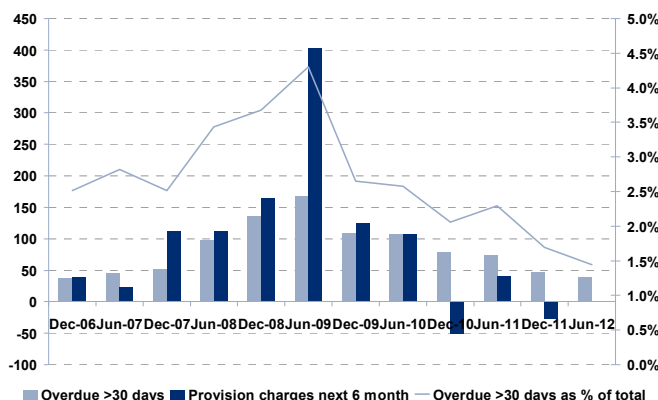
On the day of the merger (January 4, 2013) BZ WBK will include Kredyt Bank's assets and liabilities on its balance sheet at fair value. Given its historically conservative approach to provisioning, we think that, in the process of assessing the fair value of acquired assets and liabilities, BZ WBK may revise the value of Kredyt Bank's assets (especially the value of real estate) and loans. Given the lack of detailed information on Kredyt Bank's real estate and the relatively low value (ZI 126m), in our model we assume material adjustments only in regard to loans. Based on 2Q12 data, we have assumed unchanged NPLs and increased (close to the historical level) coverage ratios in consumer, mortgage and corporate loans and we have estimated the adjustment in fair value of loans at ZI 504m.

Figure 98. Kredyt Bank – Estimate of Adjustment of Loan Fair Value, 2Q12 (Polish Zloty in million)

	Impaired	Provisions (including IBNR)	Provision coverage	Assumed coverage	Implied provisions	Implied adjustment
Consumer loans	364	305	84%	90%	328	-23
Mortgages	751	395	53%	60%	451	-56
Corporate loans	1099	453	41%	80%	879	-426

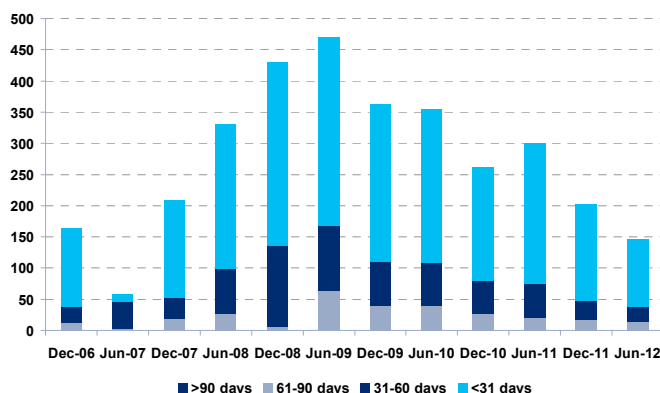
Source: Citi Research

Figure 99. Kredyt Bank – Overdue Consumer Loans vs. Provisioning, Dec 06 – Jun 12 (Polish Zloty in million)



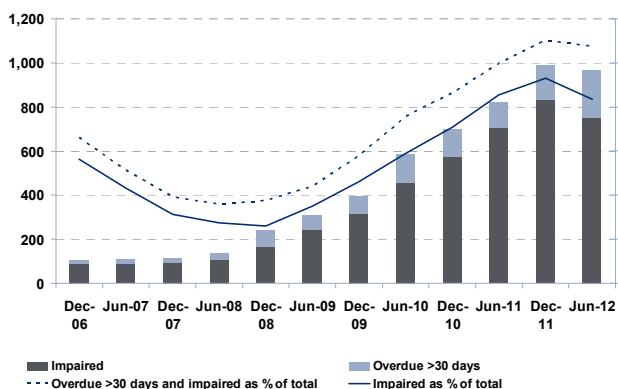
Source: Company reports and Citi Research

Figure 100. Kredyt Bank – Overdue Consumer Loans, Dec 06 – Jun 12 (Polish Zloty in million)



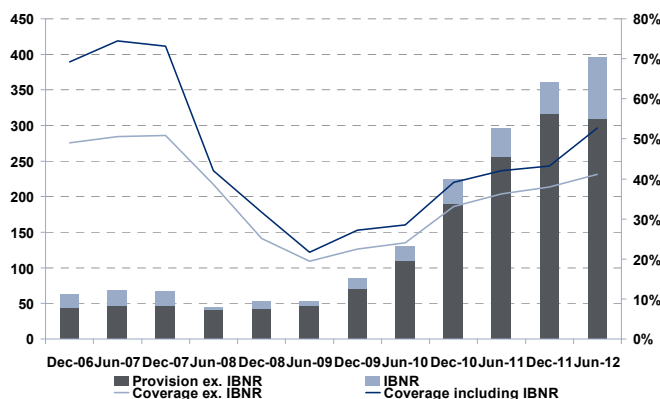
Source: Company reports and Citi Research

Figure 101. Kredyt Bank – Overdue Mortgage Loans, Dec 06 – Jun 12 (Polish Zloty in million)



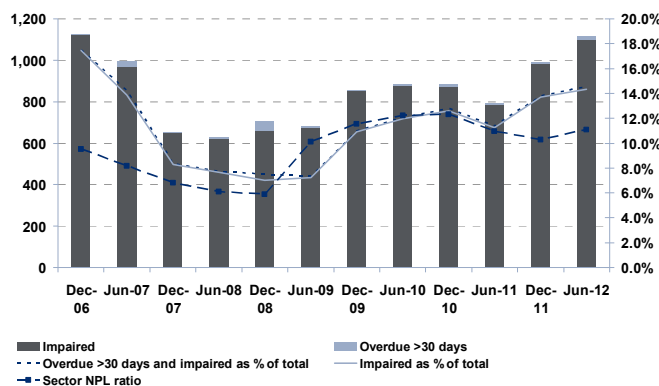
Source: Company reports and Citi Research

Figure 102. Kredyt Bank – Provision Coverage of Mortgage Loans, Dec 06 – Dec 11 (Polish Zloty in million)



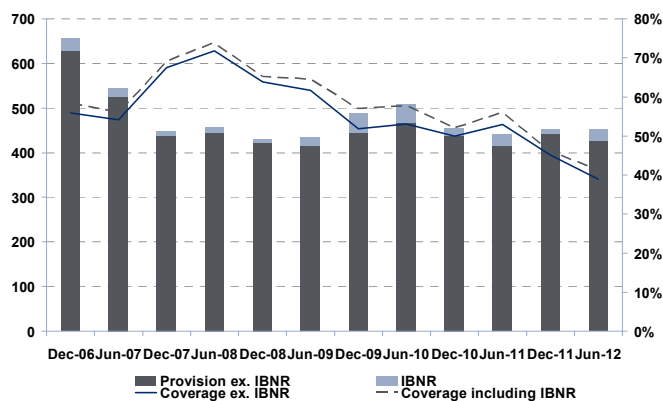
Source: Company reports and Citi Research

Figure 103. Kredyt Bank – Overdue Corporate Loans, Dec 06 – Jun 12 (Polish Zloty in million)



Source: Company reports and Citi Research

Figure 104. Kredyt Bank – Provision Coverage of Corporate Loans, Dec 06 – Jun 12 (Polish Zloty in million)



Source: Company reports and Citi Research

Figure 105. BZ WBK and Kredyt Bank – Estimate of Pro-Forma Balance Sheet, 2012 (Polish Zloty in million)

	BZ WBK	Kredyt Bank	Aggregate	Internal transactions	One-off adjustments related to the transaction	Accounting unification	Pro-forma
Cash and NBP Balances	4,157.3	963.4	5,121				5,121
Interbank placements	1,458.1	1,179.7	2,638				2,638
Financial Assets & Securities	12,801.4	9,634.8	22,436			127.5	22,564
Net client lending	39,867.6	28,533.5	68,401		-504.4		67,897
Fixed assets	479.8	223.3	703			31.1	734
Intangible assets	127.3	94.8	222			-13.8	208
Goodwill			0		1,483.1	0.0	1,483
Other assets	1,127.7	329.3	1,457			-22.9	1,434
<b>Total Assets</b>	<b>60,019.2</b>	<b>40,958.8</b>	<b>100,978</b>	<b>0.0</b>	<b>978.7</b>	<b>121.9</b>	<b>102,078</b>
Interbank borrowing	1,351.1	4,283.1	5,634				5,634
Client deposits	47,077.1	30,392.6	77,470				77,470
Other liabilities	2,204.2	1,767.7	3,972			70.7	4,043
Subordinated debt	409	971.5	1,381				1,381
Minorities	93.3	0.0	93				93
<b>Equity (ex Minorities)</b>	<b>8,884.4</b>	<b>3,543.9</b>	<b>12,428</b>		<b>1,029.8</b>		<b>13,458</b>
Share capital	746.4						935
Other capital	5,704.7						10,089
Capital from revaluation	872.4						872
Retained profits	127.1						127
Current year profits	1,433.8						1,434
<b>Total liabilities &amp; Equity</b>	<b>60,019.2</b>	<b>40,958.8</b>	<b>100,978</b>	<b>0.0</b>	<b>1,029.8</b>	<b>70.7</b>	<b>102,078</b>

Source: Citi Research estimates based on company reports

Figure 106. BZ WBK and Kredyt Bank – Estimate of Pro-Forma Profit and Loss Statement, 2012 (Polish Zloty in million)

	BZ WBK	Kredyt Bank	Aggregate	Internal transactions	One-off adjustments related to the transaction	Accounting unification	Pro-forma
Net Interest Income	2,301.1	788.3	3,089				3,089
Net Fee & Commission Income	1,385.0	341.4	1,726			224.4	1,951
Financial Income	400.5	380.5	781			-224.4	557
Other Income	23.5	55.2	79		-17.2	-12.7	49
<b>Total Revenue</b>	<b>4,110.1</b>	<b>1,565.3</b>	<b>5,675.5</b>	<b>0.0</b>	<b>-17.2</b>	<b>-12.7</b>	<b>5,645.6</b>
Operating Expenses	-1,791.1	-959.4	-2,750		21.0	2.0	-2,727
<b>Operating Profit</b>	<b>2,319.1</b>	<b>605.9</b>	<b>2,925.0</b>	<b>0.0</b>	<b>3.8</b>	<b>-10.7</b>	<b>2,918.1</b>
Provision Charge	-501.8	-166.0	-668		0.0	8.8	-659
Associate Income	19.7	1.0	21				21
One-off items					17.2	0.0	17
<b>Profit Before Tax</b>	<b>1,837.0</b>	<b>441.0</b>	<b>2,278.0</b>	<b>0.0</b>	<b>21.0</b>	<b>-1.9</b>	<b>2,297.1</b>
Minorities	-28.8	0.0	-29				-29
Tax	-374.4	-105.0	-479		-3.4	0.4	-482
<b>Net Profit</b>	<b>1,433.8</b>	<b>336.0</b>	<b>1,769.9</b>	<b>0.0</b>	<b>17.6</b>	<b>-1.6</b>	<b>1,785.9</b>

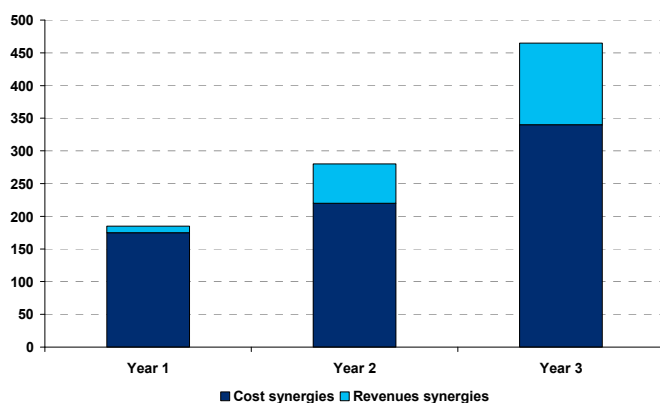
Source: Citi Research estimates based on company reports

## Synergies

### BZ WBK looks for ZI 125m revenues and ZI 340m cost synergies

At the Investor Day on Feb 4, 2012, BZ WBK slightly revised upward Santander's projection of merger synergies to pre-tax ZI 465m (vs. ZI 436m announced by Santander in February 2012).

Figure 107. BZ WBK – Synergy Estimates (Polish Zloty in million)



Source: Company presentation

Figure 108. BZ WBK – Synergy Estimates (Polish Zloty in million)

	Year 1	Year 2	Year 3
Cost synergies	175	220	340
Revenues synergies	10	60	125
<b>Total (pre-tax)</b>	<b>185</b>	<b>280</b>	<b>465</b>
<b>Total (after tax)</b>	<b>150</b>	<b>227</b>	<b>377</b>

Source: Company presentation

### ZI c125m revenues synergies due to leveraging Kredyt Bank's platform and client base to BZ WBK standards

BZ WBK intends to achieve fully phased operating revenue synergies of ZI c125m in 2015 through leverage of Kredyt Bank's platform and client base to BZ WBK standards, e.g.:

- to cross-sell insurance products to Kredyt Bank's client base and actively manage penetration rates by product;
- to more actively manage the fee line, increase transactional activity and increase penetration and fees in debit and credit cards;
- to collect through Kredyt Bank's branches assets under management of ZI c1.3bn by 2015 and leverage BZ WBK Asset Management expertise
- to align margin in SMEs in the two banks;
- to develop brokerage services for Kredyt Bank's retail clients

**Cost synergies through...**

BZ WBK plans to reach fully passed operating cost synergies of ZI c340m in 2015 due to:

**... operational integration,...**

■ operational integration , e.g.:

- consolidation of support functions;
- adoption of internal best practices across business and support units;

**.... changes in IT and communisation,...**

**...lower marketing spend,...**

- closing of c50 branches;

**...economies of scale and...**

**...cost savings in property management**

■ changes in IT and communication, e.g.:

- migration to single platform in mid 2014;
- review of all IT contracts and licences under Santander Group terms;
- achieving economies of scale in IT maintenance and support functions;

■ lower marketing spend (one brand replacing two brands) and utilisation of strong BZ WBK brand awareness;

■ economies of scale across all other operating cost lines;

■ cost savings in property management due to:

- headquarters consolidation (Kredyt Bank's headquarters lease contract expires in 2015 and will not be extended);
- branch closures;
- review of all rental agreements.

**Figure 109. BZ WBK – Distribution Network (2012/2015E)**

	Old BZ WBK	Old Kredyt Bank	Aggregated	New BZ WBK	Planned closure
Branches*	519	370	889	840**	49
SME centres	10	10	20	12	8
Business and corporate centres	10	13	23	12	11

Note: \*Excluding 108 franchise outlets and 115 mobile sales agents \*\* The bank plans to open new branches

Source: Company presentation

We now forecast ZI 373m of synergies. As we explained in our note [BZ WBK and Kredyt Bank - A Good Marriage: Upgrading BZ WBK and Kredyt Bank to Buy](#), published in April 2012, we believe Santander's cost savings are credible but we are sceptical on targeted revenue synergies.

**We don't count on revenue synergies...**

The 'cherry-picking' practices of clients make it difficult to successfully achieve cross-sell strategies unless a bank provides low-cost products. Thus banking on a material increase in cross-sell to Kredyt Bank clients is unrealistic, in our view. We therefore view BZ WBK's projection of ZI 125m in revenue synergies in 2015 as ambitious. We see the biggest potential for revenue growth from:

- Lowering funding cost (should the bank stop taking deposits from the most expensive 5% of Kredyt Bank's deposits and reduce the interest rate for remaining depositors by 20bp it would lower interest costs by ZI 180m annually);

- Increased pricing of SME and other loans (8bp higher lending spread would lead to ZI 25m higher interest income annually)
- Increasing margin on investment funds by changing asset mix and taking higher share in management fee (a 33bp increase in margin would lead to ZI 15m higher revenues annually); and
- Higher sales of insurance related to lending products (at the moment these revenues are much lower than in BZ WBK despite Kredyt Bank's bigger book of retail loans and we expect them to increase by ZI 40m in 2015).

On the other hand, we expect the new merged bank will lose some revenues due to lower lending activity driven by branch closures, client attrition, increased pricing and tightening lending underwriting standards, and we assume a loss of 9% of Kredyt Bank's loans, which implies a ZI 247m decline in interest income. We expect that benefits from improved deposit and investment fund spread will be nearly fully offset by lower loan volumes, hence we assume only ZI 10m revenue synergies in 2015. However, due to lower volume of loans and better credit risk management, we expect net provisioning to decline by ZI 55m in 2015.

...but view BZ WBK's projection of cost synergies as credible

Santander's projection of ZI 340m cost synergies looks ambitious but achievable, in our view. It implies a 34% reduction vs. Kredyt Bank's 2011 cost base (we assume that the substantial majority of cost cuts will happen at Kredyt Bank). We estimate that closure of 20% of Kredyt Bank's branches and a reduction of Kredyt Bank's head office costs by 50% could contribute to ZI 322m in total savings by 2015.

Figure 110. BZ WBK and Kredyt Bank – Estimate of Cost Synergies, 2015E (Polish Zloty in million)

	BZ WBK (2011)	Kredyt Bank (2011)	Combined (2011)	Kredyt Bank as % of total	2015E Potential savings (%)	2015E Potential savings (Zl million)
Rents and maintenance	222	108	330	33%	25%	27
IT, telecommunication and post services	152	107	259	41%	30%	32
Advisory	27	24	51	46%	100%	24
Transport	35	16	51	31%	30%	5
Security	12	9	21	41%	30%	3
Taxes	62	115	177	65%	0%	0
Marketing	84	41	125	33%	100%	41
Purchases	26	3	29	12%	25%	1
Other	61	45	106	42%	25%	11
<b>General Costs</b>	<b>682</b>	<b>467</b>	<b>1,149</b>	<b>41%</b>	<b>31%</b>	<b>143</b>
<b>Staff costs</b>	<b>977</b>	<b>443</b>	<b>1,420</b>	<b>31%</b>	<b>34%</b>	<b>150</b>
Headcount	9,383	4,963	14,346	35%	34%	1,682
head office	na	2,297			50%	1,149
branches and subsidiaries	na	2,666			20%	533
Monthly staff costs per employee	8.7	7.4	8.2			
<b>Amortisation</b>	<b>216</b>	<b>90</b>	<b>306</b>	<b>29%</b>	<b>32%</b>	<b>29</b>
<b>Total costs</b>	<b>1,875</b>	<b>1,000</b>	<b>2,875</b>	<b>35%</b>	<b>32%</b>	<b>322</b>

Source: Company reports and Citi Research estimates

“Right-sizing the business has already begun”

Since the merger announcement in February 2012, both banks have achieved material cost reduction. In 2012 operating expenses declined by 5.6% yoy in BZ WBK and by 5.3% yoy in Kredyt Bank, headcount was reduced by 5.9% yoy and 7.0% yoy, respectively, while the aggregated number of branches declined by 10 outlets.

**Given distorted base, it is tricky to present detailed synergy forecasts**

Due to the pre-merger cost restructuring started in 2012 and the abnormal increase in Kredyt Bank's cost of funding in 2012, caused by funding from KBC being replaced by local deposits (even in a scenario of no merger we had assumed a gradual decline in Kredyt Bank's cost of funding), it is tough to set the base for synergies hence we treat projections of the merger synergies as an illustration of the expected trends rather than as a precise calculation. Since April 2012 we have slightly revised our synergy estimates, taking into account the lower cost base at both banks due to headcount reduction in 2012 (less room for cost savings) and a higher cost of funding at Kredyt Bank (greater room for revenue synergies).

**Figure 111. BZ WBK – Synergy Estimates, 2015E (Polish Zloty in million)**

	Santander (Feb 2012)	BZ WBK (Feb 2013)	Citi Research (Apr 2012)	Citi Research Feb 2013)
Revenues synergies	114	125	0	10
Cost synergies	322	340	322	308
Cost of risk synergies			69	55
<b>Total Pre-tax synergies</b>	<b>436</b>	<b>465</b>	<b>391</b>	<b>373</b>
After tax synergies	349	377	317	302

Source: Company reports, Citi Research

## Summary of Financial Forecasts

We expect BZ WBK's net profit to rise to ZI 1,907 in 2013 (+33% yoy, pro-forma +7% yoy, EPS +6% yoy) driven by:

- higher net interest income (pro-forma +3% yoy), positively affected by decreased cost of funding in the former Kredyt Bank, due partly to the high base (in 2011-2012 the bank was replacing part of funding from KBC with local deposits and had to offer high rates to attract new deposits) and due partly to post-merger re-pricing of deposits;
- lower provisioning (pro-forma -11% yoy) because we expect that, in the process of assessment of the fair-value of Kredyt Bank's assets (to include them into BZ WBK's books and calculate goodwill on the transaction), the value of Kredyt Bank's loans will be set conservatively below the current book value and owing to that provisioning in the coming quarters will be relatively muted (in other words, we expect a significant part of 2013 provisioning in Kredyt Bank not to go through P&L but to enlarge goodwill).

Based on historical sector data, we think that BZ WBK's normalized (through-the-cycle) cost of risk is about 110bp while Kredyt Bank's is about 100bp. Longer term (2015) we think that, due to improvements in credit policy, the bank will be able to reduce its cost of risk to 100bp.

We note that in our forecasts for BZ WBK (and for other Polish banks) we include:

- a reduction in interchange fee from c1.6% in 2012 to c1.1% (so far the card organisations have voluntarily reduced the interchange fee to c1.1%-1.3% but parliament is working on a law to set the upper limit at 1.0%);
- implementation of bank levy tax at 0.1% of RWAs (parliament is working on the draft of a bill that states that in the year, when the bank levy is implemented, banks will be required to pay the full annual levy – for details on implementation of the interchange cap and banking tax, see [Polish Banks Big Picture – November 2012 - Two Things You Can't Avoid](#)).



## Changes to Our Estimates (Pro-Forma)

Figure 112. BZ WBK – Changes in Income Statement Estimates (Pro-Forma), 2012 – 2014E

	2012E			2013E			2014E		
	OLD	Actual	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Net Interest Income	3,086.1	3,089.4	0.1%	3,159.3	3,176.0	0.5%	3,529.1	3,382.9	-4.1%
Net Fee & Commission Income	1,716.7	1,950.8	13.6%	1,701.3	1,764.7	3.7%	1,870.5	1,955.0	4.5%
Financial Income	469.6	556.7	19%	365.3	855.0	134.0%	367.8	424.3	15.4%
Other Income	225.6	48.8	-78.4%	180.9	122.0	-32.6%	187.7	122.0	-35.0%
<b>Total Revenue</b>	<b>5,498.0</b>	<b>5,645.6</b>	<b>2.7%</b>	<b>5,406.8</b>	<b>5,917.7</b>	<b>9.5%</b>	<b>5,853.7</b>	<b>5,884.2</b>	<b>0.5%</b>
Labour Costs	-1,413.4		na	-1,354.4	-1,332.8	-1.6%	-1,329.9	-1,289.3	-3.1%
General Costs	-1,150.5		na	-1,231.1	-1,389.4	12.9%	-1,217.8	-1,211.7	-0.5%
Depreciation	-214.7		na	-320.5	-189.8	-40.8%	-209.4	-194.0	-7.4%
<b>Operating Expenses</b>	<b>-2,778.6</b>	<b>-2,727.4</b>	<b>-1.8%</b>	<b>-2,906.1</b>	<b>-2,912.1</b>	<b>0.2%</b>	<b>-2,757.2</b>	<b>-2,695.0</b>	<b>-2.3%</b>
<b>Operating Profit</b>	<b>2,719.4</b>	<b>2,918.1</b>	<b>7.3%</b>	<b>2,500.7</b>	<b>3,005.7</b>	<b>20.2%</b>	<b>3,096.5</b>	<b>3,189.2</b>	<b>3.0%</b>
Provision Charge	-709.0	-659.0	-7.1%	-1,005.5	-588.7	-41.5%	-734.0	-761.0	3.7%
Associate Income	15.6	20.8	33.2%	8.8	8.0	-8.6%	8.8	8.0	-8.6%
<b>Profit Before Tax</b>	<b>2,026.0</b>	<b>2,297.1</b>	<b>13.4%</b>	<b>1,504.0</b>	<b>2,425.0</b>	<b>61.2%</b>	<b>2,371.3</b>	<b>2,436.1</b>	<b>2.7%</b>
Minorities	-29.5	-28.8	-2.6%	-34.0	-31.0	-8.9%	-50.0	-47.0	-6.1%
Tax	-435.3	-482.4	10.8%	-306.6	-486.9	58.8%	-481.6	-489.2	1.6%
<b>Net Profit</b>	<b>1,561.1</b>	<b>1,785.9</b>	<b>14.4%</b>	<b>1,163.4</b>	<b>1,907.1</b>	<b>63.9%</b>	<b>1,839.7</b>	<b>1,900.0</b>	<b>3.3%</b>
EPS (ZI)	16.6		na	12.4	20.4	64.6%	19.6	20.3	3.7%
DPS (ZI)	13.4		na	9.9	15.3	53.7%	15.7	15.2	-3.2%

Source: Company reports, Citi Research

Figure 113. BZ WBK – Changes in Balance Sheet Estimates (Pro-Forma), 2012 – 2014E

	2012E			2013E			2014E		
	OLD	Actual	Chg.	OLD	NEW	Chg.	OLD	NEW	Chg.
Cash and NBP Balances	2,384	5,121	114.8%	2,348	5,197	121.3%	2,983	5,773	93.5%
Interbank placements	2,550	2,638	3.5%	2,722	2,041	-25.0%	2,912	2,268	-22.1%
Financial Assets & Securities	27,204	22,564	-17.1%	28,145	23,919	-15.0%	29,102	24,382	-16.2%
Net client lending	69,696	67,897	-2.6%	71,605	71,658	0.1%	75,239	75,137	-0.1%
Fixed assets	820	734	-10.5%	887	533	-39.9%	961	592	-38.4%
Other assets	1,698	3,126	84.1%	1,758	2,950	67.8%	1,819	3,067	68.5%
<b>Total Assets</b>	<b>104,352</b>	<b>102,078</b>	<b>-2.2%</b>	<b>107,464</b>	<b>106,298</b>	<b>-1.1%</b>	<b>113,016</b>	<b>111,218</b>	<b>-1.6%</b>
Interbank borrowing	10,559	5,634	-46.6%	7,918	4,729	-40.3%	6,242	2,837	-54.5%
Client deposits	77,480	77,470	0.0%	83,867	82,211	-2.0%	91,281	88,988	-2.5%
Other liabilities	4,244	5,423	27.8%	3,662	4,945	35.0%	2,292	4,462	94.7%
Minorities	94	93	-0.8%	128	124	-3.0%	178	171	-3.8%
Equity (ex Minorities)	11,974	13,458	12.4%	11,889	14,290	20.2%	13,023	14,759	13.3%
<b>Total liabilities &amp; Equity</b>	<b>104,352</b>	<b>102,078</b>	<b>-2.2%</b>	<b>107,464</b>	<b>106,298</b>	<b>-1.1%</b>	<b>113,016</b>	<b>111,218</b>	<b>-1.6%</b>
BVPS (ZI)	128	144	12.0%	130	153	17.2%	138	158	14.0%

Source: Company reports, Citi Research

Figure 114. BZ WBK – Changes in Key Ratios Estimates (Pro-Forma), 2012 – 2014E

	2012		2013E		2014E	
	OLD	Actual	OLD	NEW	OLD	NEW
<b>NIM on AIEA</b>	<b>3.10%</b>	<b>3.96%</b>	<b>3.08%</b>	<b>3.16%</b>	<b>3.29%</b>	<b>3.22%</b>
NIM on Total Ave. Assets	2.99%	3.84%	2.98%	3.06%	3.20%	3.11%
Net Fee & Commission Income/Total Income	31.2%	33.7%	31.5%	29.8%	32.0%	33.2%
Net Fee & Commission Income/Deposits	2.2%	2.9%	2.0%	2.1%	2.0%	2.2%
<b>Cost/Income</b>	<b>50.5%</b>	<b>43.6%</b>	<b>53.7%</b>	<b>49.2%</b>	<b>47.1%</b>	<b>45.8%</b>
Cost/Avg. Assets	2.7%	3.0%	2.7%	2.8%	2.5%	2.5%
Effective tax rate	21.5%	20.4%	20.4%	20.1%	20.3%	20.1%
Dividend Payout Ratio	0.0%	75.0%	0.0%	75.0%	0.0%	75.0%
<b>Provisions/Avg Net Loans</b>	<b>1.04%</b>	<b>1.29%</b>	<b>1.42%</b>	<b>0.84%</b>	<b>1.00%</b>	<b>1.04%</b>
Equity/Assets	11.5%	15.0%	11.1%	13.6%	11.5%	13.4%
<b>Loans/Deposits</b>	<b>90.0%</b>	<b>84.7%</b>	<b>85.4%</b>	<b>87.2%</b>	<b>82.4%</b>	<b>84.4%</b>
Loans/Total Assets	66.8%	66.4%	66.6%	67.4%	66.6%	67.6%
<b>ROE</b>	<b>13.9%</b>	<b>17.7%</b>	<b>9.8%</b>	<b>13.7%</b>	<b>14.8%</b>	<b>13.1%</b>
ROA	1.51%	2.39%	1.10%	1.84%	1.67%	1.75%
NPLs/Total Loans	7.0%	5.4%	7.0%	6.9%	6.4%	6.5%
Provision Coverage of NPLs	58.5%	69.1%	57.7%	65.0%	56.7%	68.5%
RWA/Total Assets	48.4%	78.2%	50.3%	74.0%	51.1%	75.0%
<b>CAR</b>	<b>15.0%</b>	<b>16.6%</b>	<b>13.5%</b>	<b>15.3%</b>	<b>13.4%</b>	<b>14.9%</b>

Source: Company reports, Citi Research

## Annual Financials

Figure 115. BZ WBK – Income Statement (Pro-Forma), 2012-2015E (Polish Zloty in million)

	2012	2013E	Chg.	2014E	Chg.	2015E	Chg.
Net Interest Income	3,089.4	3,176.0	2.8%	3,382.9	6.5%	3,665.1	8.3%
Net Fee & Commission Income	1,950.8	1,764.7	-9.5%	1,955.0	10.8%	2,150.4	10.0%
Financial Income	556.7	855.0	53.6%	424.3	-50.4%	426.3	0.5%
Other Income	48.8	122.0	150.2%	122.0	0.0%	120.0	-1.6%
<b>Total Revenue</b>	<b>5,645.6</b>	<b>5,917.7</b>	<b>4.8%</b>	<b>5,884.2</b>	<b>-0.6%</b>	<b>6,361.8</b>	<b>8.1%</b>
including merger synergies	0.0	35.6	na	50.5	41.7%	10.1	na
Labour Costs		-1,332.8	na	-1,289.3	-3.3%	-1,301.5	0.9%
General Costs		-1,389.4	na	-1,211.7	-12.8%	-1,041.0	-14.1%
Depreciation		-189.8	na	-194.0	2.2%	-201.7	4.0%
<b>Operating Expenses</b>	<b>-2,727.4</b>	<b>-2,912.1</b>	<b>6.8%</b>	<b>-2,695.0</b>	<b>-7.5%</b>	<b>-2,544.2</b>	<b>-5.6%</b>
including merger synergies	0.0	82.3	na	232.9	183.1%	308.0	32.3%
integration costs	-18.8	-250.0	1229.8%	-120.0	-52.0%	0.0	na
<b>Operating Profit</b>	<b>2,918.1</b>	<b>3,005.7</b>	<b>3.0%</b>	<b>3,189.2</b>	<b>6.1%</b>	<b>3,817.7</b>	<b>19.7%</b>
Provision Charge	-659.0	-588.7	-10.7%	-761.0	29.3%	-781.4	2.7%
Associate Income	20.8	8.0	-61.5%	8.0	0.0%	10.0	25.0%
Profit Before Tax	2,297.1	2,425.0	5.6%	2,436.1	0.5%	3,046.2	25.0%
Minorities	-28.8	-31.0	7.5%	-47.0	51.7%	-59.5	26.7%
Tax	-482.4	-486.9	0.9%	-489.2	0.5%	-578.8	18.3%
<b>Net Profit</b>	<b>1,785.9</b>	<b>1,907.1</b>	<b>6.8%</b>	<b>1,900.0</b>	<b>-0.4%</b>	<b>2,407.9</b>	<b>26.7%</b>
EPS (Zl)		20.4	na	20.3	-0.4%	25.7	26.7%
DPS (Zl)		15.3	na	15.2	-0.4%	19.3	26.7%

Source: Company reports, Citi Research

Figure 116. BZ WBK – Balance Sheet (Pro-Forma), 2012-2015E (Polish Zloty in million)

	2012	2013E	Chg.	2014E	Chg.	2015E	Chg.
Cash and NBP Balances	5,121	5,197	1.5%	5,773	11.1%	6,234	8.0%
Interbank placements	2,638	2,041	-22.6%	2,268	11.1%	2,449	8.0%
Financial Assets & Securities	22,564	23,919	6.0%	24,382	1.9%	26,332	8.0%
Net client lending	67,897	71,658	5.5%	75,137	4.9%	81,148	8.0%
Fixed assets	734	533	-27.4%	592	11.1%	639	8.0%
Other assets	3,126	2,950	-5.6%	3,067	3.9%	3,312	8.0%
<b>Total Assets</b>	<b>102,078</b>	<b>106,298</b>	<b>4.1%</b>	<b>111,218</b>	<b>4.6%</b>	<b>120,115</b>	<b>8.0%</b>
Interbank borrowing	5,634	4,729	-16.1%	2,837	-40.0%	3,064	8.0%
Client deposits	77,470	82,211	6.1%	88,988	8.2%	96,552	8.5%
Other liabilities	5,423	4,945	-8.8%	4,462	-9.8%	4,526	1.4%
Minorities	93	124	33.2%	171	37.8%	231	34.7%
Equity (ex Minorities)	13,458	14,290	6.2%	14,759	3.3%	15,742	6.7%
<b>Total liabilities &amp; Equity</b>	<b>102,078</b>	<b>106,298</b>	<b>4.1%</b>	<b>111,218</b>	<b>4.6%</b>	<b>120,115</b>	<b>8.0%</b>
BVPS (Zl)	144	153	6.2%	158	3.3%	168	6.7%

Source: Company reports, Citi Research

Figure 117. BZ WBK – Key Ratios (Pro-Forma), 20012-2015E (Percentage)

GROUP	2012	2013E	2014E	2015E
<b>NIM on AIEA</b>	<b>3.13%</b>	<b>3.16%</b>	<b>3.22%</b>	<b>3.30%</b>
NIM on Total Ave. Assets	3.11%	3.06%	3.11%	3.17%
Net Fee & Commission Income/Total Income	34.6%	29.8%	33.2%	33.8%
Net Fee & Commission Income/Deposits	2.5%	2.1%	2.2%	2.2%
<b>Cost/Income</b>	<b>48.3%</b>	<b>49.2%</b>	<b>45.8%</b>	<b>40.0%</b>
Cost/Avg. Assets	2.7%	2.8%	2.5%	2.2%
Effective tax rate	27.0%	20.1%	20.1%	19.0%
Dividend Payout Ratio	na	75.0%	75.0%	75.0%
<b>Provisions/Avg Net Loans</b>	<b>0.98%</b>	<b>0.84%</b>	<b>1.04%</b>	<b>1.00%</b>
Equity/Assets	13.2%	13.6%	13.4%	13.3%
<b>Loans/Deposits</b>	<b>87.6%</b>	<b>87.2%</b>	<b>84.4%</b>	<b>84.0%</b>
Loans/Total Assets	66.5%	67.4%	67.6%	67.6%
<b>ROE</b>	<b>15.0%</b>	<b>13.7%</b>	<b>13.1%</b>	<b>15.8%</b>
ROA	1.80%	1.84%	1.75%	2.08%
NPLs/Total Loans	7.0%	6.9%	6.5%	6.0%
Provision Coverage of NPLs	57.8%	65.0%	68.5%	70.8%
RWA/Total Assets	76.0%	74.0%	75.0%	76.0%
<b>CAR</b>	<b>14.2%</b>	<b>15.3%</b>	<b>14.9%</b>	<b>14.3%</b>

Source: Company reports, Citi Research

## Santander's Obligations

### KNF' Requirements

#### Santander is obliged...

#### ... to increase free-float in BZ WBK and...

#### ...make Santander Consumer Bank the direct subsidiary of BZ WBK

KNF (Polish FSA) approved BZ WBK merger with Kredyt Bank under several conditions. Santander is obliged to:

- increase BZ WBK's free-float from 8.6% currently (including the EBRD's 1.7% stake) to 25% by April 1, 2013 and 30% by December 31, 2014 (In the future Santander will have to maintain at least a 30% free-float or consider a further increase to 40%);
- make Santander Consumer Bank, currently directly held by Santander, a direct subsidiary of BZ WBK (by March 31, 2014); and
- make Santander Consumer Finance a direct subsidiary of Santander Consumer Bank (in 9 months from the implementation of the amended recommendation T);

- ensure that the share of independent members on the supervisory board does not decline below 50%; and
- bring to trading its shares on the GPW (Warsaw Stock Exchange) by December 31, 2014.

## Acquisition of Santander Consumer Bank Polska

**Santander Consumer Bank is a medium-sized bank specialised in consumer finance...**

**...and was merged with AIG Bank Polska in 2011**

Santander Consumer Bank is a medium-sized bank specialised in consumer finance. It was founded by Santander on the base of a banking licence acquired from Bank of America and the network of PTF, an intermediary specialised in car loans, purchased from its private owners. The bank operated initially under the brand CC-Bank but in 2006 was re-branded to Santander Consumer Bank. The bank had a leading position in car loans (competing with GE Money Bank, merged later with BPH, with Dominet Bank, merged with Fortis Bank and later rebranded to BNP-Paribas, and with Getin Bank). It engaged also in mortgage lending and until the end of 2008 it focused on FX-denominated mortgages. In 2010 the bank took over AIG Bank Polska, a bank specialised in consumer loans, and merged with it in 2011.

Santander Consumer Bank is controlled by Santander (at the end of 2011 it had a 70% stake and 75% plus 1 in votes); a minority stake is held by AIG.

**Figure 118. Santander Consumer Bank – Shareholders Structure, 2011**

	Shares	% (shares)	% (votes)
Santander Consumer Finance	3.64	70%	75% plus 1 vote
AIG Consumer Finance Group	1.56	30%	25% minus 1 vote
Total	5.2	100%	

Source: Company reports

At the end of 2011 the bank's distribution network consisted of:

- 178 own branches;
- 56 franchise partners and
- 11,751 points-of-sale distributing instalment loans.

**Santander Consumer Bank specialises in car loans...**

Historically, the bank's core activity was car loans. According to the bank's estimates, its market share in car loans was about 14.3% in 2011. The bank offers loans for purchase of new and used cars as well as cash loans collateralised on cars. It closely cooperates with car dealers (in 2011 it had cooperation agreements with Honda, Mazda, Suzuki, Subaru, Kia and Hyundai distributors).

**...instalment loans,...**

The share of instalment loans in total loans increased after the acquisition of AIG Bank Polska. In 2011 the bank entered the sub-segment of large retailers and big cities. It started to cooperate with electronic goods distributors like Media Saturn Holding, Media Markt and Neonet. Due to restrictions on instalment lending imposed by the KNF's Recommendation T on good practices in consumer lending, in January 2012 the instalment loan activity was transferred to a separate legal entity, Santander Consumer Finance.

**...cash loans and credit cards...**

Cash loans were core products for both Santander Consumer Bank (since 2005) and AIG Bank Polska (since 1999). Loans are sold directly and through intermediaries. The bank is one of the leaders in that market segment. Other important products are credit cards, offered in the past by both banks (Santander Consumer and AIG).

...as well as in loans for car dealers

The bank has exited the mortgage market but mortgages still account for 45% of total loans

The bank offers also financial products to car dealers (loans for purchase of car stock, working capital loans and bank guarantees).

Mortgages command the highest share of the bank's loan book (Zl 5.2bn, 45% of total loans in 2011) but since 2009 the bank has not granted new mortgage loans. We note that 63% of mortgage loans (Zl 3.3bn, 28% of total loans) are denominated in FX.

Figure 119. Santander Consumer Bank – Profit and Loss Statement, 2008-2011 (Polish Zloty in million)

	2008	2009	2010	2011
NII	224	344	919	1,089
Net fee	55	42	110	186
Other revenues	76	13	-17	-35
<b>Total revenue</b>	<b>355</b>	<b>398</b>	<b>1,013</b>	<b>1,240</b>
Administrative costs	-143	-147	-350	-513
<b>Pre-provision operating income</b>	<b>212</b>	<b>251</b>	<b>663</b>	<b>727</b>
Provisioning	-79	-206	-289	-310
<b>Pre-tax</b>	<b>133</b>	<b>45</b>	<b>374</b>	<b>417</b>
Income Tax	-28	-20	-83	-89
<b>Net profit</b>	<b>106</b>	<b>25</b>	<b>291</b>	<b>328</b>

Source: Company reports

Figure 120. Santander Consumer Bank – Key Balance Sheet Items, 2008-2011 (Polish Zloty in million)

	2008	2009	2010	2011
Loans	9,684	9,438	12,048	11,647
Assets	10,081	9,915	13,755	13,311
Deposits	111	83	4,225	5,203
Equity	791	865	1,613	1,915

Source: Company reports

Figure 121. Santander Consumer Bank – Key Ratios, 2008-2011 (Polish Zloty in million)

	2008	2009	2010	2011
<b>ROE</b>	<b>13%</b>	<b>3%</b>	<b>24%</b>	<b>19%</b>
ROA	1.0%	0.2%	2.5%	2.4%
NIM (on average interest earnings assets)	1.1%	0.2%	2.5%	2.5%
NIM (on average assets)	1.0%	0.2%	2.5%	2.4%
Net fees to assets	0.5%	0.4%	0.9%	1.4%
Revenues to assets	3.5%	4.0%	8.6%	9.2%
Costs to assets	1.4%	1.5%	3.0%	3.8%
<b>Cost-to-income</b>	<b>40.2%</b>	<b>37.0%</b>	<b>34.6%</b>	<b>41.4%</b>
<b>Cost of risk</b>	<b>0.81%</b>	<b>2.15%</b>	<b>2.69%</b>	<b>2.61%</b>
<b>CAR</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>11.4%</b>

Source: Company reports and Citi Research

Basing on 2011 financials, we provisionally value Santander Consumer Bank at Zl 4.9bn

Based on 2011 financials and assuming a 20% sustainable ROE, 10.50% cost of equity (in line with our methodology, increased by 50bp vs. the base 10.0% due to the bank's material but not significant exposure to FX mortgages) and a 4.5% perpetual growth rate, we provisionally value the bank at Zl 4.9bn.

**Figure 122. Santander Consumer Bank – Valuation, 2011 (Percentage/Polish Zloty in million)**

ROE	20%
g	4.5%
COE	10.5%
implied P/BV	2.6
Valuation	4,946
Implied PE (2011)	15.1

Source: Citi Research estimates

**We don't know if BZ WBK will pay in cash or shares or if it will acquire a 70% or a 100% stake in the bank**

At BZ WBK's Investor Day the bank's representatives said they will keep Santander Consumer Bank an independent legal and business entity but haven't disclosed the details of the planned acquisition. We do not know:

- if the transaction will be paid in cash or in BZ WBK's shares;
- if BZ WBK will acquire 100% stake in Santander Consumer or only the 70% stake held by Spanish Santander Consumer Finance (the remaining 30% stake is controlled by AIG).

**Acquisition in cash would lead to material decline in capital ratios**

A cash acquisition of Santander Consumer Bank for ZI 4.9bn would lead to a ZI c.5.2pp decline in the bank's 2013E CAR and a c.4.9pp decline in Tier 1 to 10.2% and 7.9%, respectively. Given regulatory pressure to keep the CAR above 12% and Tier 1 above 9% we don't expect BZ WBK to decide on a cash acquisition.

If BZ WBK acquires 100% of Santander Consumer Bank with its own shares, Santander's stake in the bank would remain broadly unchanged, while AIG would get a c5% stake in the new BZ WBK. On the other hand, if BZ WBK acquires only a 70% stake, Santander's stake in BZ WBK would increase by c3-4pp.

## Acquisition of Santander Consumer Finance

**Santander Consumer Finance is a non-banking company specialised in instalment loans**

Santander Consumer Finance is a non-banking company specialised in instalment loans. Since the beginning of 2012 it has been taking over instalment business from the bank as the KNF's Recommendation T significantly limits the ability of banks to conduct such activity. The recommendation on good practices in consumer lending requires banks to make lending decisions on the basis of documents confirming the client's income. Instalment loans are granted predominantly to individuals that are not clients of a bank but are interested in purchasing goods sold by retailers cooperating with a bank. The decision process needs to be fast because clients want to make purchases immediately, but they usually don't have certificates of income with them so banks adhering to the recommendation are unable to grant the loan.

**We expect that, after implementation of the amended Recommendation T, Santander will stop granting loans through its non-banking subsidiary**

According to the draft of the amended Recommendation T, announced in October 2012, banks in good financial condition (e.g. with a CAR above 12% and a Tier 1 above 9%) will be allowed to grant instalment loans according to a simplified procedure, i.e. basing the lending decision on scoring and the client's declaration regarding income. The upper limit for the simplified procedure will be twice the average salary (ZI 3,680 in January 2013) – comfortably high, given that the average instalment loan is less than ZI 5,000. We expect that, after implementation of the amended Recommendation T, Santander will stop granting loans through its non-banking subsidiary. We think Santander Consumer Bank's business activity will hence materially decline and it will be acquired at a relatively low price.

Given the lack of disclosure of 2012 results of both companies and details on the planned acquisition, we do not incorporate Santander Consumer Bank or Santander Consumer Finance into our forecasts for BZ WBK.

## Bank Zachodni WBK

### Company description

Prior to the merger Bank Zachodni WBK SA was Poland's fifth-largest bank by assets, with a market share of 5%. It was historically focused on servicing medium-sized companies and retail clients.

In February 2012 Santander and KBC announced plans to merge their Polish subsidiaries, BZ WBK and Kredyt Bank. The merger (finalized in January 2013) created Poland's third-largest bank in terms of deposits, assets and equity and the fourth-largest in terms of loans. With the merger BZ WBK also strengthened its position as the third-largest bank in terms of own branches.

### Investment strategy

As a result of the merger, BZ WBK emerges as Poland's third-largest bank. We think it will continue to benefit from strong management (BZ WBK managers will continue to manage the merged entity) and Santander's know-how in retail banking (including best practices in cost management). The merger will add significant scale to the operation and should enable the bank to strengthen its position as one of the most profitable banks in Poland. We rate the stock Buy.

### Valuation

Our Standard Warranted Equity Valuation of ZI 311 per share is based upon the formula:  $\text{Price} / \text{Book value} = (\text{Sustainable RoE} - \text{growth}) / (\text{Cost of equity} - \text{growth})$ . We set our assumption of sustainable ROE at 15.5% and use a cost of equity of 10.0% and a sustainable growth rate of 4.5%. Our Economic Value Added Valuation of ZI 371 per share is equal to the sum of the net present value of the bank's future economic value-added (forecast earnings adjusted for excess equity, less a capital charge reflecting the opportunity cost of capital).

In line with the approach we adopt for the rest of our coverage universe, our target price is based on the more conservative approach (WEV) and is set at ZI 311 per share.

### Risks

Risks to the Polish banking market include: (1) the possibility of adverse movements in interest rates and bond yields, which could affect earnings; and (2) the macro economy may perform better or worse than anticipated and lead to higher or lower provisioning and slower or faster loan growth than anticipated. Specifically for Bank Zachodni WBK, we highlight risks that may affect the achievement of our target price: (1) the bank's large exposure to the real estate and construction sectors; (2) earnings are sensitive to mutual fund inflows/outflows and the financial results of the bank may be better or worse than our forecasts depending on the development of the bank's mutual fund business. Additionally, the achievement of our target price depends on successful completion of the merger process and achieving expected synergies. If the impact on the company from any of these factors proves to be less/more negative than we anticipate, the stock could materially outperform/underperform our target price.

## Notes



## **Notes**

## 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

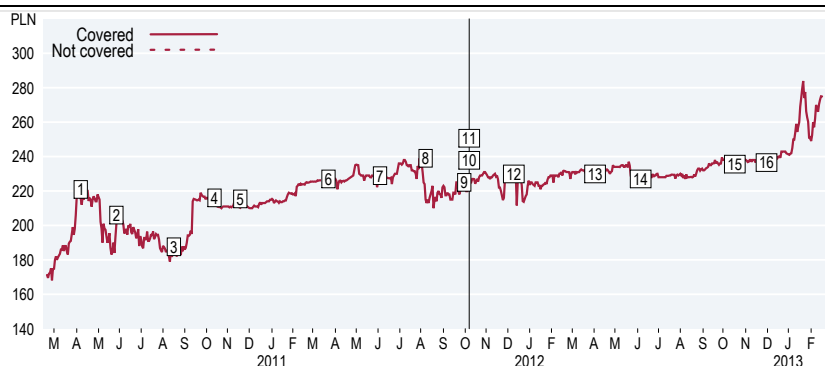
#### Bank Zachodni WBK (BZW.WA)

##### Ratings and Target Price History

##### Fundamental Research

Analyst: Andrzej Powierza

Covered since March 2 2011



	Date	Rating	Target Price	Closing Price
1	7-Apr-10	*3M	*216.00	215.70
2	27-May-10	*1M	*222.00	200.90
3	17-Aug-10	*2M	*216.00	184.40
4	13-Oct-10	*3M	216.00	213.00
5	18-Nov-10	*2M	*233.00	210.20
6	23-Mar-11	2M	*251.70	225.70

\* Indicates change

	Date	Rating	Target Price	Closing Price
7	3-Jun-11	2M	*248.00	228.40
8	8-Aug-11	2M	*253.00	215.00
9	30-Sep-11	2M	*239.00	225.00
10	7-Oct-11	Stock rating system changed		
11	7-Oct-11	*2	239.00	222.00
12	9-Dec-11	2	*229.00	229.70

	Date	Rating	Target Price	Closing Price
13	3-Apr-12	*1	*270.00	233.00
14	6-Jun-12	1	*264.00	227.90
15	17-Oct-12	1	*263.00	237.20
16	30-Nov-12	1	*266.00	239.00

Rating/target price changes above reflect Eastern Standard Time

#### Bank Zachodni WBK (BZW.WA)

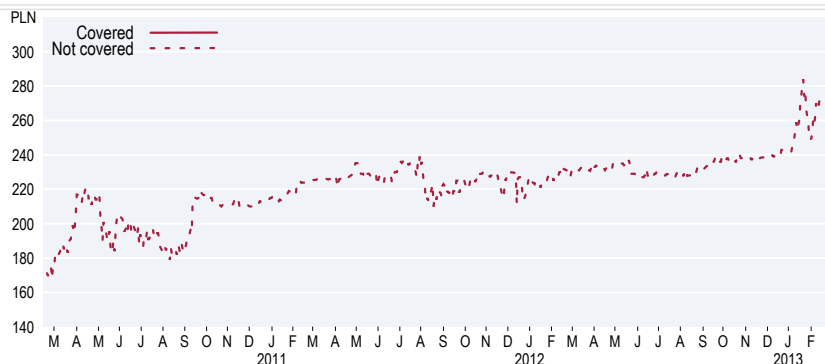
##### Ratings and Target Price History

##### Best Ideas Research

##### Relative Call (3 Month)

Analyst: Andrzej Powierza

Covered since March 2 2011



\* 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 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% of the DMBH coverage 0% of which are IB clients.

Citigroup Global Markets Ltd is mandated as Joint Bookrunner on the announced sale of Unicredit's 9.1% stake in Bank Pekao. DMBH is a market maker in the publicly traded equity securities of Bank Pekao SA. DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% 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 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% 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 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% 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.

DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% of the DMBH coverage 0% of which are IB clients.

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Citigroup Global Markets Limited is currently mandated as Joint Global Co-ordinator in relation to the recently announced accelerated equity offering for PKO Bank Polski ('PKO BP'). DMBH is a market maker in the publicly traded equity securities of PKO BPG A member of the household of DMBH Analyst, holds a long position in the securities of PKO BPG DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% of the DMBH coverage 0% of which are IB clients

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DMBH is a market maker in the publicly traded equity securities of PZU. DMBH Analyst, holds a long position in the securities of PZU. DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% of the DMBH coverage 0% of which are IB clients. Michal Fidelus, Assistant, holds a long position in the shares of Powszechny Zaklad Ubezpieczen SA.

DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% of the DMBH coverage 0% of which are IB clients.

DMBH has received compensation from Bank Zachodni WBK for providing market maker services in the past 12 months. DMBH is a market maker in the publicly traded equity securities of Bank Zachodni WBK. DMBH rating distribution versus Investment Banking service provision in the past 12 months as at 31st December 2012 is as follows: Buy (1) representing 38% of the DMBH coverage 0% of which are IB clients, Hold (2) representing 38% of the DMBH coverage 0% of which are IB clients, Sell (3) representing 25% of the DMBH coverage 0% of which are IB clients.

Cornette Van Zyl, Analyst, holds a long position in the securities of Standard Bank Group.

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

Within the past 12 months, Citigroup Global Markets Inc. or its affiliates has acted as manager or co-manager of an offering of securities of Bank Pekao SA, National Bank of Abu Dhabi, Banque Saudi Fransi, Halkbank, Banco Santander, Garanti Bank, National Societe Generale Bank, PKO BP, Sberbank RF, First Gulf Bank PJSC, Yapi Kredi Bank, Raiffeisen Bank Intl, Bank VTB, Bank Zachodni WBK, ABSA Group Limited.

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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 National Bank of Abu Dhabi, First Bank of Nigeria Plc, Banco Santander, Garanti Bank, Isbank, Sberbank RF, Abu Dhabi Commercial Bank, Bank VTB, Bank Zachodni WBK, Attijariwafa Bank.

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